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 OF FORMER COMMISSIONERS AND STAFF OF THE SECURITIES AND EXCHANGE COMMISSION, AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST[1]

Amici are former Commissioners and staff of the Securities and Exchange Commission ("SEC" or "Commission") now working in academia, non-governmental public interest organizations, or the private sector. *Amici* maintain a continuing and substantial interest, by virtue of their prior public service and present positions, in preserving the Commission's ability to fulfill its mandate as the chief enforcer of the federal securities laws and protector of the financial marketplace. Based upon their experience, *amici* are particularly cognizant of the historical importance of the equitable disgorgement remedy in civil enforcement proceedings brought by the SEC for (a) effectuating the purpose of the federal securities laws and (b) providing complete relief for violations of those laws, notwithstanding the availability of statutory monetary penalties for such violations.

Amici believe that the disgorgement remedy in SEC civil enforcement cases may be vulnerable, in light of the Court's recent jurisprudence, to being misunderstood to be (a) not equitable in nature, and (b) of diminished importance given the availability of other SEC enforcement tools, such as monetary

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[1] No counsel for a party authored any part of this brief and no counsel or party made a monetary contribution intended to fund the preparation or submission of it. Only the *amici* and their attorneys have paid for the filing and submission of this brief. Pursuant to Rule 37.3(a), all parties consented to the filing of this brief. A copy of Petitioners' blanket consent to *amicus curiae* briefs is on file with the Court, and Respondent has consented individually in writing.

penalties, that have evolved more recently. *Amici* submit this brief in the hopes of avoiding that misunderstanding, which, should it take hold, would in their view unjustifiably and substantially erode the SEC's enforcement capability and, by extension, the health and security of the financial marketplace.

Luis A. Aguilar served as a Commissioner of the SEC from 2008 to 2015. He has been a partner at McKenna Long & Aldridge, LLP (subsequently merged with Dentons US LLP); Alston & Bird LLP; Kilpatrick Townsend & Stockton LLP; and Powell Goldstein Frazer & Murphy LLP (subsequently merged with Bryan Cave LLP). During his time at the SEC, Commissioner Aguilar represented the Commission as its liaison to both the North American Securities Administrators Association and to the Council of Securities Regulators of the Americas. He also served as the primary sponsor of the SEC's first Investor Advisory Committee. He began his legal career as an attorney at the SEC.

Roel C. Campos served as a Commissioner of the SEC from 2002 to 2007, and is now Senior Counsel and Chair of the Securities Enforcement practice at Hughes Hubbard & Reed, LLP. His current practice includes defending matters involving financial regulators, conducting internal investigations, and advising senior management and boards on proposed rulemakings by financial regulators. Prior to his SEC service, Commissioner Campos was a corporate transactions/securities lawyer and litigator, and served as a federal prosecutor in Los Angeles. He is a current member of the Committee on Capital Markets Regulation, an

independent and nonpartisan 501(c)(3) research organization dedicated to improving the regulation of the U.S. capital markets.

Roberta Karmel is the Centennial Professor of Law at Brooklyn Law School, and was a Commissioner of the SEC from 1977 to 1980. Prior to that, she was an enforcement attorney, Branch Chief, and Assistant Regional Administrator in the SEC's New York Regional Office. Commissioner Karmel is a former Public Director of the New York Stock Exchange, and was also a Fulbright Scholar studying the harmonization of the securities laws in the European Union. She is the author of *Life at the Center: Reflections on Fifty Years of Securities Regulation* (2014) and *Regulation by Prosecution: The Securities and Exchange Commission Versus Corporate America* (1982), and has widely published articles on securities regulation and international securities law in dozens of law reviews and journals.

Bevis Longstreth served as a Commissioner of the SEC from 1981 to 1984. Both prior to and after his service as Commissioner, he was a partner in the New York-based law firm of Debevoise & Plimpton, LLP for twenty years. From 1994 to 1999, Commissioner Longstreth was an Adjunct Professor at Columbia University School of Law, teaching the regulation of financial institutions. He has been a frequent speaker and lecturer on various securities and corporate law topics, and is a former member of the Board of Governors of the American Stock Exchange. For many years he served on the Pension Finance Committee of The World Bank. Currently

he serves on the board of New School University and is a member of the Council on Foreign Relations.

Tyler Gellasch was Counsel to Commissioner Kara Stein from 2013 to 2014. He currently is Executive Director of the Healthy Markets Association, where he leads efforts by pension funds, investment advisers, broker dealers, data vendors, and stock exchanges to promote the integrity of the capital markets. He is also a partner at Myrtle Makena LLP, an economic and capital markets policy consulting firm.

