Liu v. SEC: Limiting Disgorgement, but by How Much?

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I. Introduction

To extract what it calls "ill-gotten gains" from wrongdoers, the Securities and Exchange Commission (SEC) relies heavily on the amorphous remedy of "disgorgement." Last year, the SEC obtained $4.3 billion in monetary remedies for violations of the federal securities laws.[1] Of that total, about $3.2 billion was from disgorgement orders.[2]

Disgorgement is "[t]he act of giving something (such as profits illegally obtained) on demand or by legal compulsion."[3] And the disgorgement remedy is "[r]estitution measured by the defendant's wrongful gain."[4] Easily stated, but the remedy of disgorgement itself—particularly the way the SEC uses it—is not so clearly defined.[5]

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[1] U.S. Sec. & Exch. Comm'n, Div. of Enf't, 2019 Ann. Rep. 16 [hereinafter 2019 Annual Report].

[2] *Id.*

[3] Disgorgement, Black's Law Dictionary (11th ed. 2019).

[4] Restatement (Third) of Restitution & Unjust Enrichment § 51 cmt. a (Am. Law Inst. 2011); see also *id*. at § 51(4) ("The object of restitution in such cases is to eliminate profit from wrongdoing while avoiding, so far as possible, the imposition of a penalty. Restitution remedies that pursue this object are often called 'disgorgement' or 'accounting.'").

[5] *Id.* at § 51 cmt. e ("The object of the disgorgement remedy—to eliminate the possibility of profit from conscious wrongdoing—is one of the cornerstones of the law of restitution and unjust enrichment. . . . While its purpose is easily stated and readily understandable, the application of the remedy involves well-known, sometimes intractable difficulties.").

The SEC initially grounded disgorgement in the district court's equitable authority to order remedies separately from those the SEC was explicitly authorized to pursue. Later, Congress explicitly authorized the SEC to seek equitable relief. Nevertheless, disgorgement has strayed far from this equitable authority. As a practical matter, SEC disgorgement often penalizes by leaving the defendant worse off, and it routinely fails to return disgorged funds as restitution to those harmed by the wrongdoer.

In *Liu v. SEC*,[6] the Supreme Court considered whether the SEC is authorized to seek, and district courts are empowered to grant, disgorgement by statutory authority providing for "any equitable relief that may be appropriate or necessary for the benefit of investors."[7] The Court found that the SEC may pursue disgorgement, but only insofar as it stays within the bounds of a traditional equitable remedy: "a disgorgement award [must not] exceed a wrongdoer's net profits and [must be] awarded for victims."[8]

Neither accepting the SEC's expansive view of disgorgement nor the petitioner's request to strike the remedy altogether, the Supreme Court landed in the middle. Specifically, the Court recognized that Congress authorizes the SEC to seek equitable remedies but found that the agency's disgorgement orders often exceed the scope of its authority. While *Liu* leaves many questions unanswered, its immediate effects are welcome, and include increased scrutiny of SEC requests for disgorgement, more frequent return of disgorged funds to victims, and increased transparency and consistency in the application of SEC remedies.

II. A Brief History of SEC Remedies and Disgorgement

Before examining the *Liu* decision in detail, it is useful to understand the history of the SEC's remedial authority and about how the SEC has used the disgorgement remedy.

A. SEC Remedies

Although the SEC has been enforcing the securities laws since its inception in 1934, its regulatory toolkit has expanded over time.

[6] Liu v. SEC, 140 S. Ct. 1936 (2020).

[7] 15 U.S.C. § 78u(d)(5).

[8] Liu, 140 S. Ct. at 1940.

In the beginning, Congress limited the SEC's remedial authority to injunctions barring future violations of the securities laws and referring cases to the Department of Justice for criminal prosecution.[9] Back then, courts generally refused to provide broad injunctive relief, confining their orders to the conduct at issue. Accordingly, SEC injunctions were of limited scope, usually restricting the defendant's conduct or trading with respect to a particular stock; defendants could simply resume their unlawful activities with other securities not subject to the injunction.[10]

For the first 30 years or so of its existence, the level of SEC enforcement activity waxed and waned, but the remedies available to the commission remained constant.[11]

By the 1960s, the commission began advancing more expansive interpretations of the securities laws, including developing a substantial insider-trading doctrine.[12] The SEC also broadened its remedial power by appealing to the inherent equitable authority of courts to order ancillary relief.[13]

In 1970, the SEC for the first time obtained a monetary order for equitable relief in *Texas Gulf Sulphur*.[14] In this insider-trading case, the district court ordered corporate insiders who had traded in advance of public knowledge about a mineral strike to disgorge their trading profits.[15] The Second Circuit upheld the ruling, in relevant part, noting that "the SEC may seek other than injunctive relief in order to

[9] See 1 T. Hazen, Law of Securities Regulation §1:37 (7th ed., rev. 2016); see also SEC Historical Society, Oral Histories Committee, Roundtable on Enforcement, A Brief History of the SEC's Enforcement Program 1934–1981, 2 (Sept. 25, 2002).

[10] SEC Historical Society, *supra* note 9, at 5.

[11] *Id.* at 2–3 (discussing SEC's early enforcement activity); *id.* at 13 (noting that the commission obtained in civil actions permanent injunctions against 1,059 firms and individuals in its first decade of operation); *id.* at 14 (noting that only 50 enforcement actions originating out of the home office were brought during the 1950s although enforcement actions continued from the regional offices).

[12] *Id.* at 3 (describing the 1960s as a "period distinguished by the staff's creativity and innovation in using enforcement actions to facilitate the interpretive development of the securities laws").

[13] *Id.* at 20.

[14] SEC v. Tex. Gulf Sulphur, 312 F. Supp. 77, 91–92 (S.D.N.Y. 1970), aff'd in part, rev'd in part, 446 F.2d 1301 (2d. Cir. 1971); see also SEC Historical Society, *supra* note 9, at 21; Lisa M. Fairfax, From Equality to Duty: On Altering the Reach, Impact, and Meaning of the Texas Gulf Legacy, 71 S.M.U. L. Rev. 729, 748 (2018).

[15] Tex. Gulf Sulphur, 312 F. Supp. at 91–92.

effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment."[16] This case laid the foundation for the disgorgement remedy the Supreme Court considered in *Liu*.

In the years that followed, Congress further expanded the SEC's available remedies. Fulfilling a request from the SEC, the Insider Trading Sanctions Act of 1984 gave the SEC authority to exact monetary penalties in insider-trading cases.[17] A few years later, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act) ushered in the modern era of SEC enforcement remedies.[18] The Remedies Act granted the SEC broad civil penalty authority, calculated through a three-tier framework based on the nature of the violations. Within each tier, "the fine may not exceed the higher of the gross pecuniary gain or maximum statutory amount."[19] The Remedies Act also explicitly granted the SEC the authority to "enter an order requiring accounting and disgorgement" in administrative proceedings.[20]

The Sarbanes-Oxley Act of 2002 again altered the SEC's remedial authority, explicitly authorizing the commission to "seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors."[21] Unlike the Remedies Act

[16] SEC v. Tex. Gulf Sulphur, 446 F.2d at 1308.

