No. 18-1501

In The

Supreme Court of the United States

CHARLES C. LIU and XIN WANG a/k/a LISA WANG,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR *AMICUS CURIAE* CATO INSTITUTE IN SUPPORT OF PETITIONERS

ILYA SHAPIRO
CATO INSTITUTE
1000 Mass. Ave. NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

BRADLEY J. BONDI
Counsel of Record
CAHILL GORDON & REINDEL LLP
1990 K Street NW
Suite 950
Washington, DC 20006
(202) 862-8910
bbondi@cahill.com

Counsel for Amicus Curiae Cato Institute

December 23, 2019

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

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.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

Page

TABLE OF AUTHORITIES—Continued

Page

STATUTES

OTHER AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

Page

TABLE OF AUTHORITIES—Continued

INTEREST OF *AMICUS CURIAE*[1]

Established in 1977, the Cato Institute is a nonpartisan public-policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies, established in 1989, seeks to restore the principles of constitutional government that are the foundation of liberty. Cato's Center for Monetary and Financial Alternatives was established in 2014 to reveal the shortcomings of today's monetary and financial-regulatory systems and to identify and promote alternatives more conducive to a stable, flourishing, and free society. Toward those ends, Cato holds conferences and publishes books, studies, and the annual *Cato Supreme Court Review*.

This case concerns Cato because it implicates the separation of powers and the constitutional right of individuals to receive fair notice of conduct Congress has proscribed. Cato submits this brief to demonstrate how the SEC's disgorgement authority upsets the separation of powers and violates Petitioners' right to fair notice.

[1] Pursuant to Rule 37.3(a), a letter of consent from the respondent to the filing of this brief has been submitted to the Clerk. The petitioner has filed a blanket consent to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person other than *amicus curiae* or its counsel made a monetary contribution to fund its preparation or submission.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

The Securities and Exchange Commission has been the beneficiary, if not the instigator, of an expansive body of causes of actions and remedies. Chief Justice Rehnquist famously wrote that Rule 10b-5, which is the SEC's core anti-fraud rule, is a "judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). In the area of insider trading, derived from Rule 10b-5, theories of liability have developed largely through judicial decisions. *See*, *e.g.*, *United States v. O'Hagan*, 521 U.S. 642 (1997); *Dirks v. SEC*, 463 U.S. 646 (1983); *Salman v. United States*, 137 S. Ct. 420 (2016). As causes of actions have expanded, so too have the SEC's remedies.

The SEC's application and usage of disgorgement has grown enormously. But unlike Rule 10b-5, it is hardly a judicial oak. An oak has shape and form. An oak has roots and an origin, no matter how small the acorn. The remedy of disgorgement has none of these traits. It is more akin to the "Blob" from the famous 1958 science fiction-horror film by the same name. THE BLOB (Paramount Pictures 1958). Disgorgement has no legislative basis and lacks any uniform standards. Although it initially was used as an equitable remedy, *see SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1309-10 (2d Cir. 1971), disgorgement has become a means to penalize wrongdoers, as the Court correctly observed in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

Like the Blob from the cult-classic movie, disgorgement has become unpredictable, uncontrollable, and has struck fear in those who have had to face it. Mr. Liu is one such person as he faces a disgorgement amount that far exceeds his reported net worth. There have been many other similarly-situated defendants and there will be more in the future unless this Court becomes the Steve McQueen of the story and finally puts an end to this menace.

ARGUMENT

I. CONGRESS HAS NOT EXPRESSLY AUTHORIZED DISGORGEMENT PENALTIES

Disgorgement is not explicitly authorized by the statutory language of the Securities Exchange Act. Congress must be unambiguous when providing a penal remedy to an administrative agency. *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) ("an agency literally has no power to act . . . unless and until Congress confers power upon it"). Congress has specifically enumerated the remedies available to the SEC in civil actions: civil monetary penalties, injunctions, and "appropriate or necessary" equitable relief. 15 U.S.C. §§ 77t(b), (d), 78u(d)(1), (3), (5). Disgorgement, which functions as a penalty, does not fall neatly into any of these categories. *See* Petition for Writ of Certiorari, *Liu v. SEC*, No. 18-1501 (2019); *Kokesh*, 137 S. Ct. at 1643-45.

