

November 4, 2019

## Supreme Court to Consider if the SEC May Collect Disgorgement in Civil Enforcement Proceedings

On November 1, 2019, the Supreme Court granted certiorari in *Liu v. Securities and Exchange Commission*, No. 18-1501, to review the question of whether the Securities and Exchange Commission (“SEC”) may obtain disgorgement from a court for securities law violations. The Supreme Court expressly flagged, but did not address, this important question in its decision in *Kokesh v. Securities and Exchange Commission*<sup>1</sup>—a decision discussed in depth in our June 6, 2017, [client alert](#). In *Kokesh*, the Supreme Court characterized disgorgement as a “penalty” rather than an equitable remedy. Just over two years later, the Supreme Court has agreed to consider the question whether the SEC thus lacks authority to collect disgorgement pursuant to its statutory authority to obtain equitable relief. The Supreme Court’s ruling may have significant implications for the scope of enforcement remedies available to the SEC.

### The Supreme Court’s Decision in *Kokesh v. Securities and Exchange Commission*

In June 2017, the Supreme Court unanimously decided *Kokesh v. Securities and Exchange Commission*, holding that disgorgement in SEC enforcement proceedings operates as a “penalty” and is therefore subject to the general federal statute of limitation applicable to the enforcement of penalties.<sup>2</sup> The Supreme Court reasoned that penalties (i) seek to redress crimes against the public, as opposed to against individuals, and (ii) operate for the purposes of punishment and deterrence rather than compensation.<sup>3</sup> It opined that SEC disgorgement orders meet this standard because they “go beyond compensation, are intended to punish, and label defendants wrongdoers as a consequence of violating public laws.”<sup>4</sup>

At oral argument, five of the Justices noted the lack of clear statutory authority for the SEC to seek disgorgement in civil actions.<sup>5</sup> In a footnote to its opinion, the Court cautioned that “[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in

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<sup>1</sup> 137 S. Ct. 1635 (2017).

<sup>2</sup> *Id.* at 1644.

<sup>3</sup> *Id.* at 1642.

<sup>4</sup> *Id.* at 1645 (internal citations and quotation marks omitted).

<sup>5</sup> Oral Argument Transcript 7-9, 13, 31, 52, *Kokesh v. SEC*, 137 S. Ct. 1635 (April 18, 2017) (No. 16-529); *see also* Securities Exchange Act of 1934 § 21B(e), 15 U.S.C. § 78u-2(e).

SEC enforcement proceedings.”<sup>6</sup> The question whether courts possess such authority is now squarely before the Court in *Liu*.

### **Factual and Procedural Background of *Liu***

The SEC brought a civil enforcement action against petitioners, Charles C. Liu and Xin Wang, and others alleging that they violated certain federal securities laws by fraudulently raising approximately \$27 million from investors and misappropriating the funds.<sup>7</sup> After a summary judgment award in favor of the SEC, the United States District Court for the Central District of California ordered petitioners to disgorge over \$26 million of their profits from the scheme, in addition to paying over \$8 million in civil penalties and other remedies.<sup>8</sup>

On appeal to the Ninth Circuit, petitioners challenged the District Court’s disgorgement order. Citing *Kokesh*, petitioners argued that the SEC does not have the authority to seek disgorgement.<sup>9</sup> The Ninth Circuit affirmed the district court’s disgorgement order, explaining that it was bound by circuit precedent because the *Kokesh* Court declined to address whether the SEC was authorized to seek disgorgement as a remedy, and so *Kokesh* was not “clearly irreconcilable” with the circuit’s “longstanding precedent on this subject.”<sup>10</sup>

Petitioners subsequently filed a petition for a writ for certiorari, asking the Supreme Court to review the question “[w]hether the Securities and Exchange Commission may seek and obtain disgorgement from a court as ‘equitable relief’ for a securities law violation even though this Court has determined that such disgorgement is a penalty.”<sup>11</sup>

### **Key Arguments in *Liu***

In their certiorari-stage briefing, petitioners emphasized that Congress has authorized the SEC to seek three types of remedies in enforcement proceedings: injunctions, civil monetary penalties, and equitable relief.<sup>12</sup> Congress has not expressly authorized the SEC to seek disgorgement in its civil enforcement

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<sup>6</sup> *Kokesh*, 137 S. Ct. at 1642 n.3.