[17] See Paul S. Atkins & Bradley J. Bondi, Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program, 13 Fordham J. Corp. & Fin. L. 367, 385 (2008); The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 3, 102 Stat. 4677 (permitting the SEC to seek three times the profits realized [or losses evaded] as a civil penalty).

[18] Atkins & Bondi, *supra* note 17, at 391–92; see also, Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (1990); Richard A. Spehr & Michelle J. Annunziata, The Remedies Act Turns Fifteen: What Is Its Relevance Today?, 1 N.Y.U. J.L. & Bus., 587, 588 (2005).

[19] 15 U.S.C. §§ 77t(d)(2)(A)-(C), 78u(d)(3)(A)-(B); see also Spehr & Annunziata, *supra* note 18, at 589, 591–92; Atkins & Bondi, *supra* note 17, at 392.

[20] 15 U.S.C. § 77h-1(e); see also Spehr & Annunziata, *supra* note 18, at 593. The Remedies Act gave the SEC two additional remedies: administrative authority to seek temporary and permanent cease and desist orders, permitting the SEC to bypass the onerous process of getting an emergency restraining order which required injunction proceedings (15 U.S.C. § 77h-1; Spehr & Annunziata, *supra* note 18, at 589–90); and officer and director bars in federal court (15 U.S.C. § 78u(d)(2); Spehr & Annunziata, *supra* note 18, at 594).

[21] 15 U.S.C. § 78u(d)(5). The Sarbanes-Oxley Act also allowed the SEC to seek a forfeiture of bonuses received by executives who headed noncompliant companies and lowered the burden to obtain administrative director and officer bars. See Spehr & Annunziata, *supra* note 18, at 598–99.

grant of disgorgement authority in administrative proceedings, the Sarbanes-Oxley Act amendments do not delineate any specific type of equitable relief the SEC may seek in judicial proceedings.

Today, the SEC wields a wide range of remedial authorities. In federal court proceedings, the SEC can seek "a permanent or temporary injunction" punishable by contempt, including an injunction preventing a defendant from serving on boards of directors.[22] The SEC also may seek civil monetary penalties and equitable relief.[23]

In administrative proceedings, the SEC can issue orders requiring a person "to cease and desist from committing or causing a violation" of the securities laws, requiring affirmative "steps to effect compliance" with the law, prohibiting a person "from acting as an officer or director" of a publicly traded company, and requiring accounting and disgorgement.[24] The SEC also may impose civil penalties.

B. Disgorgement in Practice

While the SEC's ability to obtain disgorgement has become relatively well-accepted by the courts, there has been little clarity as to what exactly the SEC is entitled to under a "disgorgement" order.[25]

Because disgorgement has long been considered an equitable remedy, the SEC has enjoyed substantial procedural and evidentiary advantages when pursuing it.[26] Courts generally require the SEC to distinguish between legally and illegally obtained profits and identify the causal link between the unlawful activity and the profit to be disgorged. But because these calculations are logistically difficult to verify, courts have said that the SEC needs to proffer only a "'reasonable approximation of profits causally connected to the violation,'"[27]

[22] 15 U.S.C. § 77t(b); see also *id.* § 78u(d).

[23] 15 U.S.C. § 77t(d)(2)(A)-(C); *id*. §§ 78u(d)(3)(B), (d)(5).

[24] 15 U.S.C. §§ 77h-1(a), (f), (e).

[25] See, e.g., SEC v. Cavanaugh, 445 F.3d 105, 118–20 (2d Cir. 2006); SEC v. Huffman, 996 F.2d 800, 802–03 (5th Cir. 1993).

[26] See Russell G. Ryan, The Equity Façade of SEC Disgorgement, 4 Harv. Bus. L. Rev. Online 1, 4–5 (2013).

[27] SEC v. Whittemore, 659 F.3d 1, 7 (D.C. Cir. 2011) (quoting SEC v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1231 (D.C. 1989)); see also, e.g., SEC v. Calvo, 378 F.3d 1211, 1217–18 (11th Cir. 2004) ("Exactitude is not a requirement; '[s]o long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty.'") (quoting SEC v. Warde, 151 F.3d 42, 50 (2d Cir. 1998)).

and then the burden shifts to the defendant to disprove the SEC's calculation.[28]

As a result, the SEC's disgorgement awards are often difficult to square with traditional equitable remedies that do not punish the offender.[29] In practice, they are often untethered from the violation in question and exceed the value of illegally obtained profits, leaving a defendant worse off.[30]

In some circumstances, disgorgement has little causal connection to the underlying offense. For example, the SEC often pursues disgorgement as a remedy for violating the accounting provisions of the Foreign Corrupt Practices Act (FCPA).[31] But it is difficult to see how incorrectly accounting for payments—rather than bribes themselves—result in ill-gotten gains. The SEC nevertheless has received sizable disgorgement orders in cases where the only offense charged was recordkeeping.[32]

[28] See, e.g., SEC v. Benson, 657 F. Supp. 1122, 1133–34 (S.D.N.Y. 1987) (holding that, for the purposes of disgorgement, once the SEC has demonstrated the "existence of a fraudulent scheme to misappropriate corporate funds, defendant bears the burden of demonstrating that he received less than the full amount allegedly misappropriated and sought to be disgorged"). In addition, the equitable nature of the remedy means that defendants facing SEC disgorgement do not have the right to a jury trial. Courts have also accepted the SEC's position that a disgorgement order is enforceable through contempt sanctions and is not a debt that triggers the protections normally afforded to judgment debtors under the Federal Debt Collection Procedures Act. See Ryan, *supra* note 26, at 4–5.

[29] See Brief for Law Professors as Amici Curiae Supporting Petitioners at 8, Liu v. SEC, 140 S. Ct. 1936 (2020) (No. 18-1501); see also *id.* at 15 ("Equity's broad powers are tolerable—as a matter of political morality and as a matter of constitutional principle—only because there are limits. There is much that equity can do, but only because there are things it cannot do. Because there is no right to a civil jury trial for an equitable claim, one of those things that equity cannot do is inflict punishment.").

[30] See Brief for Cato Institute as Amicus Curiae Supporting Petitioners at 11, Liu v. SEC, 140 S. Ct. 1936 (2020) (18-1501) [hereinafter Cato Amicus].

[31] See 15 U.S.C. § 78m(b)(2)(A)-(B) (requiring public companies to make and keep accurate books, records, and accounts and to devise and maintain internal accounting controls).