Andy Green was Counsel to Commissioner Kara Stein from 2014 to 2015. Prior to that he served as counsel to U.S. Senator Jeff Merkley from 2009 to 2014, including a tenure as staff director of the Economic Policy Subcommittee in the U.S. Senate. He currently is Managing Director of Economic Policy at the Center for American Progress in Washington, D.C.

Walter Jospin was Director of the Atlanta Regional Office of the SEC from 2015 to 2018. Prior to that he was a staff lawyer with the Enforcement Division of the SEC in Atlanta and a partner at Paul Hastings LLP, where he specialized in SEC defense matters, governance, and corporate transactions. He is presently of counsel at Finch McCranie LLP, handling SEC enforcement matters and whistleblower cases.

Jordan A. Thomas served as an Assistant Director and Assistant Chief Litigation Counsel in the SEC's Division of Enforcement from 2003 to 2011. Mr. Thomas has testified on Capitol Hill

regarding SEC enforcement, and is presently a partner and Chair of the Whistleblower Representation Practice at Labaton Sucharow LLP, where he represents SEC whistleblowers.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioners argue that the SEC has no authority to request, and that courts have no authority to award, disgorgement as a remedy in SEC enforcement actions brought in federal court. For this argument, Petitioners rely on the Court's recent decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), in which the Court ruled that disgorgement, as applied in an SEC enforcement action, operates as a penalty for purposes of applying the statute of limitations set forth in 28 U.S.C. § 2462. Since the Court has deemed disgorgement a penalty under § 2462, Petitioners argue, that remedy may no longer be considered equitable for any purpose, and accordingly falls outside the scope of relief permissible in SEC actions brought in federal court—notwithstanding fifty years of historical practice and jurisprudence, along with effective congressional support, to the contrary.

Amici submit this brief to explain why this Court's recent characterization of disgorgement as a penalty for the sole purpose of applying a five-year statute of limitations to that remedy is not an adequate basis for terminating the ability by lower courts to award disgorgement of all of the gains generated by a securities law violation, as the facts and circumstances permit, when requested by the Commission. Petitioners' argument to the contrary

(1) elides or, worse, distorts the well-documented basis for and function of the disgorgement remedy in SEC enforcement actions brought in federal court, (2) ignores the constraints that exist and which courts routinely observe, guided by the specific circumstances of each case, on the scope of relief available through disgorgement, and (3) misreads congressional intent over the last half century with respect to the SEC's open and well-documented practice of requesting court-ordered disgorgement. In response, *amici* submit the following:

First, Petitioners' argument that the SEC lacks authority to seek disgorgement of all of the gains obtained through a securities law violation runs counter both to the statutory text of the federal securities laws and to the longstanding principle that district courts have broad equitable powers to fashion relief for violations of those laws. *SEC v. Cavanagh*, 445 F.3d 105 (2d Cir. 2006); *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1193 (9th Cir. 1998).

The courts' equitable powers long precede, and are not superseded by, the stepwise monetary penalties enacted by Congress in the 1990s for securities law violations. These equitable powers include the power to ensure that securities law violations remain entirely unprofitable to those who commit them. *Cavanagh*, 445 F.3d at 119. At the heart of this power is one of the "great principles of equity, [i.e.,] securing complete justice" for wrongs impacting the public interest, and effectuating the purpose of laws meant to protect that interest. *Porter v. Warner Holding Co.*, 328 U.S. 395, 398-400 (1946).

Petitioners' requested relief would, if adopted and made law, ensure *in*complete justice for securities law violations going forward. Decades of jurisprudence and commentary explain that the gains obtained through securities law violations cannot always simply be equated to a wrongdoer's cash receipts. Returning parties to the *status quo* prior to a violation must also include, where circumstances dictate, awards that account for other types of gains from a violation, such as (i) expenditures made in furtherance of and funded by the violation, (ii) proceeds from the violation that are otherwise spent in the violator's own interests, (iii) wrongful proceeds directed to third parties or affiliates, or (iv) enhanced revenue opportunities made possible by the violation (to name just several examples). No other court-ordered form of relief within the "full panoply" of SEC enforcement tools lauded by the Court in *Kokesh*—including the monetary penalties and other injunctive relief favorably cited therein—would ensure recovery of those types of gains from wrongdoing. *Kokesh*, 137 S. Ct. at 1640.

Because disgorgement aims in every instance to recoup the equivalent of the gains from a securities violation—including the types of gains described above—in the service of restoring the *status quo ante* to arrive at "complete justice" and effectuate the purpose of the securities laws, it remains an equitable remedy, not a legal one. Nor is it completely replaceable by another remedy within the SEC's toolkit, meaning its disallowance would leave a sudden gap in enforcement of the securities laws, without any congressional suggestion (much

less explicit direction) that this be so. That result would be contrary to law. *Porter*, 328 U.S. at 398.

