Securities Litigation Alert

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Court Appears Disinclined to End SEC's Ability to Obtain Disgorgement

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Key Points

- The Supreme Court heard oral arguments on whether the SEC has the authority to obtain disgorgement in civil actions to enforce the federal securities laws.
- The Court appeared willing to preserve the SEC's ability to obtain disgorgement in civil actions with some possible limitations.

On March 3, 2020, the Supreme Court heard oral arguments in Liu v. SEC, No. 18-1501, to review whether the Securities and Exchange Commission (SEC) has the authority to obtain disgorgement in civil actions to enforce the federal securities law.

As discussed in greater depth in our article in The Daily Journal previewing Liu v. SEC, the SEC has relied on disgorgement of ill-gotten gains as one of its main and most effective tools for several decades. However, the petitioners in this case argued that, in light of the Supreme Court's decision in Kokesh v. SEC, 137 S. Ct. 1635 (2017), the SEC does not have authority to obtain disgorgement as an equitable remedy in court proceedings. (In Kokesh, the Court held that disgorgement in the securities enforcement context is a "penalty" within the meaning of 28 U.S.C. § 2462, and is therefore subject to a five year statute of limitations.)

At oral arguments on March 3, 2020, there did not appear to be much support from the Court for finding disgorgement to be outside the SEC's statutory authority. Justice Ginsburg warned petitioners that simply because the Court held in Kokesh that disgorgement was a penalty for the purposes of statute of limitations, that did not mean it was a penalty in other contexts and therefore unavailable to the SEC as an equitable remedy "to assume that characterization in one context carries over to another is a notion that has all the tenacity of original sin and must constantly be guarded against. So all Kokesh did was say, for statute of limitations purposes, this is a penalty. It did not say—in fact, it was specific in footnoting that it was not saying that in every context it is a penalty."[1]

Yet, there appeared to be some support among the justices for limiting SEC disgorgement in civil actions to net profits and requiring the SEC to attempt to return the disgorged profits to harmed investors. Justices Alito, Kavanaugh, Gorsuch and

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Kagan all asked questions centered on this potential rule. For example, Justice Alito proposed to petitioners, “Suppose [disgorgement] was limited to net profits and suppose every effort was made to return the money to the victims of the fraud. Would that not fall within a traditional form of equitable relief?”

If the Supreme Court holds this is the limitation on the SEC’s ability to seek disgorgement in civil actions, this will not drastically upend the SEC’s settled practice. Even the government conceded at oral arguments that it “wouldn’t have a problem with” returning funds to investors where feasible if that was the Court’s decision. Despite the justices’ questioning which appears to indicate their preference for maintaining the overall status quo with a few limitations, we will continue to monitor this space and await their decision which can be expected at the latest by June 2020.

[1] These quotations are drawn from the rough transcript released by the Supreme Court on March 3, 2020. A copy of the transcript is available at the following link: https://www.supremecourt.gov/oral_arguments/argument_transcripts/2019/18-1501_097c.pdf.

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