Since the landmark case *Texas Gulf Sulphur Co.*, a number of federal courts have concluded that disgorgement is an ancillary equitable remedy, and may be requested as "appropriate or necessary" equitable relief under 15 U.S.C. § 78u(d)(5). *See Texas Gulf Sulphur Co.*, 446 F.2d at 1307-08 (finding multiple common law examples of courts providing ancillary equitable relief absent from the statutory language)*; see also SEC v. Cavanaugh*, 445 F.3d 105, 118-20 (2d Cir. 2006) (holding that, because courts of chancery had the power to order equitable disgorgement, contemporary courts possess the same authority); *SEC v. Huffman*, 996 F.2d 800, 802-03 (5th Cir. 1993) (stating that disgorgement is an equitable injunction in the public interest).

Viewing disgorgement as a remedy in equity is incompatible with the Court's reasoning in *Kokesh*. There, the Court established that disgorgement (1) operates as a penalty for statute of limitations purposes under 28 U.S.C. § 2462 and (2) that it serves a punitive purpose, rather than a strictly remedial one. *See Kokesh*, 137 S. Ct. at 1643-45. The Court reasoned that disgorgement "bears all the hallmarks of a penalty," and is therefore more accurately classified as a penalty than an equitable remedy. *Id.* at 1644. Although the Court did not offer "an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings," the Court's reasoning precludes the possibility of characterizing disgorgement as anything other than a punitive measure. *Id.*, n.3.

Courts of equity may not enforce punitive civil penalties. *See Tull v. United States*, 481 U.S. 412, 424 (1987); *Hecht Co. v. Bowles*, 321 U.S. 321, 329-30 (1944) (equity is an "instrument for . . . adjustment and reconciliation" rather than punishment); *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 270-72 (1993) (White, J., dissenting) ("[C]ourts of equity would not . . . enforce penalties or award punitive damages"). As Petitioner appropriately describes, disgorgement is not "supported by any express or implied authority of the federal courts to grant equitable relief." Petition for Writ of Certiorari at 10, *Liu v. SEC*, No. 18-1501 (2019); *see Kokesh*, 137 S. Ct. at 1644.

Disgorgement similarly lacks support in the language of the statutes authorizing civil monetary penalties. Disgorgement is not enumerated among the civil monetary penalties available to the SEC, each of which carries a maximum permissible amount. 15 U.S.C. §§ 77t(d), 78u(d)(3)(B); *see* Petition for Writ of Certiorari at 15, *Liu v. SEC*, No. 18-1501 (2019). The absence of a particular remedy creates a "presumption that [the] remedy was deliberately omitted." *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985). "The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement." *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 97 (1981). Such a comprehensive legislative scheme already exists for enforcement of the federal securities laws. *See* Brief of Petitioner at 16, *Liu v. SEC*, No. 18-1501 (2019); *Kokesh*, 137 S. Ct. at 1640 & n.1 (detailing the SEC's "full panoply of enforcement tools"). Neither the SEC nor the courts may read into the statute a penalty that is not provided by the plain language. *See Stark v. Wickard*, 321 U.S. 288, 309 (1944) ("When Congress passes an Act empowering administrative agencies to carry on governmental activities, the power of those agencies is circumscribed by the authority granted.").