Second, disgorgement in the context of SEC enforcement proceedings is in no way a "limitless monetary penalt[y]" as Petitioners contend. (Pet. Br. at 1). To be clear, a disgorgement award is, in all instances, confined by the total gains produced by a securities violation. A return to the *status quo*, by definition, cannot seek recompense beyond the universe of known proceeds generated by a wrongful act—and, in many cases, often concerns amounts less than that. Indeed, disgorgement (as with other forms of equitable relief) is not even mandatory in SEC enforcement proceedings. *See Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944). Instead, both the fact and amount of disgorgement is discretionary, guided by the specific facts and circumstances presented to the court in its equitable capacity. *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1113-16 (9th Cir. 2006).

Where, as in the case against Petitioners here, a lower court decides based on the evidence before it that a securities violator's purportedly "legitimate" business expenses were actually in service to a fraudulent scheme, those business expenses may be deemed part of the proceeds that are eligible to be recovered through disgorgement. In such cases, complete justice demands that a securities violator not be permitted to get away with spending unlawfully obtained proceeds in an attempt to further enrich him or herself. *SEC v. Liu*, 262 F. Supp. 3d 957, 975-76 (C.D. Cal. 2017). In short, spending unlawful proceeds for an illegitimate

purpose, or redirecting them elsewhere, should not absolve a securities law violator from having to account for those proceeds.

The Court should not supplant the equitable discretion that has been exercised by trial courts for decades when awarding disgorgement with a new rule outlawing such determinations entirely. If the courts' use of equitable powers helps to deter future securities law violations by making them entirely unprofitable, that should be applauded as helping to fulfill the fundamental purpose of the securities laws—not cited as the very basis for defining disgorgement out of the realm of equity and thus out of the panoply of tools available to the SEC to enforce those laws.

Third, both the statutory language of the securities laws and Congress' response to the use of disgorgement in SEC enforcement proceedings over the past half century argue in favor of—not against—the continued availability of disgorgement to provide complete relief for securities law violations. *SEC v. DiBella*, 409 F. Supp. 2d 122, 129-35 (D. Conn. 2006), *overruled in part on other grounds by Kokesh* 137 S. Ct. at 1645. It is both illogical and contrary to law to assume that by explicitly authorizing the SEC to pursue disgorgement as a remedy in administrative enforcement proceedings, Congress expressly disavowed the SEC's longstanding history of pursuing that same remedy in civil enforcement proceedings. Instead, Congress has recognized the availability and importance of the disgorgement remedy to effectuating the purpose of the securities

laws, and has chosen to expand rather than limit its availability.

ARGUMENT

I. AS A REMEDY, DISGORGEMENT IS BOTH LIMITED IN SCOPE AND NECESSARY TO PROVIDE COMPLETE RELIEF FOR VIOLATIONS OF THE SECURITIES LAWS.

A. The power to order disgorgement of the entire gain from a securities violation is consistent with the courts' equitable authority to render complete justice and to effectuate the policy behind the securities laws.

Section 27 of the Securities Exchange Act of 1934 (Exchange Act) grants federal courts exclusive jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). Since the Second Circuit's ruling in *Texas Gulf Sulphur*, a court's equitable authority under Section 27 has been widely read to include the power to order disgorgement of all of the ill-gotten gains obtained through the violation of federal securities laws.[2] The reasoning is simple: "[i]t would severely defeat the purposes of the [Exchange] Act if a violator . . . were

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[2] *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307-08 (2d Cir. 1971); *see also First Pac. Bancorp*, 142 F.3d at 1191-92.

allowed to retain the profits from his violation." *Texas Gulf Sulphur*, 446 F.2d at 1308.[3]

The breadth of a court's equity power to secure complete relief—including through injunctive rulings and/or disgorgement—is explained in *Porter*. There, the Court held, in the context of the Emergency Price Control Act of 1942, that a court's equitable powers authorized it, in its discretion, to "give effect to the policy of Congress" through disgorgement orders where necessary, in order to ensure "future compliance" with and advance the "statutory policy" of the Act being enforced. *Porter*, 328 U.S. at 398-400. The "full scope" of a court's jurisdiction in equity, the Court held, includes the discretion to award remedies aimed at "securing complete justice" and "protect[ing] the public interest while giving necessary respect to the private interests involved." *Id.*

The Court itself, when serving as the court of original jurisdiction, has awarded disgorgement as an equitable remedy to "remind . . . [a party] of its legal obligations, deter[] future violations, and promote the . . . successful administration" of the law being enforced. *Kansas v. Nebraska*, 135 S. Ct. 1042, 1057 (2015). The Court noted that, while sitting in

