

## SEC Disgorgement Could Survive A High Court Defeat

By Rachel Graf

*Law360 (November 5, 2019, 6:48 PM EST)* -- The U.S. Supreme Court recently agreed to review the U.S. Securities and Exchange Commission's authority to seek disgorgement in federal court, but there's a chance that any negative outcome for the securities regulator will be temporary.

The question before the justices is whether Congress authorized the SEC to collect disgorgement, so the issue could ultimately fall to lawmakers to decide. Members of the Senate have already introduced a bipartisan bill addressing a different high court ruling involving SEC disgorgement, suggesting there could be broad interest within Congress to settle the controversy, said Kyle DeYoung, a former SEC attorney who's now a partner at Cadwalader Wickersham & Taft LLP.

"If somebody commits fraud and steals a bunch of money, it's hard to say that you're against the SEC being able to take back the money the guy stole and give it back to investors," he said. "So I do think there is probably a decent chance that the real impending possibility that the Supreme Court is going to take away the SEC's ability to get disgorgement might actually spur Congress into action."

The justices agreed Friday to take up an appeal by a couple who had been ordered to disgorge almost \$27 million for defrauding Chinese investors who thought their money was going toward a proton therapy cancer treatment center. The investors were part of the U.S. Immigrant Investor Program, referred to as the EB-5 program, which provides U.S. visas to foreigners who invest at least \$1 million, and in some cases as little as \$500,000, in a "commercial enterprise" that creates at least 10 full-time jobs for American employees.

The couple, Charles Liu and Xin Wang, have argued another Supreme Court ruling called *Kokesh* stripped the SEC of its right to collect disgorgement. That ruling found the SEC's collection of disgorgement should be subject to the five-year statute of limitations on civil penalties, since the remedy is often intended to prevent future wrongdoing rather than to compensate victims.

In a footnote to the *Kokesh* ruling, the justices said they weren't taking a position on "whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."

It was only a matter of time until they revisited the question, attorneys said.

"They made a point to table it in a footnote because it appears that there was some discomfort with this

particular remedy," said Susan Resley, deputy practice leader of Morgan Lewis & Bockius LLP's securities enforcement and litigation group.

Five of the justices had also questioned the SEC's authority to seek disgorgement during oral arguments in the *Kokesh* case.

In the current case, an adverse ruling by the Supreme Court would likely impact SEC enforcement at least in the short term, even if its disgorgement authority is ultimately decided by Congress.

The agency might decide to pursue higher fines to make up for the substantial amount of disgorgement it could forfeit, attorneys said. Last year, parties in SEC actions were ordered to disgorge about \$2.5 billion, substantially more than the \$1.4 billion in fines the SEC obtained.

Alternatively, the SEC might bring more claims in administrative proceedings rather than in the federal courts. Congress did authorize the agency to collect disgorgement in administrative proceedings, although that process is facing challenges of its own.

"One thing I know for sure: If the case goes against the SEC, the SEC is not going to just wave the white flag and stop enforcement efforts in cases it thinks are appropriate," said O'Melveny & Myers LLP securities litigation partner Matthew Close.

The SEC might not even wait for a ruling to adjust its tactics.

In their *Kokesh* opinion, the justices said disgorgement was a penalty for statute-of-limitations purposes largely because disgorged funds haven't always been returned to investors. Sometimes, the funds are dispersed to the U.S. Treasury instead.

Liu and Wang have argued that disgorgement is being used as a penalty in their case because the district court ordered them to surrender more money than they made from the unlawful EB-5 scheme.

With that in mind, the SEC might focus on cases where the disgorgement is clearly limited to ill-gotten gains or where it can prove that the money obtained through disgorgement would be returned to harmed investors, Cadwalader's DeYoung said.

"It'll be interesting to see if they start kind of preparing for the worst," he said.

The case is *Charles C. Liu et al. v. U.S. Securities and Exchange Commission*, case number 18-1501, in the U.S. Supreme Court.

--Editing by Aaron Pelc and Michael Watanabe.