[32] See, e.g., SEC v. Chevron Corp., No. 07 CV. 10299 (SHS), 2007 WL 9612123, at *1 (S.D.N.Y. Nov. 20, 2007) (imposing $25 million in disgorgement); SEC v. Textron, Litig. Release No. 20251, 91 SEC Docket 1197 (Aug. 23, 2007) (imposing $2.3 million in disgorgement); see also Cato Amicus, *supra* note 31, at 12–13; Mike Koehler, "The SEC Has Collected Approximately $4.6 Billion in Disgorgement in FCPA Enforcement Actions," FCPAProfessor.com Apr. 20, 2020, http://fcpaprofessor.com/sec-collected-approximately-4-6-billion-disgorgement-fcpa-enforcement-actions/ (stating that "the SEC has secured approximately $775 million in approximately 60 corporate no-charged bribery disgorgement actions").

In other circumstances, defendants are required to disgorge benefits that they do not possess. For example, in insider-trading cases, disgorgement can include the profits that others have made on trading linked to the defendant.[33] These profits, however, never belonged to the defendant. Disgorgement awards also are routinely entered without regard for whether the defendant still possesses the funds to be disgorged.[34]

Under still other circumstances, courts have accepted the SEC's broad view of what constitutes illegally obtained profits and ordered disgorgement without subtracting legitimate expenses incurred by the defendant.[35]

Given this wide latitude, disgorgement awards are an increasingly important part of the SEC's enforcement efforts. Approximately 75 percent of the $4.3 billion the SEC obtained in 2019 was disgorgement.[36] This is not a new trend; disgorgement has outpaced monetary penalties for years.[37]

Yet money returned to those harmed by securities law violations is consistently well below the amount of disgorgement ordered. In 2019, the SEC returned approximately $1.2 billion to investors.[38] In 2016, that number was just $140 million.[39]

[33] See, e.g., Warde, 151 F.3d at 49 ("A tippee's gains are attributable to the tipper, regardless whether benefit accrues to the tipper"); SEC v. Clark, 915 F.2d 439, 441, 454 (9th Cir. 1990) (requiring defendants to disgorge the profits that his stockbroker made from unlawful trades); see also SEC v. Contorinis, 743 F.3d 296, 302 (2d Cir. 2014) (requiring defendant to disgorge both his gains and the benefit that accrued to third parties); *id.* at 310 (Chin, J., dissenting) (noting that the disgorgement order was for more than the criminal forfeiture order).

[34] See, e.g., SEC v. Banner Fund Int'l, 211 F. 3d 602, 617 (D.C. Cir. 2000) (ordering disgorgement where defendant no longer possessed the ill-gotten gains); see also Ryan, *supra* note 26, at 10 (disgorging gains akin to "a doctor advising an emaciated patient to disgorge last year's Thanksgiving dinner").

[35] See, e.g., SEC v. Brown, 658 F.3d 858, 860–61 (8th Cir. 2011) (per curiam) (ordering joint-and-several disgorgement of funds collected from investors and concluding that "the overwhelming weight of authority hold[s] that securities law violators may not offset their disgorgement liability with business expenses").

[36] 2019 Annual Report, *supra* note 1, at 16.

[37] *Id.* (showing penalties and disgorgement from 2015 to 2019). Prior to 2015, the SEC does not appear to have systematically reported civil penalties and disgorgement separately, but disgorgement was a substantial portion of the total penalties ordered.

[38] *Id.* at 17. Because the amount of disgorgement distributed is tied to when it is collected, the amount of money returned to those harmed may not be closely tied to the disgorgement ordered in any particular fiscal year.

[39] *Id.*

Thus, despite the wide range of remedies available, the SEC, perhaps not surprisingly, has grown increasingly reliant on disgorgement, a remedy that it has enjoyed wide and largely unchecked discretion in fashioning.

III. The SEC and the Supreme Court before *Liu*

The SEC is no stranger to Supreme Court review of its enforcement authority. In the last seven years, the Supreme Court has reviewed five SEC enforcement actions, including *Liu*. The SEC prevailed in only one of those cases,[40] and two of the agency's losses laid the groundwork for *Liu*.[41]

Those two cases—*Gabelli* and *Kokesh*—both addressed the statute of limitations in 28 U.S.C. § 2462, which requires enforcement suits for "any civil fine, penalty, or forfeiture" to be brought within "five years from the date when the claim is first accrued." In *Gabelli*, the Supreme Court unanimously rejected the SEC's argument that the statute of limitations for fraud claims begins running when the fraud is discovered, not when it occurred.[42] The Court ruled that the SEC, which "as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect[,]" is limited to five years from the date the fraud began because its cases "involve[] penalties, which go beyond compensation, are intended to punish, and label defendants wrongdoers."[43]

Gabelli opened the door to the litigation in *Kokesh*, which specifically addressed whether SEC disgorgement is a "penalty" subject to the five-year time limit of § 2462.[44] The Supreme Court, again unanimously, rejected the SEC's argument that disgorgement orders are not subject to the limitations period, holding that "[d]isgorgement in the securities-enforcement context is a 'penalty' within the meaning of § 2462."[45]

The Court described three characteristics that make SEC disgorgement a penalty. First, "SEC disgorgement is imposed by the courts as

[40] Lorenzo v. SEC, 139 S. Ct. 1094 (2019).

[41] Kokesh v. SEC, 137 S. Ct. 1635 (2017); Gabelli v. SEC, 568 U.S. 442 (2013).

[42] Gabelli, 568 U.S. at 445.

[43] *Id*. at 451–52; see also *id*. at 454 (finding a "lack of textual, historical, or equitable reasons to graft a discovery rule onto the statute of limitations of § 2462").

[44] Kokesh, 137 S. Ct. 1635.

[45] *Id*. at 1639.

a consequence for violating . . . public laws," meaning that the violation is against the United States as opposed to an individual victim.[46] Second, "SEC disgorgement is imposed for punitive purposes."[47] Deterrence is "inherently punitive," and the Court explained that in the years since *Texas Gulf Sulphur*, "it has become clear that deterrence is not simply an incidental effect of disgorgement."[48] Third, disgorged funds are not necessarily paid to victims, rendering SEC disgorgement often "not compensatory."[49] By exceeding the profits gained by the violation and failing to account for a defendant's expenses, the Court recognized that SEC disgorgement "does not simply restore the status quo; it leaves the defendant worse off."[50]

Although the Court explicitly reserved the question of "whether courts possess the authority to order disgorgement in SEC enforcement proceedings,"[51] its blunt language casting disgorgement as a penalty invited *Liu*.

IV. *Liu* Litigation

A. Background and Lower-Court Litigation

The SEC filed suit in district court against Charles Liu, Xin Wang (his wife), and several corporate defendants alleging violations of Rule 10b-5 and Section 17(a) of the Securities Act.[52] Liu and Wang solicited nearly $27 million from foreign investors under the EB-5 Program, which provides U.S. visas in return for investment in certain job-creating projects. The funds were supposed to be used to build a cancer treatment center, but although some steps were taken to advance the project (such as bulldozing the chosen site), no center was completed. Only a fraction of the funds raised were used for the purposes described in the program's offering memorandum.

[46] *Id.* at 1643.

[47] *Id.*

[48] *Id.* (noting that the *Texas Gulf Sulphur* court emphasized the need "to deprive the defendants of their profits in order to . . . protect the investing public by providing an effective deterrent to future violations") (quoting Tex. Gulf Sulphur, 312 F. Supp. at 92).