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[3] As discussed further below, Section 21(d)(5) of the Exchange Act, which was added to that law by the Sarbanes-Oxley Act of 2002 (SOX), Pub. L. No. 107-204, 116 Stat. 745, provides yet more explicit support for the availability of "any equitable relief that may be appropriate or necessary for the benefit of investors" in "any action or proceeding brought or instituted by the Commission" to enforce the securities laws. 15 U.S.C. § 78u(d)(5).

equity, it "may exercise its full authority to remedy violations of and promote compliance with" the law, "so as to give complete effect to public law." *Id.* at 1053. Further, "when federal law is at issue and the public interest is involved, a federal court's equitable powers assume an even broader and more flexible character than when only a private controversy is at stake." *Id.* (internal citations omitted).

Porter's admonition that equity's role is to advance the policy of laws designed to protect the public interest, and provide complete relief for their violation, finds its expression in literally hundreds of cases decided since *Texas Gulf Sulphur* in which disgorgement of ill-gotten gains has been used to enforce the federal securities laws.[4] "Complete justice" in such cases means ensuring that securities laws violations are rendered completely "unprofitable" to those who commit them.[5]

Ensuring that violations remain unprofitable means more, where circumstances dictate, than simply recovering a wrongdoer's direct pecuniary

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[4] *See, e.g., SEC v. Petrofunds*, 420 F. Supp. 958, 960 (S.D.N.Y. 1976) ("[T]he entire purpose and thrust of an SEC enforcement action is expeditiously to safeguard the public interest by enjoining recurrent or continued violations of the securities acts. The claims for relief asserted in such an action [including disgorgement] stem from, and are colored by, the intense public interest in SEC enforcement of these laws.").

[5] *See Texas Gulf Sulphur*, 446 F.2d at 1308; *Cavanagh*, 445 F.3d at 117; *JT Wallenbrock*, 440 F.3d at 1113; *First Pac. Bancorp*, 142 F.3d at 1191; *SEC v. Blavin*, 760 F.2d 706, 713 (6th Cir. 1985); *SEC v. Contorinis*, 743 F.3d 296, 307 (2d Cir. 2014).

proceeds from a violation. That is because a wrongdoer may profit from a securities law violation in diverse ways. These may include (i) drawing salary and other unjust compensation from a company funded by securities law violations (*First Pac. Bancorp*, 142 F.3d at 1192); (ii) continually funding a fraudulent enterprise with the funds unlawfully obtained through that enterprise (*JT Wallenbrock*, 440 F.3d at 1115); (iii) unjustly enriching one's affiliates or family members (*Contorinis*, 743 F.3d at 307) or (iv) enhancing one's likelihood of future benefits through securities fraud (*id.* at 304), to name just several examples.

In *Texas Gulf Sulphur*, for instance, the district court ordered disgorgement by an insider-trader defendant of not just the proceeds that he had personally derived, but also those derived by third-party "tippees" to whom he had passed inside information.[6] The Second Circuit, affirming, reasoned that absent the recovery of such proceeds through disgorgement, insider traders could easily evade the law by having relatives or acquaintances engage in illegally profitable trades, or by engaging in reciprocal tipping relationships with insiders in different corporations to their mutual benefit (without trading on their own inside information). *Id.* at 1308. Equity's dual purpose of rendering complete justice and effectuating the policy of the law, in other words, meant ensuring that the total gains from unlawful insider trading should not go unaddressed simply because of where the "tipper"

[6] *Texas Gulf Sulphur*, 446 F.2d at 1307.

directed those gains. *Id.*; *see also Contorinis*, 743 F.3d at 303-06.[7]

In *JT Wallenbrock*, defendant-operators of a Ponzi scheme in which $139.4 million was stolen from investors objected to the inclusion of (i) $36.6 million in claimed "business and operating expenses," (ii) a $131 million "loan" from one defendant to another, and (iii) $23 million in business receipts that they claimed were "unrelated to income from defrauded investors" in the total amount they were ordered to disgorge. *JT Wallenbrock*, 440 F.3d at 1113. The Ninth Circuit disagreed and affirmed the trial court's order based on the factual record before it, observing that:

> [r]ather than put their own money at risk, the defendants benefitted from the use of investors' money to spend at the defendants' discretion—whether to cover operating expenses, invest in start-up companies, pay personal expenses or to pay fake returns to investors to perpetuate the fraud. Given these circumstances, all $253.2 million obtained from investors was an ill-gotten gain that unjustly enriched the defendants.

