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SEC Update

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Supreme Court to Hear US Securities and Exchange Commission Disgorgement Case

The Supreme Court has granted writs of *certiorari* to a number of cases involving challenges to the authority of the US Securities and Exchange Commission (Commission) over the last several years. Continuing the trend, on November 1, 2019, the Court announced that it would hear the case titled *Charles C. Liu et al. v. U.S. Securities and Exchange Commission*¹ during the 2019-2020 term. Based on the *Kokesh v. Securities and Exchange Commission*² decision in 2017, the industry anticipated that the Court would grant *certiorari* to a case like *Liu*, which challenges the authority of the Commission to seek disgorgement in federal court under the federal securities laws.

SEC Enforcement Proceedings in Federal Court and Disgorgement

In SEC enforcement proceedings in federal court, the Commission may seek, among other things, payment of a civil money penalty and/or “disgorgement.” As noted by the Court, “disgorgement is a form of ‘restitution measured by the defendant’s wrongful gain’ . . . [and] [d]isgorgement requires that the defendant give up ‘those gains . . . properly attributable to the defendant’s interference with the

claimant’s legally protected rights.’”³ Starting in the 1970s, the Commission asked courts to order disgorgement in connection with its enforcement proceedings because, at that time, the Commission was unable to seek civil monetary penalties in connection with enforcement actions.⁴ In 1990, Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act, which permitted the Commission to seek civil monetary penalties in connection with enforcement proceedings; however, the Commission continued to seek disgorgement from defendants.⁵ Furthermore, in 2013, the Court held that a five-year statute of limitations applies to statutory civil monetary penalties sought by the Commission.⁶

Kokesh Decision

In 2017, the Court unanimously held in *Kokesh* that “[b]ecause SEC disgorgement operates as a penalty under § 2462, any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued.”⁷ However, *Kokesh* addressed only the narrow question of whether disgorgement is a penalty under Section 2462 and the resultant statute of limitations. *Kokesh* did not present the question to the Court as to whether the SEC had authority to seek disgorgement in federal court under the federal securities laws and specifically stated in a

footnote to the Court's opinion that "[n]othing in [the] 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."⁸ Therefore, the footnote provided clear indications to the industry that the Court had concerns about the authority of the Commission to order disgorgement and it was anticipated that the Court would grant *certiorari* to a case in the near future presenting such a question to the Court.

Court Grants *Certiorari* to *Liu* Case

The *Liu* case involves an appeal from a decision of the United States Court of Appeals for the Ninth Circuit (Ninth Circuit). In the appeal to the Ninth Circuit, the Appellants sought "reversal of [the district court's] summary judgment order [in favor of the SEC] on numerous grounds, [including that] the district court lacked the power to order disgorgement," citing *Kokesh*.⁹ In particular, *Liu* argues that disgorgement is not an "equitable remedy" for purposes of Section 21(d)(5) under the Securities Exchange Act of 1934. However, the Ninth Circuit noted that "*Kokesh* expressly refused to reach [the] issue [and therefore the] case is not 'clearly irreconcilable' with [its] longstanding precedent on [the] subject."¹⁰ The Ninth Circuit affirmed the ruling of the district court related to the disgorgement issue as well as the other grounds for appeal raised by the Appellants.

In June 2019, a petition for writ of *certiorari* was filed with the Court in *Liu* and in November 2019, such petition was granted by the Court. It is widely expected, based on the footnote in the *Kokesh* matter, the Court will rule against the Commission on the disgorgement issue.

Conclusion

The Commission has not experienced great success at the Supreme Court, with the Court ruling against the Commission in two recent landmark

cases. The *Liu* matter will be widely watched and if the Court rules as anticipated, it could have wide ranging effect on Commission enforcement actions in federal court. If the Court rules against the Commission in *Liu*, Congress could quickly pass legislation granting the Commission authority to seek disgorgement in federal court. Although such legislation should have bi-partisan support in Congress, it could still be difficult for Congress to pass such a bill in such a divisive atmosphere.

Ms. Marino is an attorney with Sidley Austin LLP in Boston, MA. This article has been prepared for informational purposes only and does not constitute legal advice. This information is not intended to create, and the receipt of it does not constitute, a lawyer-client relationship. Readers should not act upon this without seeking advice from professional advisers. The content therein does not reflect the views of the firm.

NOTES

- ¹ See Charles C. Liu *et al.* v. U.S. Securities and Exchange Commission, Case No. 18-1501. See also Securities and Exchange Commission v. Charles C. Liu, *et al.*, 754 F. App'x 505 (9th Cir. 2018).
- ² See *Kokesh* v. Securities and Exchange Commission, 137 S.Ct. 1635 (2017).
- ³ See *Kokesh* at 1640, citing Restatement (Third) of Restitution and Unjust Enrichment § 51, Comment a, p. 204 (2010) (Restatement (Third)).
- ⁴ See *Kokesh* at 1640.
- ⁵ See *id.*
- ⁶ See *id.* at 1640-41; see also *Gabelli v. SEC*, 568 U.S. 442, 454 (2013).
- ⁷ See *Kokesh* at 1638.
- ⁸ See *Kokesh* at n. 3.
- ⁹ See Securities and Exchange Commission v. Charles C. Liu, *et al.*, 754 F. App'x 505 (9th Cir. 2018).
- ¹⁰ See *id.*, citing *Miller v. Gammie*, 335 F.3d 8 89, 900 (9th Cir. 2003) (en banc).

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