

November 4, 2019

## U.S. Supreme Court Grants *Certiorari* in *Liu v. Securities and Exchange Commission*

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### Supreme Court Agrees to Decide Whether the SEC May Obtain Disgorgement in Civil Enforcement Actions for Securities Fraud Violations

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#### SUMMARY

On November 1, the U.S. Supreme Court granted *certiorari* in *Liu v. SEC*, No. 18-1501. This appeal, which likely will be decided in the spring or early summer of 2020, presents the question of whether the SEC may obtain disgorgement as a component of “equitable relief” in a civil action to enforce securities law violations. The SEC has often sought disgorgement in civil enforcement actions as a method of augmenting (sometimes doubling) the amount of money that the SEC could otherwise obtain, thus increasing recoveries or settlement amounts. Although courts have long allowed the SEC to obtain disgorgement, some courts have suggested that the Supreme Court’s 2017 decision in *Kokesh v. SEC*<sup>1</sup> holding that disgorgement is a penalty for statute of limitations purposes effectively abrogated the SEC’s authority to be awarded “equitable” disgorgement. If the Supreme Court holds that the SEC may continue to obtain disgorgement, the decision will likely maintain the *status quo* in SEC enforcement actions. But a decision by the Supreme Court holding that the SEC cannot obtain disgorgement would have a significant impact on the amount of money the SEC can recover in future civil enforcement actions.

#### BACKGROUND

There is no explicit statute authorizing the SEC to obtain disgorgement—a type of restitution measured by the defendant’s wrongful gain aimed at preventing unjust enrichment—in civil enforcement proceedings before a court. The SEC’s sole statutory remedy in an enforcement action was injunctive relief up until the enactment of the Securities Enforcement Remedies and Penny Stock Reform Act in 1990, which expressly authorized the SEC to seek civil monetary penalties.<sup>2</sup> Prior to 1990, in the absence of any statutory

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authorization to be awarded monetary relief, the SEC instead “urged courts to order disgorgement as an exercise of their inherent equity power to grant relief ancillary to an injunction.”<sup>3</sup> Since the 1970s, courts have ordered disgorgement in SEC enforcement actions “in order to deprive...defendants of their profits in order to remove any monetary reward for violating securities laws and to protect the investing public by providing an effective deterrent to future violations.”<sup>4</sup>

In its 2017 decision in *Kokesh*, the Supreme Court addressed whether, for statute of limitations purposes, disgorgement is a “penalty”—and thus subject to the five-year statute of limitations under 28 U.S.C. § 2462—or “equitable relief” available based on a court’s inherent equity power—and thus not subject to any explicit statute of limitations. Although the question was not directly presented, at oral argument, several Justices questioned whether the SEC had statutory authority to obtain disgorgement at all.<sup>5</sup> The Court unanimously held that the SEC’s disgorgement remedy constitutes a “penalty,” reasoning that disgorgement “bears all the hallmarks of a penalty: [i]t is imposed as a consequence of violating a public law and it is intended to deter, not to compensate.”<sup>6</sup> The Court expressly noted that it was not deciding “whether courts possess authority to order disgorgement in SEC enforcement proceedings or whether courts have properly applied disgorgement principles in this context.”<sup>7</sup>

Following *Kokesh*, most lower courts that addressed the issue pointed to this reservation by the Court and declined to find that *Kokesh* overruled circuit precedent authorizing the SEC to obtain disgorgement in enforcement actions.<sup>8</sup>

At the same time, some judges have suggested that *Kokesh* effectively abrogated earlier disgorgement precedent or implied that the Supreme Court would—if given the opportunity—determine that disgorgement is not available to the SEC as a remedy in civil enforcement actions.<sup>9</sup> Notably, Justice Kavanaugh, who was appointed to the Supreme Court after *Kokesh* was decided, appears to have adopted a broad reading of *Kokesh*’s implications while serving on the U.S. Court of Appeals for the D.C. Circuit.<sup>10</sup>

The petitioners in *Liu* contend that the lower courts’ continued acceptance of the SEC’s assertion that it may be awarded disgorgement by a court as an equitable remedy, on top of any statutorily authorized civil penalty, cannot survive the reasoning underlying the holding in *Kokesh*. Petitioners argue that Congress explicitly identified the types of relief that the SEC may be awarded from courts in an enforcement action—injunctive relief, equitable relief and certain civil monetary penalties—and because disgorgement is not equitable relief the SEC is not authorized to obtain it.<sup>11</sup> The SEC maintains that disgorgement has always been an equitable remedy and specifically that the SEC has the authority to obtain disgorgement because both the Securities Act<sup>12</sup> and the Exchange Act<sup>13</sup> permit a court to enjoin violations of the federal securities laws, and such authority includes the power to order disgorgement. No *amicus* briefs have been filed yet, but it is likely that there will be a number supporting the parties’ positions.

## IMPLICATIONS

The Supreme Court's decision to hear this case injects uncertainty into the SEC's practice of obtaining equitable disgorgement in civil enforcement actions. Although the Supreme Court likely will not issue a decision until the spring or early summer of 2020, the fact that the Court has agreed to consider this question—along with certain Justices' comments during the *Kokesh* oral argument—may impact settlement negotiations. Additionally, parties who are presently litigating with the SEC should be certain to preserve arguments that the SEC lacks statutory authority to obtain disgorgement as an equitable remedy.