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[7] "Whether the defendant's motive is direct economic profit, self-aggrandizement, psychic satisfaction from benefitting a loved one, or future profits by enhancing one's reputation as a successful fund manager, the insider trader who trades for another's account has engaged in a fraud, secured a benefit thereby, and directed the profits of the fraud where he has chosen them to go." *Id.* at 303.

Id. at 1114 (internal citations omitted). Accordingly, for purposes of disgorgement, the only offset permitted against the total gain was the amount actually paid back to investors ($113.8 million). *Id.*

The court reasoned in *JT Wallenbrock*—based, again, on a detailed factual record—that since the "entire business enterprise and related expenses were not legitimate at all, and no aspect of the defendants' conduct [could] be fairly characterized as a function of the way a securities firm does business," defendants' claimed business and operating expenses should not be offset from the disgorgement amount. *Id.* at 1115. As for the "loan" made by one defendant to another, the court observed that it was actually funded by the fraudulently-obtained proceeds from investors to the Ponzi scheme. *Id.* at 1115-16. Finally, as for the supposed $23 million in "unrelated" income, the court found (again based on a detailed factual record) that forensic accounting showed defendants' claim to be incorrect—the $23 million consisted entirely of investor funds. *Id.* at 1116.

Petitioners' case itself is similarly instructive. There, the trial court ruled, based on an "extensive evidence of a thorough, long-standing scheme to defraud investors," that Petitioners' claimed business expenses should not be offset against the total gain from Petitioners' securities law violation when calculating the disgorgement award. *SEC v. Liu*, 262 F. Supp. 3d 957, 976 (C.D. Cal. 2017). Specifically, the trial court found that these purported business expenses, which included "contracts with overseas marketers and a significant

portion of [Petitioner's] compensation," were "set at the inception of the project," which would necessarily have required tapping into the funds raised from unwitting purchasers of the securities sold by Petitioners. *Id.*; *SEC v. Liu*, 754 F. App'x 505, 509 n. 4 (9th Cir. 2018). Accordingly, the court considered such expenses not to have been legitimately undertaken, but rather part and parcel of the scheme to defraud investors.

As each of the foregoing examples illustrates, whenever a court sitting in equity uses its discretion to order a wrongdoer to disgorge gains from a securities law violation that go beyond the wrongdoer's personal proceeds, that finding is based on a detailed factual record, and the rationale is the same: in some reasonably plausible way, a failure to disgorge a larger universe of gains would result in the wrongdoer being unjustly enriched, and permitting that would mean undermining the federal securities laws. Disgorgement of such gains greatly reduces the perverse incentives that might otherwise exist for a wrongdoer to simply spend, redirect, funnel or otherwise structure away the proceeds from a securities law violation so they cannot be considered "personal" proceeds subject to disgorgement. Petitioners' requested relief would remove the obstacles to such incentives.

It also bears noting that, although SEC disgorgement is often used to provide restitution to defrauded investors, that is not practicable in every circumstance. Victims of securities fraud may not always be identifiable, or other exigencies may make it impractical to distribute funds from a

disgorgement award.[8] Indeed, not every case even involves a "victim" who has lost money—such as where a wrongdoer violates a valid bar order that simply prohibits his practice before the SEC.[9] However, those facts, where applicable, should not shield a wrongdoer from accounting for all of the unlawful gains he or she obtains by way of a securities law violation. To permit that would be contrary to the central goal of equity to arrive at complete justice and effectuate the policy of the securities laws, which is to ensure at a minimum that violations of those laws do not benefit the violators.

The supposed "full panoply" of monetary penalties and other injunctive relief available to the

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[8] *See, e.g., SEC v. Drexel Burnham Lambert, Inc.*, 956 F. Supp. 503 (S.D.N.Y.), *aff'd sub nom. SEC v. Fischbach Corp.*, 133 F.3d 170 (2d Cir. 1997) (Payment of defendants' disgorged profits to United States Treasury, following action for securities law violations based on illegal takeover of corporation, was appropriate in light of cost and difficulty of locating minority shareholders, difficulty of devising coherent formula for distributing money among such shareholders, and defendants' long history of preying on public companies and failure to comply with securities laws); Thomas Lee Hazen, 6 *Treatise on the Law of Securities Regulation* § 16.18 (2019) ("[a]lthough distribution of the disgorgement proceeds to investors may be appropriate in many cases, disgorgement is not appropriate when there are a large number of investors with relatively small claims. The SEC simply is not equipped to act as a collection agency in every case that results in compensable losses to investors.").

[9] *See, e.g., SEC v. Jones*, 155 F. Supp. 3d 1180 (D. Utah 2015) (awarding disgorgement by accountant for profits derived from his bar order violations).

