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PERSPECTIVE

Arguments on challenge to SEC ability to get disgorgement

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The U.S. Securities and Exchange Commission has relied on disgorgement of ill-gotten gains as one of its main and most effective enforcement tools for several decades. It was broadly accepted until fairly recently that the SEC could obtain disgorgement as a form of equitable relief in enforcement actions in federal court, even though disgorgement may not have been expressly authorized by statute.

This settled understanding has been called into question as the Supreme Court will hear oral arguments today, March 3, in *Liu v. SEC*, 18-1501, to review whether the SEC has the authority to obtain disgorgement in civil actions to enforce the federal securities law.

The issue in *Liu* emerged as a direct result from the Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). In *Kokesh*, the court held that disgorgement in the securities enforcement context is a "penalty" within the meaning of 28 U.S.C. Section 2642, and is therefore subject to its five year stat-

ute of limitations for civil penalties. The court found that SEC disgorgement was a penalty for three distinct reasons: (1) SEC disgorgement is imposed by the courts as a consequence for

violating public laws rather than standing in the shoes of injured parties; (2) SEC disgorgement is imposed for the punitive purpose of deterrence; and (3) in many cases, SEC disgorgement is not used to compensate victims, but rather is paid to the Treasury. In a footnote, the court limited its decision, noting "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context. The sole

question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period." Since *Kokesh* was decided, Courts of Appeals

across the country have wrestled with the question raised by this footnote — do courts have the authority at all to order disgorgement in SEC enforcement proceedings? For example, in *Saad v. SEC*, Justice Brett Kavanaugh, then a sitting judge on the U.S. Court of Appeals for the D.C. Circuit, noted in a concurrence that *Kokesh* "overturned a line of cases from [the D.C. Circuit] ... that had concluded the disgorgement was remedial and not punitive." 873 F.3d 297, 305 (D.C. Cir. 2017) (Kavanaugh, J., concurring).

Liu began as a summa-

ry judgment decision by the federal district court for the Central District of California, in which the district court entered summary judgment in favor of the SEC, finding that the defendants violated Section 17(a)(2) of the Securities Act of 1933, and ordering them to disgorge millions of dollars in ill-gotten gains associated with their conduct. *SEC v. Liu*, 262 F. Supp. 3d 957, 976 (C.D. Cal. 2017). The defendants had raised approximately \$27 million from Chinese investors under the EB-5 Immigrant Investor Program, which allows foreign citizens to obtain visas in exchange for investments in the United States. The defendants promised to invest the funds in a proton therapy cancer treatment center. Yet, instead of investing the funds in the manner contemplated by their offering, the district court found that the defendants misappropriated most of the money and ordered them to jointly and severally disgorge the entire amount raised, minus funds remaining in their corporate accounts. The district court also imposed \$8.2 million in civil penalties and permanently enjoined the defendants from future

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solicitation of EB-5 Program investors. The 9th U.S. Circuit Court of Appeals affirmed the district court's summary judgment order. On appeal to the appellate court and in its petition for certiorari to the Supreme Court, the defendants argued that in light of *Kokesh*, the SEC cannot, as a matter of law, obtain disgorgement as an equitable remedy from the courts. The petitioners relied heavily on *Kokesh*'s footnote that the Supreme Court had yet to address "whether courts have properly applied disgorgement principles in this context" or "whether courts possess authority to order disgorgement in SEC enforcement proceedings" at all. On Nov. 1, 2019, the Supreme Court granted certiorari.

In their moving papers, petitioners espouse two main arguments to the court. First, petitioners argue that Congress did not explicitly authorize the SEC to seek disgorgement in civil court proceedings, and therefore disgorgement was unavailable as a remedy. Second, petitioners argue that following *Kokesh*, the SEC could not pursue disgorgement as "equitable relief" in the courts because SEC disgorgement is a penalty, not an equitable remedy. The government, the respondents in the action, has responded that there is

specific statutory authority for the SEC to pursue disgorgement. The government also contends that despite *Kokesh*'s holding, SEC disgorgement is still a form of permitted equitable relief, not a penalty.

Liu has attracted significant attention from outside parties. 19 amicus briefs have been filed with the Supreme Court, including from law professors, think tanks, state attorneys general, and members of Congress. In particular, the legal academy has split in its amicus briefs to the court over whether SEC disgorgement is a traditional equitable remedy that would be available to the SEC in the court system. However, the

law professors behind two of the three amicus briefs agree that the SEC has overstepped the bounds of traditional equitable remedies by demanding disgorgement of more than the "net profits" gained by defendants. See *Brief of Amici Curiae Law Professors in Support of Petitioners at 17 and 25*; *Brief of Remedies and Restitution Scholars as Amici Curiae in Support of Neither Side at 21*. Depending on the interpretation of the SEC's authorizing statutes and the legal history of equitable remedies, disgorgement may cease to be an available remedy to the SEC in civil actions.

If the Supreme Court decides that the SEC is no

longer permitted to pursue disgorgement of ill-gotten gains in federal court, this would drastically shift the landscape for SEC practitioners. The SEC has forced defendants to disgorge billions of dollars through enforcement settlements and litigations over the years. If the court ends the SEC's disgorgement practice in civil actions, it is probable that the SEC will seek new legislation to explicitly authorize disgorgement. The SEC may also shift enforcement to its administrative proceedings, where even petitioners acknowledge Congress has formally authorized the SEC to seek disgorgement as a remedy. ■

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