The Supreme Court is currently considering whether the Securities and Exchange Commission may seek and obtain monetary disgorgement from a federal court - as opposed to an administrative body - as “equitable relief” for securities law violations, even though the applicable statutory provision does not explicitly authorize monetary disgorgement and the Supreme Court has determined that such disgorgement is a penalty. The matter is *Liu v. Securities and Exchange Commission* where Charles C. Liu and Xin Wang a/k/a Lisa Wang are opposing an SEC...
disgorgement order against them.

In *Liu*, Charles Liu and Xin Wang operated an investment fund. According to the SEC, the petitioners wrongfully diverted invested funds. The SEC filed a lawsuit in U.S. District Court and the subsequent decision ordered the petitioners to disgorge roughly $20 million, the amount they purportedly raised from investors through an alleged fraud. The Ninth Circuit affirmed. Liu and Wang then petitioned the Supreme Court for review.

In May 2020, the Supreme Court heard oral argument.

While the SEC argued that disgorgement has long been perceived as an “equitable” remedy and that it acts as a deterrent, the *Liu* petitioners took the position that the longstanding judicial perception is legally unjustified. The *Liu* petitioners primarily did so by relying upon the Supreme Court’s recent opinion in *Kokesh v. SEC*.

In *Kokesh*, the Supreme Court held that SEC disgorgement has a primarily punitive purpose, but did so solely in the context of considering the applicable statute of limitations. In fact, the *Kokesh* Court stated that “[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings.”

Nevertheless, the *Liu* petitioners argued that *Kokesh* should be applied in deciding whether disgorgement is a penalty. The *Liu* reasoned that disgorgement is punitive in nature because money obtained from defendants is not always returned to victims, but rather paid to the U.S. Treasury. The *Liu* petitioners further reasoned that that disgorgement simply cannot be considered an equitable remedy because “equitable” relief is designed to restore the status quo as it existed prior to the commission of the alleged wrongdoing.

Additionally, the *Liu* petitioners argue that assuming disgorgement awards are even legally permitted, they should be limited to defendants’ net profits, rather than the net loss to aggrieved investors. According to the *Liu* petitioners, “legitimate” business expenses incurred by defendants should be deducted when calculating net profits. According to the SEC, however, no legitimate business expenses existed as all had some nexus to the alleged fraudulent scheme.

It is not difficult to see how, from a digital advertising and marketing standpoint, the outcome in *Liu* is likely to extend to Federal Trade Commission federal judicial enforcement actions and related defense strategies, including strategies during the investigational phase. The FTC wields the threat of disgorging ill-gotten gains as a “equitable” remedial threat. The agency also routinely seeks awards of “equitable” monetary relief under Section 13(b) of the FTC Act in enforcement actions, as measured by consumers’ loss – in effect, requiring defendants to pay more than they ever actually pocketed.

If the Supreme Court strikes down entirely or more narrowly limits the SEC’s authority with respect to disgorgement awards and how such awards are calculated, the FTC may face more aggressive legal challenges that disgorgement under the FTC Act is also a penalty, that the remedy does not fall within the scope of equitable relief allowed by Section 13(b), and that award calculations should be based upon
revenue, less legitimate expenses. The FTC may find itself having to reconsider its enforcement policies which, in turn, could result in fewer judicial advertising enforcement actions with relatively large monetary recoveries.

While all eyes are currently on Liu, there has also been a flurry of other judicial activity related to the FTC’s enforcement authority, including: whether Section 13(b) authorizes district courts to enter a permanent injunctions that order wrongdoers to return ill-gotten money, and whether the FTC is legally permitted to obtain injunctions against defendants for alleged past misconduct.

A ruling in favor of the Liu petitioners could embolden arguments by FTC practice counsel that the agency does not possess the authority to obtain equitable monetary relief under section 13(b) of the FTC Act.