SEC described in *Kokesh*[10] would not allow the SEC to obtain disgorgement from a wrongdoer of any proceeds beyond the gross amount of his own pecuniary gains from a securities law violation. By eliminating the ability of courts to award broader disgorgement in SEC civil enforcement proceedings, and limiting the SEC's remedies in such proceedings to statutory monetary penalties and more limited injunctive relief, Petitioners' requested ruling would create a substantial and unwarranted gap in the SEC's enforcement capabilities.

B. As a remedy, disgorgement is both constrained and guided by the specific facts and circumstances of the violation(s) at issue.

Although disgorgement is an important enforcement tool for the SEC, it is not a "limitless" remedy as Petitioners contend. (Pet. Br. at 1). To begin with, disgorgement in any amount is discretionary, not mandatory, in SEC civil enforcement proceedings. *See Contorinis*, 743 F.3d at 304 (court not compelled to order disgorgement from insider trader defendants when gains accrue to innocent third parties); *JT Wallenbrock*, 440 F.3d at 1114 (discussing discretionary offsets for "legitimate" business expenses). Indeed, "[a] grant of [equity] jurisdiction to issue compliance orders hardly suggests an absolute duty to do so under any and all circumstances." *Hecht*, 321 U.S. at 329.

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[10] *Kokesh*, 137 S. Ct. at 1640.

Second, a disgorgement amount is necessarily capped by the total gain generated by a securities law violation, with offsets allowed for items such as legitimate business expenses and/or gains not causally connected to the securities violation. *JT Wallenbrock*, *supra*; *SEC v. Manor Nursing Centers*, 458 F.2d 1082, 1104 (2d Cir. 1972) (restricting disgorgement award to proceeds obtained in connection with stock offering, excluding the additional profits earned on such proceeds).

Calculating the disgorgement amount in an SEC enforcement proceeding is, accordingly, a fact-intensive exercise, heavily dependent on the evidence presented and the specific circumstances of each case, and not necessarily equivalent to the total gain connected with a securities violation. As discussed above, a defendant may be determined, based on the facts, to have personally benefited in myriad ways from a securities violation beyond his or her own pecuniary proceeds. *See First Pac. Bancorp,* 142 F.3d at 1192 (even where defendant allegedly lost money directly in the scheme, defendant benefitted so as to justify disgorgement); *Contorinis*, 743 F.3d at 303 (discussing indirect benefits justifying disgorgement); *SEC v. Solow*, 554 F. Supp. 2d 1356, 1365 (S.D. Fla. 2008) (defendant failed to offer sufficient evidence that commissions paid to third parties should be offset against disgorgement award).

Alternatively, the facts may lead a court to offset some expenses against a proposed disgorgement award to account for necessary business costs. In *SEC v. Thomas James Assocs.,*

Inc., 738 F. Supp. 88 (W.D.N.Y. 1990), for instance, the court noted that the defendant company (i) "provide[d] employment for 300 individuals in a number of states," (ii) had, prior to the litigation, "enjoyed a relatively clean record with both the SEC and the industry's self-regulating bodies," and (iii) "fill[ed] a niche in the capital markets as a company willing to underwrite highly speculative, but credible, companies." *Id.* at 92-93. In other words, the defendant company—unlike the enterprise led by Petitioners here—was not itself found to be a fraudulent enterprise with no legitimate business purpose. The court accordingly permitted the offset of certain "necessary business expenses" against the SEC's requested disgorgement amount. *Id.*[11]

At a minimum, a securities law violator should not be able to "avoid or diminish his responsibility to return his ill-gotten gains" simply by establishing that "he is no longer in possession of such funds due to subsequent, unsuccessful investments or other forms of discretionary spending." *Id.* at 95. To permit that would be to frustrate the aims of the securities laws, which is the opposite of equity's mandate as set out in *Porter*.

It is important to recognize, therefore, that Petitioners' argument is grounded in a fundamental mistrust of courts' abilities to exercise their fact-

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[11] *See also SEC v. Universal Exp., Inc.*, 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009) (discussing discretion of courts to "deduct from the disgorgement amount any direct transaction costs, such as brokerage commissions, that plainly reduce the wrongdoer's actual profit.").

finding and equity powers responsibly in SEC civil enforcement proceedings—something that courts across the circuits have done essentially without controversy, and with Congress' effective approval, for half a century.