[49] *Id.* at 1644 (explaining that "[w]hen an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty").

[50] *Id.* at 1645.

[51] *Id.* at 1642 n.3.

[52] SEC v. Liu, 262 F. Supp. 3d 957 (C.D. Cal. 2017).

The district court granted summary judgment to the SEC, finding that Liu and Wang misappropriated most of the money raised, paying $12.9 million to marketing firms (arguably controlled by Liu and Wang) to solicit new investors and paying themselves approximately $8.2 million in salaries, none of which was authorized by the private offering memorandum for the securities. The district court ordered Liu and Wang to pay civil penalties equal to the $8.2 million they had personally received from the project, permanently enjoined them from future solicitation of EB-5 Program investors, and ordered them to disgorge the entire amount they had raised from investors (minus a small amount that was left in the corporate accounts).

The district court rejected the defendants' argument that disgorgement should be offset by their legitimate expenses, stating that "the Ninth Circuit has indicated that the proper amount of disgorgement is the entire proceeds from a scheme minus amounts paid to investors."[53]

The Supreme Court issued its opinion in *Kokesh* shortly after the district court's decision. On appeal to the Ninth Circuit, Liu argued that because *Kokesh* found disgorgement to be a penalty, the SEC lacked authority to seek (and the district court to order) disgorgement. The Ninth Circuit found that "*Kokesh* expressly refused to reach" the authority to order disgorgement and therefore relied on its own "longstanding precedent" to uphold the district court's order.[54] The Ninth Circuit also rejected Liu's argument seeking credit for legitimate business expenses, maintaining that "the proper amount of disgorgement in a scheme such as this one is the entire amount raised less the money paid back to the investors."[55]

B. Supreme Court Litigation

1. Liu's arguments

Liu reasoned that because *Kokesh* found disgorgement to be a penalty and held that penalties are "outside 'the well-established rules of equity jurisprudence,'" disgorgement is not available as equitable relief.[56] Liu distinguished Congress's express authorization

[53] *Id.* at 975 (citation omitted).

[54] SEC v. Liu, 754 Fed. Appx. 505, 509 (9th Cir. 2018).

[55] *Id.*

[56] Brief for Petitioners at 1, Liu v. SEC, 140 S. Ct. 1936 (2020) (No. 18-1501) (quoting Livingston v. Woodworth, 56 U.S. 546, 559 (1854)).

for "disgorgement" in administrative proceedings, arguing that Congress did not authorize the SEC to obtain "limitless monetary penalties under the label 'disgorgement'" when authorizing "equitable" relief in federal court actions.[57]

Pointing out that disgorgement leaves defendants worse off by failing to offset legitimate expenses and requiring repayment of benefits accrued by third parties, Liu argued that disgorgement "bears all the hallmarks" of a penalty.[58] Additionally, because disgorgement seeks payment without considering whether the defendant retained a particular asset or fund, and because disgorgement typically does not return funds to the victims, disgorgement "is the type of 'merely . . . personal claim'" that is "a quintessential action at law."[59] As Liu saw it, disgorgement "was invented by creative agency lawyers in the 1960s and 1970s" and is not historically an equitable remedy.[60]

Liu argued that where Congress has provided a comprehensive remedial scheme for the SEC to use in federal court actions, conspicuously leaving out any reference to disgorgement, "the explicit authorization of certain remedies is 'strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate.'"[61] Liu stressed that "Congress has given the SEC ample enforcement tools to protect investors from wrongdoers," including the power to seek monetary penalties that force a defendant to surrender his ill-gotten gains.[62] "If the SEC needs still more tools," Liu concluded, "it must appeal to Congress, not the courts."[63]

[57] *Id*.

[58] *Id*. (quoting Kokesh, 137 S. Ct. at 1644).

[59] *Id*. at 32 (citing Montanile v. Bd. of Trs. of the Nat'l Elevator Indus. Health Ben. Plan, 136 S. Ct. 659 (2016)). Using his own case as an example, Liu asserted that the district court found that Liu and Wang gained $6,714,580 and $1,538,000 respectively from their scheme; the rest of the funds were no longer in their possession. Yet the court ordered them to disgorge—jointly and severally—nearly $27 million.

[60] *Id*. at 2.

[61] *Id.* at 15 (quoting Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 147 (1985)); see also *id.* at 33 ("Where law authorizes a complete enforcement scheme, the agency may pursue the relief included in that scheme. But where law withholds or limits a remedy, equity may not invent another to fill the gap, no matter how appealing the invention may seem.") (citation omitted).

[62] *Id.* at 14. Such monetary penalties measured by "the gross amount of pecuniary gain" to the defendant were also imposed on Liu and Wang.

[63] *Id*.

2. The SEC's arguments

The SEC, on the other hand, argued that "'disgorgement of improper profits' has 'traditionally [been] considered an equitable remedy,'" comparing the SEC disgorgement remedy to an "accounting of profits," which "required wrongdoers to surrender profits from their wrongs."[64]

Limiting *Kokesh* to its effect on the statute of limitations, the SEC argued that the three *Kokesh* hallmarks of a penalty are not inconsistent with equitable relief; indeed, equitable remedies are routinely premised on violations of federal statutes, often have a deterrent effect, and are usually noncompensatory.[65] The SEC admitted that disgorgement calculations can leave a wrongdoer worse off, but that even if some courts have awarded excessive amounts of disgorgement, these decisions do "not cast doubt on the established understanding that disgorgement, if properly calculated, is an available form of 'equitable relief.'"[66]

Even if SEC disgorgement is not traditionally equitable, the SEC asserted that the Supreme Court is tasked with interpreting the words "any equitable relief."[67] In enacting the statute, Congress "was aware of, relied on, and ratified the preexisting view that disgorgement was

[64] Brief for Respondent at 5, Liu v. SEC, 140 S. Ct. 1936 (2020) (No. 18-1501) (quoting Tull v. United States, 481 U.S. 412, 424 (1987)); *id.* at 9 (citing Root v. Railway Co., 105 U.S. 189, 207 (1882)); see also *id*. ("'Disgorgement' is simply the modern name for 'accounting.'") (citing Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. a).

[65] *Id*. at 33–34; see also *id*. at 34 ("To give an example that combines all three factors: The constructive trust remedy that prevents murderers from inheriting their victims' estates is imposed upon violation of the law against murder, serves in part to deter murder, and does not compensate—yet it has always been considered equitable.") (citation omitted).

[66] *Id.* at 42; see also *id*. at 40 ("Courts have understood that those rules would sometimes leave the wrongdoer worse off than if he had followed the law, but they have reasoned that '[t]he conduct of the [wrongdoers] has not been such as to commend them to the favor of a court of equity,' that '[a] more favorable rule would offer a premium to dishonesty,' and that a wrongdoer who finds himself in a worse position 'has only himself to blame.'") (citations omitted).

