

# 3 Ways High Court's Liu V. SEC Ruling Curtails FTC Authority

By Mark Hopson, Benjamin Mundel and Lucas Croslow (July 14, 2020)

In a much anticipated decision, the U.S. Supreme Court held that the U.S. Securities and Exchange Commission can obtain disgorgement as a form of equitable relief, but it can do so only to the extent the award "does not exceed a wrongdoer's net profits and is awarded for victims."

Others have written about the effect of Liu v. SEC on the SEC.[1] But the decision will have wide-ranging implications for other federal agency enforcement actions, including those brought by the Federal Trade Commission.

In recent years, the FTC has asserted a broad view of its authority to obtain monetary relief in federal court. Liu will impose serious limitations on the scope of equitable relief the FTC can obtain and will likely curtail the FTC's restitution program considerably.

## Background on Liu v. SEC

In Liu, the defendants were accused of violating the federal securities laws by spending \$20 million of investor funds on marketing and salaries when they promised only amounts collected from a small administrative fee would be spent on such items.

The SEC brought a civil enforcement action, and the district court adjudicated liability and then ordered the defendants to disgorge the full \$26 million they raised in the fraudulent investment scheme. The district court did not permit the defendants to deduct the more than \$16 million they spent on legitimate business expenses from this disgorgement figure, and did not require the SEC to distribute the disgorged funds to the victims of the fraud.

The U.S. Court of Appeals for the Ninth Circuit affirmed the district court, and the defendants sought the Supreme Court's review. The defendants argued that the SEC lacked the authority to obtain disgorgement under statutory authority to obtain equitable relief because disgorgement is punitive and equity historically excludes punitive remedies.

The Supreme Court disagreed. It held that the SEC can obtain disgorgement or restitution as a form of equitable monetary relief as long as it is limited to the form of those remedies that were historically permitted at equity. This limitation, as discussed below, imposes significant restrictions on what monetary relief agencies can obtain under the guise of equitable claims.

## The FTC's Restitution Program

Like the SEC, in recent years the FTC has sought, and at times obtained, significant restitution awards in federal court. The text of the FTC Act, however, does not expressly authorize disgorgement, restitution or even equitable relief. Instead, Section 13(b) of the FTC Act authorizes only injunctions.



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Although most courts of appeals interpreted the FTC Act to implicitly authorize the full range of equitable remedies, including restitution and disgorgement, the U.S. Court of Appeals for the Seventh Circuit recently held in *FTC v. Credit Bureau Center LLC* that section 13(b) of the FTC Act does not "implicitly authorize an award of restitution." [2]

This created a circuit split and threatened long-standing FTC enforcement practice. The FTC petitioned the Supreme Court for a writ of certiorari, **which was granted** July 9.

While that decision could end the FTC's authority to seek disgorgement or restitution altogether, the Liu decision has already curtailed the FTC's authority in a number of important ways.

### **1. The FTC can seek only profits, not total revenues.**

When bringing cases under Section 13(b), the FTC typically seeks restitution in the form of net revenues. This approach was authorized by the Ninth Circuit in *FTC v. Commerce Planet Inc.*, where the court held that "[u]njust gains in a case like this one are measured by the defendant's net revenues ... not by the defendant's net profits." [3]

Following this decision, the FTC has sought and obtained significant settlements and judgments based on the defendants' total revenues.

Liu should end this FTC practice. The Supreme Court held that total revenues are not the proper measure of restitution under "longstanding principles of equity." Accordingly, the court concluded, "courts must deduct legitimate business expenses before ordering disgorgement," unless the agency can prove that the "entire profit of a business ... results from the wrongdoing." Thus, restitution is limited to the net profits from unlawful activity.

This requirement will create significant burdens on the FTC's ability to seek and obtain large monetary awards.

### **2. The FTC must identify and return all funds collected to consumers.**

The Supreme Court has imposed an additional hurdle for the FTC, requiring that the restitution is returned to consumers.

In past years, the FTC has deposited millions of dollars into the U.S. Department of the Treasury rather than refunding that money to consumers affected by business practices the FTC sued.

The FTC also does not typically identify which specific consumers were harmed, as opposed to those that were not harmed. Nor does it identify the amount of economic harm that an individual consumer suffered.

Under Liu, the FTC will have to do both in order to ensure that only harmed consumers receive redress and that they receive the appropriate amount of redress.

### **3. The FTC can no longer obtain "joint and several" awards against multiple defendants, but must obtain separate awards against each defendant for the ill-gotten gains attributable specifically to that defendant.**

Another tactic the FTC has increasingly used in recent years is to name corporate officers or

employees and to seek monetary relief from multiple defendants jointly and severally.

The Supreme Court's decision in *Liu* will limit the FTC's ability to do this. The court held that equity requires "holding defendants 'liable to account for such profits only as have accrued to themselves.'" Thus while the FTC can still name multiple defendants, it will not be able to obtain "joint and several" orders of restitution. This too will limit common FTC practice.

## Conclusion

In a series of cases from *Kokesh v. SEC* to *Liu v. SEC*, the Supreme Court has cast doubt on the FTC's authority to seek equitable monetary relief under Section 13(b) and has imposed important limits on this practice. The Seventh Circuit has gone further and held that the FTC cannot obtain any equitable monetary relief in federal court under section 13(b).[4]

The Supreme Court's decision to grant certiorari in *Credit Bureau* may very well lead to invalidation of the FTC's 13(b) restitution program entirely. That program is built on a method of statutory interpretation that the Seventh Circuit described as "typical of [its] era: The Court would resolve ambiguities by identifying a statute's purpose and 'deducing the result most consonant with that purpose.'"[5]

But that era of statutory interpretation that requires "us to ignore section 13(b)'s text"[6] rests on shaky foundations. The current Supreme Court very well may change course. But even if the FTC maintains its remedial authority, *Liu* imposes new and serious limitations on FTC enforcement actions and on the FTC's ability to obtain equitable monetary relief in federal court.

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[1] David Slovick, High Court Missed Chance to Define SEC Enforcement Limits, Law360 June 23, 2020, [https://www.law360.com/fintech/articles/1286053/high-court-missed-chance-to-define-sec-enforcement-limits-;](https://www.law360.com/fintech/articles/1286053/high-court-missed-chance-to-define-sec-enforcement-limits-) Dean Seal, Justices' *Liu* Ruling Creates More Questions than Answers, Law 360 June 23, 2020, [https://www.law360.com/corporate/articles/1285578/justices-liu-ruling-creates-more-questions-than-answers;](https://www.law360.com/corporate/articles/1285578/justices-liu-ruling-creates-more-questions-than-answers) W. Hardy Callcott, et al., Supreme Court Upholds Disgorgement as SEC Remedy, Sidley Austin LLP June 23, 3030, <https://www.sidley.com/en/insights/newsupdates/2020/06/supreme-court-upholds-disgorgement-as-sec-remedy>.

[2] *FTC v. Credit Bureau Ctr., LLC*, 937 F.3d 764 (7th Cir. 2019).

[3] *FTC v. Commerce Planet, Inc.*, 815 F.3d 593 (9th Cir. 2016).

[4] *FTC v. Credit Bureau Ctr., LLC*, 937 F.3d 764 (7th Cir. 2019).

[5] *Credit Bureau Center*, 937 F.3d at 777 (quoting William N. Eskridge Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 Va. L. Rev. 275, 282 (1988)).

[6] *Credit Bureau Center*, 937 F.3d at 785.