II. THE COMMISSION'S APPROACH TO DISGORGEMENT IS UNPREDICTABLE, INEFFICIENT, AND UNFAIR

Without statutory guidance, the SEC has not sought disgorgement penalties in a principled or consistent manner. "The primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains." *Kokesh*, 137 S. Ct. at 1643 (quoting *SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997)). Contrary to this well-established principle, the SEC's disgorgement awards frequently exceed the dollar value of illegally obtained profits. *See Kokesh*, 137 S. Ct. at 1644-45 (citing *SEC v. Contorinis*, 743 F.3d 296, 302 (2d Cir. 2014); *SEC v. Warde*, 151 F.3d 42, 49 (2d Cir. 1998); *SEC v. Clark*, 915 F.2d 439, 454 (9th Cir. 1990)). "In such cases, disgorgement does not simply restore the status quo; it leaves the defendant worse off." *Kokesh*, 137 S. Ct. at 1645. This is evident in the present case, where petitioners have been ordered to give up approximately $26.4 million. Petition for Writ of Certiorari at 11, *Liu v. SEC*, No. 18-1501 (2019). Most of that amount is comprised of money that was spent on lease payments, machines, and marketing efforts. *Id.* A disgorgement penalty of this magnitude will put the petitioners roughly $16 million in debt—far from the condition of the petitioners before the wrongdoing. *Id*. Unfortunately, such an expansive amount is typical of an SEC penalty award, especially disgorgement.

A. Unauthorized Disgorgement Is a Microcosm of SEC Civil Penalties Generally

The SEC's approach to the disgorgement penalty is a microcosm of its approach to civil monetary penalties generally. At any given time, the Commission's approach to monetary penalties is subject to the whims of the commissioners serving at that time. A brief review of the SEC's recent history pertaining to civil monetary penalties is instructive for understanding the concern with allowing an agency to operate without clear statutory guidance.

The Remedies Act of 1990 first enabled the SEC to seek monetary penalties against public companies. *See* Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, §§ 101, 201(2), 104 Stat. 931, 932-33, 936-37 (codified in relevant part at 15 U.S.C. §§ 77t, 78u). At that time, the Senate Committee on Banking, Housing, and Urban Affairs cautioned that the costs of monetary penalties might be passed on to shareholders. *See* S. Rep. No. 101-337, at 17 (1990). The Committee expected that the SEC would seek a monetary penalty only when the securities law violation resulted in an improper benefit to shareholders. *Id.* In cases in which shareholders are the principal victims of the violations, the Committee expected that the SEC would seek penalties instead from the individual offenders acting for a corporate issuer. *Id.* Despite these concerns, Congress did not provide statutory restrictions on the SEC.

For the first 12 years after the passage of the Remedies Act, the Commission operated as the Senate Committee anticipated, and imposed penalties sparingly and when necessary. *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 (2008). That began to change in 2002 when the SEC brought an action against the Xerox Corporation. In the Xerox action, the SEC sought and obtained a settlement for a penalty of $10 million—three times the size of any previous penalty for a similar case. *See* Press Release, SEC, Xerox Settles SEC Enforcement Action Charging Company with Fraud (Apr. 11, 2002), Release No. 2002-52. In 2003, just a year after the Xerox settlement, the total amount of monetary penalties (excluding disgorgement) imposed by the SEC on companies increased to approximately $1.1 billion, up from $101 million in the prior year. *See* SEC, *2002 Annual Report*, at 1. Since that time, penalties against corporations have continued to climb, with the high-water mark being a $550 million penalty that the SEC obtained in a settlement with an investment bank in July 2010. *See*

Press Release, SEC, Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO, Release No. 2010-123.

The Commission first provided clarity on the penalty authority with the unanimous "Statement of the Securities and Exchange Commission Concerning Financial Penalties," often known simply as the SEC's "Penalty Statement." *See* Press Release, SEC, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), Release No. 2006-4. The stated purpose of the penalty statement was to provide the maximum possible degree of clarity, consistency, and predictability in explaining how the SEC exercises its corporate penalty authority. In the Penalty Statement, the SEC identified two principal considerations for determining whether a monetary penalty against a company is appropriate: (1) the presence or absence of a direct benefit to the company as a result of the securities law violation, and (2) the degree to which the penalty will recompense or further harm the injured shareholders. These stated principles served to re-center the seeming intentions of the Congress that passed the Remedies Act. *See* S. Rep. No. 101-337, at 17 (1990).