[67] *Id.* at 45 ("One could view the award of disgorgement in this setting as a substantial departure from traditional norms (since disgorgement was historically awarded to private plaintiffs whose own legal rights had been violated), or instead as a natural means of achieving the traditional objective of disgorgement (ensuring that a wrongdoer does not profit from his wrong).").

a permissible remedy in civil actions."[68] Because there is no basis to conclude that Congress "intended to withhold an equitable remedy that lower courts had uniformly concluded was already available,"[69] the SEC concluded, the statute must include disgorgement.

C. The Supreme Court Opinion

Justice Sonia Sotomayor, writing for an 8-1 majority of the Supreme Court, vacated the judgment against Liu and remanded the case to ensure that the disgorgement award is consistent with the Court's opinion.[70] Accepting neither Liu's nor the SEC's arguments, the Court took a middle approach by upholding the SEC's remedial authority, but placing limitations on the scope of its disgorgement remedy. The Court held that a disgorgement award that "does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under 15 U.S.C. § 78u(d)(5)."[71]

The majority opinion focused its analysis on the statutory language of § 78u(d)(5). Describing its "task [as] a familiar one," the Court analyzed "whether a particular remedy falls into 'those categories of relief that were *typically* available in equity.'"[72] The Court acknowledged that "equity practice long authorized courts to strip wrong-doers of their ill-gotten gains, with scholars and courts using various labels for the remedy," but "to avoid transforming an equitable remedy into a punitive sanction, courts restricted the remedy to an individual wrong-doer's net profits to be awarded for victims."[73]

The Court outlined three limits on equitable remedies. First, "the profits remedy often imposed a constructive trust on wrongful gains for wronged victims," turning the wrongdoer into a trustee of the profits.[74] Second, "equity courts also generally awarded profits-based

[68] *Id*. at 13–14.

[69] *Id*. at 7–8.

[70] Liu, 140 S. Ct. at 1940. The majority remanded the decision "[b]ecause the parties focused on the broad question whether any form of disgorgement may be ordered and did not fully brief these narrower questions" of what an appropriate disgorgement order in this matter would be. *Id*. at 1947.

[71] *Id*. at 1940.

[72] *Id*. at 1942 (emphasis in original) (quoting Mertens v. Hewitt Assocs., 508 U.S. 248, 256 (1993)) (other citations omitted).

[73] *Id*.

[74] *Id*. at 1944.

remedies against individuals or partners engaged in concerted wrongdoing, not against multiple wrongdoers under a joint-and-several liability theory."[75] Third, "courts limited awards to the net profits from wrongdoing, that is 'the gain made upon any business or investment, when both the receipts and payments are taken into account.'"[76] Unless the entire profit resulted from wrongful activity, "courts consistently restricted awards to net profits from wrongdoing after deducting legitimate expenses."[77] The Court found that Congress incorporated these "longstanding equitable principles" into § 78u(d)(5).[78]

Recognizing the SEC's disgorgement authority, the Court nonetheless concluded that the SEC's remedy has come into "considerable tension with equity practices."[79] The Court proceeded to identify three examples of this "tension": (1) where courts have "order[ed] the proceeds of fraud to be deposited in Treasury funds instead of disbursing them to victims"; (2) where courts have "impos[ed] joint-and-several disgorgement liability"; and (3) where courts have "declin[ed] to deduct even legitimate expenses from the receipts of fraud."[80] The Court addressed these instances in turn.

First, the relevant statute expressly limits equitable relief to what is "appropriate or necessary for the benefit of investors." Noting that the statute provides limited guidance, the Court stated that "[t]he equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit."[81]

[75] *Id.* at 1945.

[76] *Id.* at 1949–50 (quoting Rubber Co. v. Goodyear, 76 U.S. 788, 804 (1870)) (other citations omitted).

[77] *Id.* at 1946.

[78] *Id.* The Court found that Congress's use of the term "disgorgement" in other statutes does not counsel otherwise. The Court reasoned that explicitly using the term disgorgement when granting the SEC administrative remedies makes sense because administrative bodies have no inherent equitable authority. *Id.* at 1946–47. And "Congress does not enlarge the breadth of an equitable, profits-based remedy simply by using the term 'disgorgement' in various statutes." *Id.* at 1947. Congress cannot be presumed to have ratified a lower court understanding of the term when passing 15 U.S.C. § 78u(d)(5) because, "among other things, the scope of disgorgement was 'far from settled.'" *Id.* (quoting Armstrong v. Exceptional Child Care Center, Inc., 575 U.S. 320, 330 (2015)).

[79] *Id.* at 1946.

[80] *Id.*; see also *id.* at 1946 n.3 (citing several circuit court decisions upholding orders that violated these principles).

[81] *Id.* at 1948.

The Court rejected the SEC's long-held view that the primary function of disgorgement is to deny wrongdoers the "fruits of their ill-gotten gains, not to return the funds to victims as a kind of restitution," concluding that disgorgement "must do more than simply benefit the public at large by virtue of depriving a wrongdoer of ill-gotten gains."[82]

Second, "impos[ing] disgorgement liability on a wrongdoer for benefits that accrue to his affiliates, sometimes through joint-and-several liability" could transform disgorgement into a penalty.[83] Declining to "wade into all the circumstances" where a judgment against multiple individuals might withstand scrutiny, the Court made clear that such a determination is fact-intensive.[84]

Finally, "courts must deduct legitimate expenses before ordering disgorgement."[85] Recognizing that expenses "incurred for the purposes of furthering an entirely fraudulent scheme" are not legitimate, the Court again established a fact-intensive inquiry to "ascertain[] whether expenses are legitimate or whether they are merely wrongful gains 'under another name.'"[86] The Court provided little guidance for this inquiry, but suggested that "some expenses from petitioners' scheme went toward lease payments and cancer-treatment equipment . . . [which] arguably have value independent of fueling a fraudulent scheme."[87]

Justice Clarence Thomas dissented, concluding that disgorgement "is not a traditional equitable remedy," and he cautioned that the majority's ruling "threatens great mischief."[88] Distinguishing disgorgement from an accounting of profits, which required a defendant to account for and repay to a plaintiff the profits that belong to the plaintiff, Justice Thomas characterized the majority's definition of

[82] *Id.* The Court explicitly left open the question whether depositing funds with the Treasury is appropriate where it is "infeasible to distribute the collected funds to investors." *Id.*

[83] *Id.* at 1949.

[84] *Id.* The Court suggested some factual circumstances that may be relevant, including whether Liu and Wang commingled their finances and whether they both enjoyed the fruits of the scheme, among other things. *Id.*

[85] *Id.* at 1950.

[86] *Id.* (quoting Goodyear, 76 U.S. at 803).

[87] *Id.*

[88] *Id.* at 1950, 1953 (Thomas, J., dissenting).

disgorgement as "compel[ling] each defendant to pay his profits (and sometimes, though it is not clear when, all of his codefendant's profits) to a third-party Government agency (which sometimes, though it is not clear when, passes the money on to victims)."[89] Justice Thomas noted the lack of tracing required with a constructive trust or equitable lien, and warned that "[a]s long as courts continue to award 'disgorgement,' both courts and the SEC will continue to have license to expand their own power."[90]

V. *Liu*'s Open Questions

On first read, the Supreme Court's decision is deceptively simple: disgorgement is allowable, but only so long as it is limited to the wrongdoer's profits and the money collected is returned to investors. But *Liu* leaves open several questions about how such a remedy will work.