C. Disgorgement's deterrent effect should not be used to define it out of existence as an equitable remedy.

Petitioners' argument that the equitable disgorgement remedy should be eliminated from the SEC's enforcement toolkit is grounded in the Court's determination in *Kokesh* that disgorgement constitutes a "penalty" for purposes of § 2462. In arriving at this determination, the Court observed that deterrence is cited as one of disgorgement's objectives, but that "deterrence [is] not [a] legitimate nonpunitive governmental objectiv[e]." *Kokesh,* 137 S. Ct. at 1643-44 (citing cases). Since disgorgement "in many cases" is not compensatory, is paid to the government as a consequence of a legal violation, and seeks (at least in part) to deter violations of the securities laws, the Court reasoned, "it operates as a penalty" for purposes of triggering the five-year statute of limitations. *Id.* at 1644.

It is important to note, however, that while deterrence may be an important objective of the disgorgement remedy in SEC civil enforcement proceedings, it is not the only—nor, arguably, even the primary—objective. It is only logical that effective enforcement of the securities laws requires that a violator not be permitted to keep their profits—but that is the barest form of "deterrence." *Manor Nursing Centers*, 458 F.2d at 1104 ("[t]he

deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge their illicit profits.").[12] Indeed, as discussed further below, the reason Congress codified monetary penalties for violations of the securities laws in the 1980s and 1990s was that equitable disgorgement, by itself, was *not enough of a deterrent* to potential violators. *See* Section II, *infra.* As former Commissioner Luis A. Aguilar stated:

> A central tool in making sure that enforcement actions deter future violations is the ability to impose civil money penalties. While disgorgement—which is the surrender of ill-gotten gains—is an important remedy, it merely puts fraudsters back in the position they were before the fraud occurred. If committing fraud can leave someone no worse off that if they had been honest, they might begin to think that crime can pay. Penalties are necessary to change that calculus and ensure that fraud does not pay.[13]

Accordingly, whatever disgorgement's effectiveness may be as the barest form of deterrent

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[12] *See also Petrofunds*, 420 F. Supp. at 960 ("To permit the (retention) of a portion of the illicit profits would impair the full impact of the deterrent force that is essential if adequate enforcement of the securities acts is to be achieved.") (internal citations and ellipses omitted).

[13] Luis A. Aguilar, Speech by SEC Commissioner: Market Upheaval and Investor Harm Should Not be the New Normal (May 24, 2010), https://www.sec.gov/news/speech/2010/spch052410laa-1.htm#P187_31142.

against future securities violations should not serve as the basis for eliminating it from the SEC's enforcement toolkit.

Moreover, while the goal and/or effect of deterring conduct may be a *sine qua non* for a penalty, the fact that a remedy or course of action may deter conduct does not automatically make it punitive rather than remedial. If that were the case, the mere investigation of an individual by the SEC would be considered "punitive," because any rational actor wants to avoid it, is required to expend resources to contend with it, and thus is deterred from pursuing conduct that would prompt it.

Similarly, any individual is made financially, psychologically and/or emotionally "worse off" by simply having to defend himself from an SEC enforcement action, even if such action is eventually dismissed or results in no disgorgement. Whether an action or remedy makes one "worse off" is accordingly—like "deterrence"—too imprecise a criterion to determine whether a remedy or course of action is punitive rather than remedial. *See Kokesh*, 137 S. Ct. at 1645. The real question is whether, when ordering disgorgement, a court seeks to put a defendant back into the position he would have been had he not violated the law, or alternatively, seeks to inflict a punishment. *Universal Exp.,* 646 F. Supp. 2d at 563. And as the caselaw makes clear, when a court declines to offset a securities law violator's business expenses against a disgorgement award, that court is not inflicting punishment, but rather is ensuring—based on the detailed factual record before it—that the violator does not profit, directly or

indirectly, from his violation. *Contorinis*, 743 F.3d at 306.

II. CONGRESS HAS ENDORSED EQUITABLE DISGORGEMENT AS AN IMPORTANT TOOL IN ENFORCING THE FEDERAL SECURITIES LAWS.

It is well-settled that "[w]hen Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in light of the statutory purposes." *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291-92 (1960). Moreover, the "comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. . . The great principles of equity, securing complete justice, should not be yielded to light inferences, or doubtful construction." *Porter*, 328 U.S. at 398.

Congress' response to the courts' half-century practice of awarding disgorgement in SEC civil enforcement proceedings to render complete justice and effectuate the policies underlying the federal securities laws has been one of acquiescence followed by outright endorsement—far from the "clear and valid legislative command" to the contrary that this Court's precedent would require in order to grant Petitioners' requested relief. *Amici* highlight just several examples below.

