

November 7, 2019

Supreme Court to Review SEC's Disgorgement Power

In a case that could potentially limit the Securities and Exchange Commission's remedial powers in securities fraud and Foreign Corrupt Practices Act cases, *Liu v. SEC*, the Supreme Court will consider a challenge to the SEC's practice of obtaining disgorgement in judicial enforcement actions.¹ Disgorgement has been a powerful remedy that the SEC has wielded in judicial and administrative enforcement actions under the federal securities laws and the FCPA. Although the SEC has statutory authority to seek civil penalties, no statute expressly authorizes the SEC to seek and obtain disgorgement in an enforcement action.² Nevertheless, since the 1990s, the SEC has regularly sought disgorgement, in addition to civil monetary penalties and injunctions, to resolve enforcement actions. Unlike civil monetary penalties which are capped in amount by statute and subject to standards of proof, disgorgement awards need only "reasonably approximate" the amount of ill-gotten gains arising from the violation.³ Such an expansive standard can, and has, led to significant disgorgement orders against individual and corporate defendants. In fact, the amount the SEC obtains from disgorgement routinely exceeds the amount it secures from civil monetary penalties. For example, in 2018, the SEC obtained approximately \$2.5 billion in disgorgement, compared with \$1.4 billion in civil monetary penalties.⁴

Recent Judicial Limitation on SEC's Disgorgement Authority

Recently, in *Kokesh v. SEC*,⁵ the Supreme Court held that a five-year statute of limitations applies to disgorgement in enforcement actions because it operates as a penalty. In making this determination, the Court reasoned that a penalty is a sanction that is imposed in a *punitive* way for an infraction of a public law.⁶ The Court explained that when the SEC seeks disgorgement, it acts in the public interest to remedy harm to the public at large and pursues disgorgement for punitive purposes (such as general deterrence) rather than to equitably compensate victims for their losses.⁷ Notably, however, the Court expressly declined to rule on whether or not courts have the authority in the first instance to award disgorgement in such enforcement actions. The Court will now have an opportunity to address this issue in *Liu*, a case arising from the Ninth Circuit.

Court Agrees to Hear Additional Challenge to SEC Disgorgement Authority in *Liu v. SEC*

The *Liu* case began in May 2016, when the SEC sued Charles Liu and Xin “Lisa” Wang for defrauding Chinese investors by misusing funds solicited from investors under the EB-5 Immigrant Investor Program for an alleged private placement offering investment in a cancer treatment center.⁸ In April 2017, a federal district court in California granted the SEC’s motion for summary judgment against the defendants, finding that they violated Section 17(a)(2) of the Securities Act of 1933. The district court also granted the relief requested by the SEC when it: ordered the defendants to disgorge approximately \$27 million raised from investors; imposed an \$8.2 million civil monetary penalty against them (representing the amount the defendants had allegedly paid to themselves); and permanently enjoined them from soliciting future investments.⁹ Defendants appealed to the Ninth Circuit, arguing, among other things, that the district court lacked the statutory authority to order disgorgement because, under *Kokesh*, disgorgement is not an equitable remedy. In October 2018, the Ninth Circuit affirmed the disgorgement award, reasoning that *Kokesh* was not “clearly irreconcilable” with . . . longstanding precedent on this subject.”¹⁰

In their petition for review by the Supreme Court, defendants urged the Court to resolve the question of whether the SEC can obtain disgorgement from a court as “equitable relief” even though the Supreme Court concluded in *Kokesh* that, for statute of limitations purposes, disgorgement is, in fact, a penalty. In support of their argument, defendants contend that the disgorgement amount awarded by the district court exceeded the amount of their ill-gotten gains and is not subject to a requirement that it be returned to alleged victims.

The SEC, in its opposition to the petition, maintains that a court’s power to order equitable relief encompasses the right to order disgorgement in enforcement actions. The SEC contends that a host of statutes, including the Securities Act of 1933, the Securities Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002 authorize federal courts to order equitable relief for securities law violations, including

disgorgement. The SEC further argues that disgorgement may qualify as a form of equitable relief for some purposes, even though it has been ruled to be a penalty for others, such as the statute of limitations.

Conclusion

The *Kokesh* holding significantly curtailed the SEC’s disgorgement authority by precluding the SEC from obtaining disgorgement of ill-gotten gains from conduct occurring beyond the statute of limitations period. Indeed, in 2018, the SEC acknowledged that, following *Kokesh*, it had forgone at least \$800 million in disgorgement that it could have sought that year due to the newly-applicable five-year statute of limitations.¹¹

A ruling against the SEC in *Liu* has the potential to limit even further – and possibly eliminate – the amount the SEC may obtain through disgorgement. Such a ruling could alter the landscape of SEC enforcement actions and limit the SEC’s leverage against individuals for violations of the securities laws and the Foreign Corrupt Practices Act.

Weil will continue to monitor this case and report on the Supreme Court’s decision in *Liu*, which is expected by June 2020.

¹ *Liu v. SEC*, No. 18-1501.

² See Securities Enforcement Remedies and Penny Stock Reform Act, 104 Stat. 932, codified at 15 U.S.C. § 77t(d).

³ See, e.g., *SEC v. Whittemore*, 659 F.3d 1, 7 (D.C. Cir. 2011) (citing *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1232 (D.C. Cir. 1989)).

⁴ 2018 Annual Report of the Division of Enforcement, SEC, at 15 (2018), available at <https://www.sec.gov/enforcement-annual-report-2018.pdf>. In 2017, the SEC obtained disgorgement of \$3 billion, compared with \$832 million in civil monetary penalties. *Id.*

⁵ *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

⁶ *Id.* at 1643.

⁷ *Id.* at 1643-44.

⁸ *SEC v. Liu*, 262 F. Supp. 3d 957, 970-72 (S.D. Cal. 2017).

⁹ *Id.* at 973-76.

¹⁰ See *SEC v. Liu*, 754 F. App'x 505, 509 (9th Cir. 2018).

¹¹ Steven Peikin, Co-Director, Division of Enforcement, SEC, Remedies and Relief in SEC Enforcement Actions (Oct. 3, 2018), *available at* <https://www.sec.gov/news/speech/speech-peikin-100318>.

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White Collar Defense, Regulatory & Investigations is published by the Litigation Department of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

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