A. What Does It Mean to Be for "the Benefit of Investors"?

The *Liu* decision gives great weight to § 78u(d)(5)'s language restricting equitable relief to that which "may be appropriate or necessary for the benefit of investors." The Supreme Court counseled that the equitable nature of disgorgement "generally requires the SEC to return a defendant's gains to the wronged investors for their benefit."[91] This restriction is a seismic shift for the SEC, which, despite touting the return of some disgorgement funds to investors,[92]

[89] *Id.* at 1951.

[90] *Id.* at 1954. Justice Thomas also noted that the majority's decision will cause confusion in administrative practice because it is "unclear whether the majority's new restrictions on disgorgement will apply to these proceedings as well. If they do not, the result will be that disgorgement has one meaning when the SEC goes to district court and another when it proceeds in-house." *Id.* Acknowledging the majority's acceptance of disgorgement, Justice Thomas would have implemented bright-line rules to limit disgorgement orders "to be consistent with the traditional rules of equity": (1) "the order should be limited to each petitioner's profits"; (2) "the order should not be imposed jointly and severally"; and (3) "the money paid by petitioners should be used to compensate petitioner's victims." *Id.* at 1954–55.

[91] *Id.* at 1948.

[92] See, e.g., 2019 Annual Report, *supra* note 1, at 17 ("The Commission returned a substantial amount of money to harmed investors."); *id.* at 21 ("The Supreme Court's June 2017 decision in *Kokesh v. SEC* continues to impact adversely the Commission's ability to disgorge and return funds to investors injured by long-running frauds,

does not view disgorgement as primarily compensatory.[93] Post-*Liu*, the SEC must do more than merely deposit disgorgement proceeds in the U.S. Treasury.

But what more must it do? This question touches not only on what should be done with disgorgement proceeds, but also on the circumstances under which disgorgement is permissible at all.

It seems obvious that where victims are easily identified and easily compensated, disgorged funds should be returned to them. Yet it is easy to underestimate the complexity of this endeavor. Not only must the total amount to be disgorged be calculated, but also the amount to be returned to each eligible investor. If the SEC must establish these facts prior to entry of a disgorgement order, this will delay resolution and could drag the court into detailed factual determinations about individual investors who are not parties to the SEC's civil action. The SEC may seek to avoid this complication by expanding its use of Fair Funds, which were created by the Sarbanes-Oxley Act to collect and distribute disgorgement proceeds and civil monetary penalties "for the benefit of investors who were harmed by the violation."[94] With a Fair Fund, the SEC could determine who the victims are and how much they should receive after the disgorgement order has been entered.[95] But using this mechanism is no

such as Ponzi schemes, that often directly impact retail investors."); Steven Peikin, Co-Director, Division of Enforcement, Remedies and Relief in SEC Enforcement Actions, PLI White Collar Crime 2018: Prosecutors and Regulators Speak (Oct. 3, 2018) (transcript available at SEC.gov) [hereinafter Peikin Speech] ("Even where a defendant or respondent cooperates and agrees to meaningful undertakings, it should not be entitled to keep its ill-gotten gains, which we are often in a position to restore to harmed investors.").

[93] Securities and Exchange Commission, Report Pursuant to Section 308(c) of the Sarbanes-Oxley Act of 2002, 20 (2003) ("While the Commission may seek to return disgorged funds to injured investors, the main objective of disgorgement is to take the profits away from wrongdoers and thereby make violations unprofitable."); see also, e.g., SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 102 (2d Cir. 1978) ("the primary purpose of disgorgement is not to compensate investors"); see also SEC v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993) ("Disgorgement does not aim to compensate the victims.").

[94] 17 C.F.R. § 201.1100, et seq. (allowing funds collected under 15 U.S.C. § 7246(a) to be included in the Fair Fund).

[95] *Id.* (describing requirements for, among other things, a plan to administer the fund including specifying who is potentially eligible to receive fund proceeds, how individuals will be notified of the fund's existence, and procedures for approving claims).

panacea; it will be subject to challenges over the SEC's distribution plans, including questions about who qualifies as a harmed investor and what payment an eligible investor is due. In other words, even under the simplest circumstances, disgorgement just got a whole lot more complicated.

Circumstances in which victims that can be identified but not easily compensated raise other issues. The SEC suggests that in these cases, depositing disgorgement funds with the Treasury is appropriate.[96] But the Supreme Court specifically left open the "question whether, and to what extent, [depositing disgorgement funds with the Treasury] nevertheless" is consistent with § 78u(d)(5).[97] Indeed, the Supreme Court even declined to weigh in on whether "feasibility" of distribution is "relevant at all to equitable principles."[98] Thus, it is unclear whether the SEC can collect disgorgement at all if it cannot distributed the funds to harmed investors.[99] Assuming that it can, the SEC's Investor Protection Fund already collects undistributed disgorgement awards, which are used to pay whistleblower awards and fund the SEC's inspector general.[100] While this fund arguably benefits investors by supporting the SEC's enforcement activities, it is not clear whether it satisfies the limitations of § 78u(d)(5), which might require a closer relationship between the violation and the investors benefited.[101] If no such relationship is required, the SEC could be empowered to use disgorgement funds for more general purposes, like whistleblower awards or investor education, perhaps regardless of whether funds could be returned to harmed investors.

Where victims cannot be easily identified, *Liu* will likely make it more difficult for the SEC to obtain disgorgement. The SEC brings suit

[96] Liu, 140 S. Ct. at 1948.

[97] *Id.*

[98] *Id.* at 1948 n.5.

[99] A similar question may arise where investors have already been compensated, for example, by insurance. Disgorging the profits under those circumstances may restore the status quo for the wrongdoer but would result in a windfall to the harmed investors.

[100] Liu, 140 S. Ct. at 1948 n.5.

[101] The *Liu* decision does not address the relationship between § 78u(d)(5)'s requirement that the relief "be appropriate or necessary for the benefit of investors," and the Court's own finding that equity requires that the remedy be "awarded for the victims." See Liu, 140 S. Ct. at 1940. The equitable principle appears to require a relationship between the misconduct and the recipient of the disgorgement award, which one may argue should inform the statutory language in § 78u(d)(5).

for a host of violations where an ill-gotten gain may be identifiable, but where it is hard, if not impossible, to identify any particular victims of the violation. For example, the SEC routinely seeks disgorgement of profits in insider-trading cases. But in "classical" insider-trading cases, it is difficult to identify the victims of an unlawful trade. And in "misappropriation" insider-trading cases, the victim from whom the information was appropriated is almost never an investor and the injury rarely matches up with a defendant's benefit.

