Alert

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COZEN O'CONNOR

Supreme Court Appears Unlikely to Further Curtail SEC Disgorgement Authority

The fate of the Securities & Exchange Commission (SEC)'s ability to obtain disgorgement moved one step closer to a decision this week with oral arguments before the Supreme Court in *Liu v. SEC*. The high court appeared willing to characterize disgorgement in an SEC enforcement proceeding as an equitable remedy. However, the questions from the Justices during oral arguments indicated that the Court may be interested in addressing a more specific issue regarding the scope of the SEC's disgorgement authority — specifically, whether disgorgement could be limited to net profits and require efforts to return the funds to investors.

In the underlying district court action in *Liu*, Charles Liu and Xin Wang were ordered to disgorge close to $27 million in connection with their alleged misappropriation of that amount from investors, in violation of Section 17(a)(2) of the Securities Act of 1933. The Ninth Circuit affirmed the lower court's order, and the issue now before the Supreme Court is whether the SEC has the authority to seek such disgorgement as an equitable remedy in light of the Court's 2017 decision in *Kokesh v. SEC*. In *Kokesh*, the Supreme Court held that disgorgement of profits is a "penalty" subject to a five-year statute of limitations; however, the Court specifically noted that it was not providing an opinion on "whether courts possess the authority to order disgorgement in SEC enforcement proceedings" as an equitable relief.

On March 3, 2020, the Supreme Court heard arguments regarding that unanswered question. Petitioners argued that the Court's decision in *Kokesh* made clear that SEC disgorgement is a penalty and that, while the SEC has statutory authority to seek disgorgement in an administrative proceeding, there is no such statutory authority in federal court. Justice Ginsburg, at the outset of petitioners' argument, however, noted that the Court's characterization of disgorgement as a penalty in *Kokesh* was specific for statute of limitations purposes and disgorgement need not be characterized as a penalty in a different context, such as for "determining whether the fraudster can retain the profits of the fraud." Justice Ginsburg went on to note that to assume characterization carries over from one context to another "is a notion that has all the tenacity of original sin and must constantly be guarded against."

Justice Alito further questioned why disgorgement would not fall "within a traditional form of equitable relief," assuming (i) it was limited to net profits and (ii) that every effort was made to return the money to the victims of fraud. The Justices' questions subsequently focused on those two conditions, particularly on the effort to return the money to investors. The Justices questioned what exactly the SEC would be required to do and whether it would be appropriate for the Court to say that as a rule, the money must be returned to investors "where feasible." Justice Gorsuch noted that, in class action practice, the Court polices the efforts of the defendant to find and return money to defrauded investors and he questioned why the Court could not similarly police the SEC to make that same effort.

The Justices' questions suggest that the Court may be comfortable in characterizing an order of disgorgement in an SEC enforcement proceeding as equitable relief when it is outside of the specific statute of limitations context of *Kokesh*, although the Court may provide limits and requirements for such disgorgement. Such a decision would be good news for the SEC — disgorgement has been a longstanding and powerful tool for the SEC in enforcement proceedings.

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