<sup>7</sup> Petition for Writ of Certiorari at 4, *Liu v. SEC*, No. 18-1501 (U.S. May 31, 2019).

<sup>8</sup> *Id.* at 5-6.

<sup>9</sup> See *SEC v. Liu*, 754 F. App’x 505, 509 (9th Cir. 2018), cert. granted sub nom. *Liu v. SEC*, No. 18-1501, 2019 WL 5659111 (U.S. Nov. 1, 2019).

<sup>10</sup> *Id.*

<sup>11</sup> Petition for Writ of Certiorari at i, *Liu*, No. 18-1501.

<sup>12</sup> *Id.* at 8 (citing 15 U.S.C. § 77t(b), (d); *id.* § 78u(d)(1), (3), (5)).

proceedings, while expressly authorizing the disgorgement remedy in SEC administrative proceedings.<sup>13</sup> Nor, according to petitioners, does disgorgement fall into any of the enumerated categories. Disgorgement did not constitute injunctive relief and was awarded in addition to the maximum permissible civil penalty.<sup>14</sup> Finally, pursuant to *Kokesh*, disgorgement is not a form of “equitable relief” but rather a penalty because it punishes the wrongdoer.<sup>15</sup> Petitioners emphasized the risk of an implied disgorgement remedy. While Congress specified maximum amounts for civil penalties, disgorgement is potentially unlimited because it is generally based on a defendant’s pecuniary gain—an amount courts generally determine based on calculations by the SEC.<sup>16</sup>

In its brief in opposition, the SEC contended that, although in light of *Kokesh*, disgorgement now constitutes a penalty for the purposes of statutes of limitations, it still qualifies as an equitable remedy.<sup>17</sup> Specifically, the SEC pointed to Supreme Court precedent which characterizes “penal” and “penalty” as words which are “elastic in meaning.”<sup>18</sup> Additionally, the SEC argued that a remedy can “qualify as a form of equitable relief even though it might also be considered ‘penal’ for some purposes.”<sup>19</sup>

### **Potential Implications of Supreme Court Review of *Liu***

In the wake of the Court’s unanimous opinion in *Kokesh*, scholars and practitioners speculated about whether the Court’s characterization of disgorgement as a penalty would have further implications for the scope of the SEC’s remedial authority. By granting certiorari in *Liu*, the Supreme Court has now squarely called the question. Notably, the Court has chosen to review this case without a split among the intermediate appellate courts, and in a case where the Ninth Circuit applied widely settled law—which may suggest that the Court is inclined to expand upon the principles set forth in *Kokesh*.

The Supreme Court’s decision has potentially major implications for a widespread SEC practice. In 2018 alone, the SEC collected approximately \$2.51 billion in disgorgement, while collecting only \$1.44 billion in civil monetary penalties.<sup>20</sup> It has used the threat of disgorgement as a key point of leverage in settlement negotiations with potential defendants. Still, the impact of a decision in petitioners’ favor would be

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<sup>13</sup> See *id.* at 8-9, 9 n.4.

<sup>14</sup> *Id.* at 11.

<sup>15</sup> *Id.* at 10-11.

<sup>16</sup> *Id.* at 15.

<sup>17</sup> Brief for Respondent in Opposition at 5-7, *Liu*, No. 18-1501 (U.S. Sept. 4, 2019).

<sup>18</sup> *Id.* at 8 (citing *Huntington v. Attrill*, 146 U.S. 657, 666-67 (1892)).

<sup>19</sup> *Id.*

<sup>20</sup> See U.S. Securities and Exchange Commission, *2018 Annual Report* 11 (2018), available at <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>.

cabined by the fact that, regardless of the Court's decision in *Liu*, the SEC will retain the ability to seek disgorgement in administrative proceedings.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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