Interested parties and defendants are lining up on issues concerning the FTC’s enforcement and remedial authority, including the agency’s continued use of “equity” to obtain monetary awards. As a result, the FTC is increasingly spending more time and staff resources battling legal challenges, shifting enforcement strategy and utilizing tolling agreements as a carrot when negotiating extensions of time to respond to civil investigative demands (CIDs).

There is no predicting how the Supreme Court will rule with any definitive accuracy. However, if you want to read the tea leaves for clues, consider that the Supreme Court has a track record of ensuring that agencies of the federal government exercise only the powers that Congress has expressly granted by statute … and FTC disgorgement is not traceable to any clear congressional authorization.

Additionally, during oral argument, the justices appeared to be willing to accept a middle ground, to wit, disgorgement as a remedy if funds are returned to defrauded investors and are limited to defendants’ net profits. Practical considerations involved in locating the former, and calculating and classifying the latter, would almost certainly exist.

A decision by the Liu Court is anticipated shorty.

You can read the Liu petitioners’ brief, [here](#).

You can read the SEC’s opposition brief, [here](#).

You can read the Liu petitioners’ reply brief, [here](#).

**Update with Decision**

The Supreme Court’s decision in Liu v. Securities and Exchange Commission has been highly anticipated. On June 22, 2020, one day following the above blog post, the Supreme Court ruled.

The main issue is whether the Securities and Exchange Commission may seek and obtain monetary disgorgement from a federal court - as opposed to an administrative body - as “equitable relief" for securities law violations, even though the applicable statutory provision does not explicitly authorize monetary disgorgement and the
Supreme Court has determined that such disgorgement is a penalty. The Court also commented upon whether, assuming disgorgement awards are even legally permitted, they should be limited to defendants’ net profits, rather than the net loss to aggrieved investors.

In an 8-1 decision and partial victory for the SEC, the Court upheld the SEC’s power to disgorge ill-gotten gains in civil enforcement lawsuits. Importantly, however, the Court remanded the case to the Ninth Circuit with instructions to reconsider the calculation of the award.

The decision is authored by Justice Sotomayor and limits the SEC’s authority to recover more than the amount of net income generated through unlawful conduct.

Justice Sotomayor stated that “courts have occasionally awarded disgorgement in three main ways that test the bounds of equity practice: by ordering the proceeds of fraud to be deposited in Treasury funds instead of disbursing them to victims, imposing joint-and-several disgorgement liability, and declining to deduct even legitimate expenses from the receipts of fraud. The SEC’s disgorgement remedy in such incarnations is in considerable tension with equity practices.”

“The court holds today that a disgorgement award that does not exceed a wrongdoer’s net profits and is awarded for victims is equitable relief permissible under” federal law, said Justice Sonia Sotomayor for the Supreme Court.

The Court also addressed the “Kokesh Issue,” whether or not it effectively decided in that case that disgorgement is necessarily a penalty, and thus not the kind of relief available at equity.

“Not so. Kokesh expressly declined to pass on the question. To be sure, the Kokesh Court evaluated a version of the SEC’s disgorgement remedy that seemed to exceed the bounds of traditional equitable principles. But that decision has no bearing on the SEC’s ability to conform future requests for a defendant’s profits to the limits outlined in common-law cases awarding a wrongdoer’s net gains.”

The Court also considered the Liu petitioners’ equity-based argument related to the failure of the SEC to return funds to victims (instead, depositing a portion of collected funds in the Treasury) and imposition of joint-and-several liability. However, because the parties focused on the broad question whether any form of disgorgement may be ordered and did not fully brief these narrower questions, the Court did not decide them. Rather, the Court discussed principles that may guide the lower courts’ assessment of these arguments on remand.

Justice Clarence Thomas dissented, stating that the SEC has no power to “disgorge” illegal gains from stock frauds.

This decision may bolster the FTC’s enforcement and investigational posture with respect to its authority to obtain equitable monetary relief under Section 13(b) of the FTC Act. However, it may also embolden defendants and recipients of compulsory process to challenge longstanding FTC remedial theories, including, but not limited to, measuring “equitable” monetary relief under Section 13(b) of the FTC Act by consumers’ loss, alone.