If the Supreme Court eliminates the SEC's ability to obtain disgorgement from courts, the SEC may shift to pursuing more enforcement through administrative proceedings, rather than actions in court, because Congress specifically provided for *both* disgorgement *and* penalties in SEC administrative proceedings.<sup>14</sup> But the SEC can be awarded civil penalties based on a defendant's wrongful pecuniary gain (the disgorgement amount) *only* in an action brought in court—as the judge may set penalties as *either* the amount of a defendant's pecuniary gain or based on the number of a defendant's alleged violations. By contrast, in an administrative proceeding, civil penalties must be calculated based on the number of a defendant's alleged violations, which in most cases produces a smaller dollar amount than a defendant's alleged ill-gotten gains.<sup>15</sup> If the Supreme Court holds that disgorgement is not available in court actions, the SEC could try to circumvent that ruling by claiming a larger number of violations in individual cases to increase the size of penalties. The SEC could also ask Congress to pass a law expressly granting the SEC the power to seek disgorgement in court actions.

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## ENDNOTES

- 1 137 S. Ct. 1635 (2017).
- 2 15 U.S.C. § 77t(d).
- 3 *Kokesh*, 137 S. Ct. at 1640 (quoting *SEC v. Tex. Gulf Sulphur Co.*, 312 F. Supp. 77, 91 (S.D.N.Y.1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2d Cir. 1971)).
- 4 *Id.*
- 5 See, e.g., Tr. of Oral Argument at 31:16-21137 S. Ct. 1635 (2017) (No. 16-529) (Chief Justice Roberts: “One reason we have this problem is that the SEC devised this remedy or relied on this remedy without any support from Congress.”); *id.* at 7:20-8:2 (Justice Kennedy: “Is it clear that the district court has statutory authority to do this? . . . Is—is there specific statutory authority that makes it clear that the district court can entertain this remedy?”).
- 6 *Kokesh*, 137 S. Ct. at 1644.
- 7 *Id.* 137 S. Ct. at 1642-44 n.3.
- 8 See, e.g., *SEC v. Camarco*, 2018 WL 6620878, at \*2 (D. Colo. Dec. 18, 2018) (“[S]ince the Supreme Court decided *Kokesh*, at least 15 federal courts have ruled that *Kokesh* did not overrule the long-standing precedent that courts possess authority to order disgorgement in SEC enforcement proceedings.”) (citing *SEC v. Liu*, 2018 WL 5308171, at \*3 (9th Cir. Oct. 25, 2018)).
- 9 See, e.g., *SEC v. Collyard*, 861 F.3d 760, 763 (8th Cir. 2017) (“*Kokesh* undermines [8th Circuit precedent’s] determination that a claim is not a ‘penalty’ simply because it is ‘equitable.’”); *Osborn v. Griffin*, 865 F.3d 417, 470, n. 1 (6th Cir. 2017) (Merritt, J., dissenting) (suggesting that “equitable disgorgement...may not even be applicable in SEC contexts” “in light of” *Kokesh*); *SEC v. Premier Links, Inc.*, 2017 WL 7792702, at \*9 n.10 (E.D.N.Y. Sept. 14, 2017) (“The Supreme Court [in *Kokesh*] indicated that it may be willing to revisit the viability of the disgorgement remedy....”); *United States v. Latorella*, 2017 WL 2785413, at \*4 n.4 (D. Mass. June 27, 2017) (Woodlock, J.) (“It bears noting that the Supreme Court [in *Kokesh*] expressly reserved the question whether courts possess authority to order disgorgement in SEC enforcement proceedings.”).
- 10 See *Saad v. SEC*, 873 F.3d 297, 305 (D.C. Cir. 2017) (“*Kokesh* overturned a line of cases from [the D.C. Circuit] that had concluded that disgorgement was remedial and not punitive.”) (Kavanaugh, J., concurring).
- 11 See 15 U.S.C. §§ 77t(b),(d); 78u(d)(1),(3),(5).
- 12 15 U.S.C. § 77t(b).
- 13 15 U.S.C. § 78u(d)(1).
- 14 See 15 U.S.C. § 78u-2 (allowing the SEC to “impose a civil penalty” calculated based on statutory tier based on the number of violations and “enter an order requiring accounting and disgorgement” in an administrative proceeding).
- 15 Compare 15 U.S.C. § 78u(d)(3) (in SEC enforcement actions in district court, under tier-one, “[t]he amount of the penalty shall be determined by the court . . . and shall not exceed the greater of (I) \$5,000 for a natural person or \$50,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation”) with 15 U.S.C. § 78u-2(b) (in administrative proceedings, under tier-one, “[t]he maximum amount of penalty for each act or omission . . . shall be \$5,000 for a natural person or \$50,000 for any other person.”); see also *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) (vacating award of civil penalties in SEC administrative proceeding not calculated based on number of violations, explaining that “the Commission must determine how many violations occurred and how many violations are attributable to each person, as the statute instructs”).

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