After the Penalty Statement, annual aggregate monetary penalty amounts began to drop significantly. In 2008, for example, the SEC imposed approximately $256 million in monetary penalties, down from approximately $1.2 billion and $1.5 billion in 2004 and 2005, respectively. *See* SEC, *Select SEC and Market Data*

Fiscal 2008; SEC, *2004 Enforcement and Market Data*; SEC, *Select SEC and Market Data Fiscal 2005*.

This newfound restraint proved short-lived, as the penalty statement lacked the power of law. In recent years, several commissioners disavowed the Penalty Statement, calling it non-binding and deferring to the discretion of each commissioner. *See* Mary Jo White, Chair, SEC, Remarks before the Council of Institutional Investors Fall Conference: *Deploying the Full Enforcement Arsenal*; *see also* Luis A. Aguilar, Commissioner, SEC, Remarks before the 20th Annual Securities Litigation and Regulatory Enforcement Seminar: *A Stronger Enforcement Program to Enhance Investor Protection* (Oct. 25, 2013). Perhaps not coincidentally, from 2013 until 2016, the average amount of monetary penalties imposed (excluding disgorgement) rose to approximately $1.165 billion. *See* SEC, *Select SEC and Market Data Fiscal 2014;* SEC, *Select SEC and Market Data Fiscal 2015;* SEC, *Select SEC and Market Data Fiscal 2016;* SEC, Div. of Enforcement, *Annual Report: A Look Back at Fiscal Year 2017*.

The current Commission seems to have taken a more measured approach to assessing monetary penalties. The aggregate amount of penalties in 2017 was $832 million, a decline of approximately 35% from the previous year. Although aggregate penalties jumped back up to a near-record $1.439 billion in 2018, more than half of this amount was attributable to one enforcement action related to a violation of the Foreign Corrupt Practices Act. *See* SEC, Div. of Enforcement, *Annual Report: 2018*; *see also* Press Release, SEC, Petrobras Reaches Settlement with SEC for Misleading Investors (Sept. 27, 2018), Release No. 2018-215. Excluding this single data point brings the total to a more modest $585 million. SEC, Div. of Enforcement, *Annual Report: 2018*, at 1. More important than the sum total of penalties collected, the Division of Enforcement's Annual Report for 2018 stated that "quantitative metrics . . . cannot adequately measure the effectiveness of an enforcement program" and "a singular focus on such metrics can result in a misalignment of incentives and objectives." *Id.* The current Commission's approach to penalties could be short-lived if the next group of commissioners share different views. That is the danger of a penal system that is not tied to expressed statutory guidance.

B. Disgorgement Itself Is a Shape-Shifting Punishment

Disgorgement amounts often are untethered from the underlying offense because the SEC has been given wide, unchallenged discretion when calculating the disgorgement amount. *See* Sasha Kalb and Marc Bohn, *Disgorgement: The Devil You Don't Know*, CORPORATE COMPLIANCE INSIGHTS (Apr. 12, 2010). When the Commission seeks disgorgement, courts first require the SEC to distinguish between legally and illegally obtained profits. *See SEC v. First City Financial Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). The Commission then is required to identify the causal link between the unlawful activity and the profit to be disgorged. *Id.* at 1231 ("Since disgorgement primarily serves to prevent unjust enrichment, the court may exercise its equitable power only over property causally related to the wrongdoing.").

Because these calculations are logistically difficult for courts to verify, the SEC is required to provide merely a "'reasonable approximation of profits causally connected to the violation.'" *SEC v. Whittemore*, 659 F.3d 1, 7 (D.C. Cir. 2011) (quoting *First City Fin.*, 890 F.2d at 1231). The defendant then shoulders the burden of proving that the SEC's estimate is unreasonable. *See id.* To make matters worse, the SEC does not provide any indication of its criteria or metrics for determining how much it will penalize a company in the years since it disavowed the Penalty Statement. Defendants and courts are reluctant to challenge the SEC's figures.