Violations under the FCPA present a similar situation. Even where the SEC charges a violation that results in identifiable ill-gotten gains to the defendant, the victims of that violation may not be easily identified. Victims of FCPA violations, where one can even be identified, may be a foreign government or the defendant's competitors.[102] In the past, these FCPA and insider-trading cases have resulted in substantial disgorgement orders (sometimes hundreds of millions of dollars).[103] But such disgorgement awards have traditionally been returned to the Treasury, which is unlikely to be permissible under *Liu*.

At bottom, *Liu*'s limitation that disgorgement must be for "the benefit of investors" will likely limit the SEC's authority to obtain disgorgement awards, although the bounds of its authority remain murky in light of these unanswered questions.[104]

B. What Are "Net Profits"?

Under *Liu*, a disgorgement award must "not exceed a wrongdoer's net profits."[105] Deducting "legitimate expenses" before ordering disgorgement would seem to be a familiar task, but liability for net profits is not so simple.[106]

[102] It is also unclear if these types of victims would satisfy § 78u(d)(5)'s requirement that equitable remedies are for the benefit of *investors*, as opposed to some other type of victim.

[103] Peikin Speech, *supra* note 92 ("The Commission has obtained disgorgement in a wide variety of matters, including offering frauds, and most all FCPA resolutions."); see Koehler, *supra* note 32 (identifying FCPA cases); see also, e.g., In re Microsoft Corp., Admin. Proc. No. 3-19260 (July 22, 2019) (ordering $13.8 million in disgorgement in connection with FCPA books and records violations).

[104] All of this added complexity further highlights a question, beyond the scope of this article, of whether the SEC should be involved in the business of seeking compensation for private losses.

[105] Liu, 140 S. Ct. at 1940.

[106] See *id.* at 1950.

Perhaps the easier question is the mechanical one of calculating net profits. Except where "the 'entire profits of a business or undertaking' result from the wrongdoing," disgorgement must account for a defendant's legitimate expenses.[107] This fact-intensive inquiry will raise a host of interpretive questions about deductibility of expenses. Some of these questions may be answered by analogy to precedent, but many will be questions of first impression.

Another loose end is whether the SEC will continue to enjoy the same evidentiary and procedural advantages. *Liu* requires more precision in the accounting for disgorgement; requiring the defendant to provide that precision by rebutting the SEC's "reasonable approximation" of disgorgement seems counterintuitive. These questions likely will be grappled with for years to come.

A more difficult question is whether the defendant must possess the net profits subject to disgorgement. The Court's analysis focused on whether disgorgement was available at equity, drawing parallels to remedies in equity that "imposed a constructive trust on wrongful gains for wronged victims."[108] But in providing guidance on the disgorgement remedy itself, the Court focused only on the end of that statement—"wrongful gains for wronged victims"—while providing little discussion as to applicability of the limitations of the "constructive trust."

As the Supreme Court explained in *Great-West Life & Annuity Insurance Co. v. Knudson*, a constructive trust requires that the "money or property identified as belonging in good conscience to the plaintiff . . . clearly be traced to particular funds or property in the defendant's possession."[109] An equitable remedy is tied specifically to those funds: "for restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant's possession."[110] Many of the SEC's disgorgement orders would not meet this test, either because the defendant was ordered to disgorge benefits that never accrued to him in the first place or because

[107] *Id*. (quoting Root, 105 U.S. at 203).

[108] *Id.* at 1944.

[109] 534 U.S. 204, 213 (2002).

[110] *Id.* at 214.

the defendant was ordered to disgorge benefits that she no longer possessed.[111]

But it is not clear whether *Liu* intended to impose a tracing requirement on the funds to be disgorged. Justice Thomas, in his dissent, said that the majority imposed "no tracing requirement," and, accordingly, that the remedy cannot be equitable.[112] But the majority's opinion is not as clear as Justice Thomas's characterization. While the majority never explicitly addressed tracing, the Court specifically identified cases where the defendants were ordered to disgorge profits earned by associates as "test[ing] the bounds of equity practice."[113] And the Court's discussion about collective liability suggests other limits on the SEC's ability to reach profits that are not in a wrongdoer's possession. Noting that the "common law [permitted] liability for partners engaged in concerted wrongdoing," the Court suggested that joint-and-several liability for codefendants may be unjust where one "was a mere passive recipient of profits."[114] This could support the notion that liability attaches only to funds that remain in a wrongdoer's possession, but it is far from a clear statement.

Given that a tracing requirement would incentivize wrongdoers to quickly dissipate profits, the SEC is unlikely to concede a tracing requirement where the Court did not explicitly require one, setting up the likelihood of future litigation to resolve this question.

C. Is Disgorgement Still Subject to a Five-Year Statute of Limitations?

Liu did not explicitly overrule *Kokesh*, but it calls into question the applicability of the earlier decision's reasoning. The Court's holding in *Kokesh* that disgorgement was a penalty and thus subject to the statute of limitations in § 2462 rested on three characteristics of disgorgement: (1) that disgorgement is imposed as a consequence of

[111] See Ryan, *supra* note 26, at 7–8 ("Common examples include insider-trading cases in which tippers are ordered to disgorge not only their own profits but also those of their tippees. Other cases involve defendants who have spent, squandered, or transferred their ill-gotten gains before being caught by the SEC, yet are still ordered to disgorge what they no longer possess.").

[112] Liu, 140 S. Ct. at 1954–55 (Thomas, J., dissenting).

[113] *Id.* at 1946, 1946 n.3 (citing Clark, 915 F.2d 439 and Contorinis, 743 F.3d at 304–06).

[114] *Id.* at 1949. This language also calls into question the SEC's ability to obtain disgorgement from relief defendants, who did not engage in wrongdoing, but who have received illicit gains resulting from violations committed by others.

violating public law; (2) that disgorgement is imposed for punitive purposes; and (3) that disgorgement is, in many cases, not compensatory. *Liu*'s reformation of disgorgement, however, undermines the second and third characteristics by suggesting that disgorgement should restore the status quo and compensate victims. Even assuming that a "penalty" for the purposes of § 2462 may not be a "penalty" in equity (or under the securities laws), the reasoning the Court laid out in *Kokesh* now seems to rest on the weak thread of the remedy being employed for a violation of public law.[115] While there may be other good arguments for holding disgorgement to the five-year limitation period—for instance, that disgorgement is a "forfeiture" within the meaning of § 2462—*Kokesh* did not address them.

The SEC has recognized the significant headwinds that *Kokesh* created for collecting disgorgement, particularly for long-running frauds.[116] As a response, the SEC may choose to argue that disgorgement is not subject to the statute of limitations to recapture some disgorgement authority. But the other limitations *Liu* imposed may make seeking it, particularly for aged misconduct, even more difficult to obtain and administer.

