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COMMENTARY

AN UNCERTAIN FUTURE FOR SEC DISGORGEMENT

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On November 1, 2019, the United States Supreme Court granted certiorari to determine whether SEC disgorgement is permissible as a penalty for securities fraud.

I. DISGORGEMENTS AND THE SEC

Disgorgement is a remedy “requiring a party who profits from illegal or wrongful acts to give up any profits he or she made as a result of his or her illegal or wrongful conduct.”¹ When the SEC orders disgorgement, the agency collects the funds and has the ability to distribute money back to those that were harmed by the fraudulent behavior. Its purpose is to prevent unjust enrichment. This remedy is often ordered when the SEC finds an entity has committed illegal activity or fraud.

This remedy for civil actions, outlined in the Securities Act, states that penalties for securities violations cannot be greater than “the gross amount of pecuniary gain to such defendant as a result of the violation”² if the violation “involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.”³

According to its annual report, the SEC ordered 3.248 billion dollars in disgorgement as penalties to companies in violation of securities law in 2019.⁴ Following these substantial disgorgements, “the Commission returned nearly \$1.2 billion to harmed investors” in the same fiscal year.⁵

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¹ *Disgorgement*, LEGAL INFORMATION INSTITUTE, <https://www.law.cornell.edu/wex/disgorgement> (last visited Nov. 15, 2019).

² 15 U.S.C. § 77t(d)(2)(C)(2010).

³ *Id.*

⁴ U.S. SEC. AND EXCH. COMM’N., DIVISION OF ENFORCEMENT, 2019 Annual Report (2019) at 16.

⁵ *Id.* at 17.

II. HOW DID THE DISGORGEMENT ISSUE GET TO THE SUPREME COURT?

The question facing the Supreme Court is “whether the Securities and Exchange Commission may seek and obtain disgorgement from a court as ‘equitable relief’ for a securities law violation even though this Court has determined that such disgorgement is a penalty.”⁶ The issue arrived at the Supreme Court following an appeal from the Ninth Circuit Court.

The SEC initially brought a securities fraud action against a Mr. Liu and a Ms. Wang in 2017 for violation of securities law following their funneling of twenty-seven million dollars from Chinese investors through the Immigration Investor Program⁷. Liu and Wang acquired the support of investors with the promise of opening a cancer therapy center that never came to fruition.⁸ A California federal district court granted summary judgment for the SEC, finding, in part, that “disgorgement in amount of total funds raised from investors was reasonable.”⁹ The court ordered disgorgement of approximately \$27 million.¹⁰ On Liu and Wang’s appeal at the Ninth Circuit, the court affirmed the decision, and held the disgorgement amount was reasonable.¹¹ Now, Liu and Wang are disputing whether disgorgement is an acceptable equitable remedy for securities fraud.¹²

Pending the Supreme Court’s decision, securities violation remedies face an uncertain future. Although a decision in 2017 limited disgorgements for securities fraud to a five-year statute of limitations¹³, Liu and Wang claim that the Supreme Court has not yet decided whether disgorgement can be ordered at all.¹⁴ If a remedy can be limited to a statute of limitations period, does that not imply a remedy is permissible? This question will be decided in the upcoming session.

III. FUTURE IMPACT

Depending on how the Supreme Court rules, the SEC’s enforcement power may be significantly diminished if there are no longer financial penalties to violating parties in the form of disgorgements. While other civil penalties will remain, return of fraudulently gained profits might not be ordered. Moving forward, will SEC actions against fraudulent behavior have as much impact and meaning for companies engaged in illegal behavior?

Many would answer “yes.” A decision prohibiting SEC disgorgement will potentially “weaken the agency’s enforcement power”¹⁵, and have significant financial repercussions.

There will be a lesser punitive impact on parties that engaged in the fraudulent business practices by removing this significant financial penalty. As several billion dollars in disgorgements are currently ordered annually, removing this remedy will change the landscape of securities fraud

⁶Grant of Cert. 1, Nov. 1, 2019, ECF No. 18-1501 (<https://www.supremecourt.gov/qp/18-01501qp.pdf>).

⁷*Sec. & Exch. Comm’n v. Liu*, 754 F. App’x 505 at 506 (9th Cir. 2018).

⁸*Id.* at 507.

⁹*Sec. & Exch. Comm’n v. Liu*, 262 F. Supp. 3d 957 (C.D. Cal. 2017).

¹⁰*Id.*

¹¹*Liu*, 754 F. App’x at 505.

¹²Grant of Cert. 1, Nov. 1, 2019, ECF No. 18-1501 (<https://www.supremecourt.gov/qp/18-01501qp.pdf>).

¹³*Kokesh v. S.E.C.*, 137 S. Ct. 1635, 198 L. Ed. 2d 86 (2017).

¹⁴Greg Stohr, *Supreme Court will Consider Stripping SEC of Disgorgement Powers*, BLOOMBERG, Nov. 1, 2019, <https://www.bloomberg.com/news/articles/2019-11-01/supreme-court-will-consider-stripping-sec-of-disgorgement-powers>.

¹⁵Lawrence Hurley, *U.S. Supreme Court to review SEC’s power to recover ill-gotten gains*, REUTERS, Nov. 1, 2019, <https://www.reuters.com/article/us-usa-court-sec/u-s-supreme-court-to-review-secs-power-to-recover-ill-gotten-gains-idUSKBN1XB4VD>.

cases. Additionally, without disgorgement of these funds, investors who fell victim to fraudulent activities of individuals or businesses might not recover any lost funds from the SEC. However, disgorgements are only one of the various remedies available to the agency. Although financial remedies will be lessened without disgorgements, the SEC will still hold significant enforcement power moving forward in the form of civil penalties and non-monetary penalties such as injunctions, bars, and suspensions against companies and individuals involved.¹⁶ Disgorgement's uncertain fate will be decided by the Supreme Court this summer.¹⁷

¹⁶ Peikin, Remedies and Relief in SEC Enforcement Actions, Securities and Exchange Commission, Oct. 3, 2018. Last accessed Dec. 20, 2019. <https://www.sec.gov/news/speech/speech-peikin-100318>.

¹⁷ *Id.*