In some areas, the disgorgement amount might have little causal connection to the underlying offense. *See* Atkins & Bondi at 393-94; Bradley J. Bondi, Statement before the United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets, Securities, and Investment On Ensuring Effectiveness, Fairness, and Transparency in Securities Law Enforcement (Jun. 13, 2018); Bradley J. Bondi, *Improving the SEC's Enforcement Program: A Ten-Point Blueprint for Reform*, Center for Financial Stability (Aug. 17, 2017). For example, disgorgement is used as a remedy for violating the books and records and internal controls provisions of the Securities Exchange Act. *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). But in cases in which the SEC has not charged any violation of the Foreign Corrupt Practice Act's anti-bribery provisions, the connection between the incorrect recording of a payment to a foreign official and any ill-gotten gains is extraordinarily tenuous. *See In re Rockwell Automation Inc.*, Admin. Proc. No. 3-14364 (May 3, 2011) (imposing $1.7 million in disgorgement in an FCPA case); *SEC v. Chevron Corp.*, No. 07-cv-10299 (S.D.N.Y. Nov. 20, 2007) (imposing $25 million in disgorgement in an FCPA case); *SEC v. Textron*, No. 07-cv-1505 (D.D.C. Aug. 31, 2007) (imposing $2.3 million in disgorgement in an FCPA case). The offense is the improper payment, rather than the mis-recording of it. It is difficult to see how the causal link between the offense and the illegally-obtained profits, particularly in those instances where the SEC has not alleged that the payment violated the FCPA's anti-bribery provisions.

Even in cases where the FCPA's anti-bribery provisions have been violated, disgorgement still bears little resemblance to unjust enrichment. For instance, in one default judgment against former Siemens executives for four alleged bribes, the SEC significantly increased the dollar figures in the statutory guidelines by having every bribe triple-counted as a bribe, a books and records violation, and an internal controls violation. *See* Russ Ryan, *Former SEC Enforcement Official Throws The Red Challenge Flag*, FCPA PROFESSOR (Feb. 10, 2014). The SEC then was able to seek a maximum of $60,000 per penalty for second-tier violations, rather than the $6,000 per penalty for first-tier violations associated with non-fraud offenses. *See id*. The court awarded the SEC another $316,000 in disgorgement of the "ill-gotten profits" from the bribery scheme, on top of the $524,000 in penalties. *See id.* The SEC's basis for seeking disgorgement was that the funds it sought were "hush money" allegedly paid to the defendant and his wife to buy his silence and false testimony that helped prevent the bribery scheme from being discovered. *See id*. Again, it strains credulity to say that such a payment could be accurately categorized as a share of the illegal profits earned as a direct result of the bribe.

CONCLUSION

In *Kokesh*, this Court did not rule on the question of the SEC's authority to seek disgorgement. *See* 137 S. Ct. at 1642 n.3. It is now clear by this Court's own reasoning that disgorgement is not an equitable remedy, and has no home in the detailed statutory scheme for civil monetary penalties. The Court should break its self-imposed silence and hold that, in the civil context, the SEC lacks any statutory basis for its pursuit of this boundless remedy. It is time once and for all for the Court to vanquish this amorphous beast, so that

Congress can construct something of form and substance in its place.[2]

Respectfully submitted,

ILYA SHAPIRO
CATO INSTITUTE
1000 Mass. Ave. NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

BRADLEY J. BONDI
Counsel of Record
CAHILL GORDON &
REINDEL LLP
1990 K Street NW
Suite 950
Washington, DC 20006
(202) 862-8910
bbondi@cahill.com

Counsel for Amicus Curiae
Cato Institute

December 23, 2019

---

[2] The 1958 movie "The Blob" ended with the words "The End?", suggesting the Blob survived its disposal in the Arctic Circle. *Amicus* hopes the same will not be true of the disgorgement Blob.