D. Can the SEC Order Broader "Disgorgement" in Administrative Proceedings?

The *Liu* decision specifically addressed disgorgement ordered in civil actions, where the relevant statute provides the SEC with the authority to seek "equitable relief."[117] The Court's analysis focused on the characteristics of equitable remedies, and assumed that the statutory language did not intend to override the traditional meaning of equity. But the SEC's remedial authority for administrative proceedings is provided by a different statutory provision that specifically grants the authority to order "disgorgement."[118] That statute

[115] Indeed, the SEC seems willing to assume that the term "penalty" is subject to different meanings. See, e.g., In re John M.E. Saad, Admin. Proc. No. 3-13678, 11 (Aug. 23, 2019) ("courts have repeatedly recognized that the inquiry under Section 2462 is distinct from the inquiry into whether a remedy is appropriate as a substantive matter").

[116] 2019 Annual Report, *supra* note 1, at 21.

[117] 15 U.S.C. § 78u(d)(5).

[118] 15 U.S.C. § 77h-1(e).

arguably would entail to a different analysis—one that considers what Congress meant by the term "disgorgement," a term that resists a standard meaning (let alone the one that the Supreme Court assigned it in *Liu*). Justice Thomas cautioned that the result may be that "disgorgement has one meaning when the SEC goes to district court and another when it proceeds in-house."[119]

Whether this confusion will become anything more than theoretical remains to be seen. Different versions of disgorgement would only add to the different remedies available in administrative proceedings and civil court actions. The SEC's decision about which forum to pursue rarely turns on a binary choice between the ability to recover more money in one forum versus another.[120] But competing definitions of disgorgement may result in a greater shift to administrative cases for certain types of misconduct, including cases where victims are less easily identifiable and receiving disgorgement in a judicial forum is now limited by *Liu*. On the other hand, the SEC could just choose to apply the same definition of disgorgement regardless of the proceeding to facilitate decision-making and settlement of matters, the vast majority of which do not proceed to litigation.[121]

[119] Liu, 140 S. Ct. at 1954 (Thomas, J., dissenting).

[120] For example, certain types of cases are difficult to bring in administrative proceedings as a practical matter, such as asset freezes.

[121] The *Liu* decision also raises ancillary questions about how disgorgement orders will be treated for insurance and tax purposes. For example, the SEC's standard settlement papers have prohibited defendants from seeking indemnification or reimbursement for penalties, but it is unclear if disgorgement should be considered a penalty under this provision. The tax treatment of disgorgement, which turns on whether disgorgement is a penalty under I.R.C. § 162(f), is also called into question by *Liu*.

Liu may also open questions for the remedial authority of other agencies. The Federal Trade Commission (FTC), for example, has a similar statutory framework wherein the FTC Act does not expressly mention monetary relief, but the courts have nonetheless allowed disgorgement as a remedy. The Supreme Court has granted certiorari in AMG Cap Mgmt v. FTC, 910 F.3d 417 (9th Cir. 2018), cert. granted, No. 19-508 (July 9, 2020) on the question of whether Section 13(b) of the Federal Trade Commission Act, by authorizing "injunctions," also authorizes the Federal Trade Commission to demand monetary relief such as restitution. *Liu* and the litigation of its open questions may also affect the understanding of "disgorgement" pursued by the Commodity Futures Trading Commission and Consumer Financial Protection Bureau, both of which have explicit statutory "disgorgement" authority. See 7 U.S.C. § 13a-1(d)(3)(B) (CFTC); 12 U.S.C. §§ 5565(a)(1), (a)(2)(D) (CFPB).

VI. Conclusion: *Liu*'s Impact

The SEC continues to enjoy access to a full panoply of remedies in civil actions and administrative proceedings to enforce the federal securities laws. Disgorgement is one tool, among many, but it is a tool that the SEC seems to have favored in recent years. The *Liu* decision is likely to change that reliance.

Even with all its open questions, *Liu* will produce observable and immediate effects. First, disgorgement awards will be more difficult to obtain. The *Liu* decision has wiped away the ease with which the SEC was permitted to estimate a reasonable approximation of a defendant's unlawful gains. Post-*Liu*, disgorgement will be subject to a more fact-intensive inquiry into what gains were truly unearned, what expenses were truly legitimate, and who is responsible for returning unlawful profits. This inquiry—even once all the open questions above are settled—will result in more scrutiny by courts of SEC disgorgement requests.

Second, and relatedly, disgorgement awards will be for more limited sums. The *Liu* decision should limit the SEC to disgorgement that restores the status quo—that is, the decision should eliminate punitive disgorgement awards that exceed the value of illegally obtained profits. In addition, net profits often will be less than the profits disgorged under the SEC's pre-*Liu* understanding of disgorgement, as courts must consider whether expenses incurred have a value independent of fueling a fraudulent scheme.

Third, a higher percentage of disgorgement, awarded and collected, will be returned to investors. The Supreme Court's decision forces the SEC to view disgorgement as restitution—not deterrence—and the rule, rather than the exception, likely will be to return disgorged funds to those who were harmed by the misconduct. Whether or not the SEC is ultimately required to return every dollar collected to a harmed investor, the SEC will return a higher percentage of disgorgement ordered to injured parties.

From a bigger-picture perspective, *Liu* should result in more transparency and predictability in remedies imposed for violations of the federal securities laws. In *Gabelli* and *Kokesh*, the Supreme Court reined in an SEC that had strayed beyond its statutory authority. The Court has done the same in *Liu*, limiting the SEC's discretion. Some lamented the decision as letting wrongdoers get off easy,[122]

[122] See, e.g., Jack Rodgers, "Investment Fraudsters Get a High Court Break on Legitimate Expenses," Courthouse News Service, June 22, 2020, https://bit.ly/3a6ezvx.

but this viewpoint ignores the SEC's flexible powers to seek other penalties, including significant civil penalties calculated based on the ill-gotten pecuniary gain to the defendant.[123] *Liu* ultimately may not result in lighter monetary punishment for wrongdoers, as the SEC may shift what it would have requested in disgorgement to a request for civil penalty instead. *Liu*'s limitations on the SEC's discretion, however, will force the SEC to make clearer distinctions between remedies meant to punish and remedies meant to restore the status quo. Drawing more distinct boundaries between the two will increase transparency and consistency in the SEC's enforcement efforts and will make it easier to assess the effectiveness of the SEC's remedial tools. Then, if Congress concludes that the SEC needs additional tools, Congress can provide them.[124]

[123] See Ryan, *supra* note 26, at 12–13 ("In short, securities law violators do not get off scot-free simply because the SEC cannot seek disgorgement in a particular case.").

[124] Congress has been responsive to the SEC's requests for additional remedies in the past, including granting the SEC the authority to seek civil penalties in insider-trading cases. See Atkins & Bondi, *supra* note 17, at 385. After *Kokesh*, Congress also considered a bill extending the statute of limitations for disgorgement to 14 years. The Investor Protection and Capital Markets Fairness Act, H.R. 4344 116th Cong. (2019), passed the House on November 19, 2019. A similar bill was introduced in the Senate in March 2019, extending the statute of limitations for disgorgement and authorizing a separate restitution remedy. Securities Fraud and Investor Compensation Act 2019, S. 799 116th Cong. (2019).