In 1984, more than a decade after *Texas Gulf Sulphur*, Congress passed the Insider Trading Sanctions Act of 1984 (ITSA), which gave the SEC

authority, for the first time, to seek monetary penalties for insider trading.[14] The House Committee's Report prior to ITSA's passage contains more than a dozen references—all favorable—to the SEC's practice of seeking disgorgement in civil enforcement proceedings, including the following:

> Once the equity jurisdiction of a court has been invoked on a showing of a securities violation, the court possesses the necessary power to fashion an appropriate remedy. Thus, the Commission may request that the court order certain equitable relief, such as the disgorgement (giving up) of illegal profits…[15]
>
> The principal, and often effectively only, remedy available to the Commission against insider trading is an injunction against further violations of the securities laws and disgorgement of illicit profits…[16]
>
> Disgorgement of illegal profits has been criticized as an insufficient deterrent, because it merely restores a defendant to his original position without extracting a real penalty for his illegal behavior…[17]
>
> The Committee believes the new penalty will give the Commission added flexibility. The

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[14] 15 U.S.C. § 78u(d)(2)(A)-(D) (Supp. II 1984 & Supp. IV 1986).

[15] H.R. Rep. No. 98-355 (1983) at 7.

[16] *Id.* at 7-8.

[17] *Id.*

> new penalty may be used in addition to existing remedies available to the Commission. Thus, in appropriate insider trading cases, the Commission may seek: (1) a court order enjoining the violator from breaking the law again; (2) disgorgement of ill-gotten gains which may, if appropriate, be paid into an escrow fund so that traders or other private parties damaged by the insider trading can obtain compensation for their losses, and (3) the imposition of the new civil money penalty payable to the U.S. Treasury …[18]
>
> In advancing this legislative proposal, the Commission is not abandoning the disgorgement remedy, which has served through the years as an important source of recovery for private plaintiffs…[19]

As the foregoing makes clear, Congress was more than cognizant of the historical use of the disgorgement remedy in SEC civil enforcement proceedings at the time it considered the addition of a monetary penalty for insider trading through ITSA. Indeed, the basis on which this new penalty was considered and ultimately added was that disgorgement was *not enough of a deterrent*, alone, to effectuate the purpose of the laws prohibiting insider trading.[20] There is no basis, given this legislative

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[18] *Id.* at 8.

[19] *Id.* at 25.

[20] *See also id.* at 24 ("In short, disgorgement is hardly a disincentive for those who may cynically (and realistically)

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history, on which to conclude that Congress believed disgorgement was not a permissible exercise of courts' equitable power in SEC civil enforcement cases involving other types of securities law violations besides insider trading.

In 1990, Congress enacted the Securities Law Enforcement Remedies Act (Remedies Act), which amended Section 21(d) of the Exchange Act to (i) expressly authorize the SEC to seek disgorgement in administrative proceedings and (ii) provide for specific, stepwise monetary penalties for securities law violations in SEC enforcement proceedings generally.[21] Far from commanding courts to desist from awarding disgorgement in civil (as opposed to administrative) proceedings as courts had already done for two decades, Congress simply assumed that disgorgement was readily available to any civil court as a means to effectuate, in its equitable capacity, complete justice and the policy of the federal securities laws. Congress assumed, in other words, that an Article III judge's equitable power—based on centuries of jurisprudence and tradition—did not need elaboration or endorsement, unlike the powers of an administrative judge. *See* Roberta S. Karmel, *Will Fifty Years of the SEC's Disgorgement Remedy Be Abolished?*, 71 SMU L. Rev. 799, 802-03 (2018).[22]

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hope to avoid being caught.") (internal quotations omitted).

[21] Remedies Act, Pub. L. No. 101-429, § 202(e), 104 Stat. 931, 938 (Oct. 15, 1990); 15 U.S.C. §§ 78u-2(e), 3(e) (2012).

[22] *See also id.* at 805 ("[I]t would be anomalous if the SEC continued to be allowed to request disgorgement in
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The legislative history for the Remedies Act bears this out. Indeed, the Senate Report for the Remedies Act "explicitly referred to SEC disgorgement actions during its justification for granting the SEC authority to buttress those disgorgement actions with civil money penalties." *DiBella*, 409 F. Supp. 2d at 131 (citing S. Rep. No. 101-337 (1990)).[23] As was previously the case with ITSA, the court in *DiBella* noted:

> Congress acknowledged the SEC's authority to seek disgorgement and found that disgorgement alone, while a necessary and important tool, often provided an insufficient deterrent effect. Consequently, Congress authorized the SEC to seek civil money penalties in addition to its then-existent authority to seek disgorgement.

Id. at 131-32; *see also* H.R. Rep. No. 101-616 (1990).

Subsequently, with the passage of the Sarbanes-Oxley Act of 2002 (SOX), Congress granted statutory authority to the SEC to seek "*any equitable relief* that may be appropriate or necessary for the *benefit of investors*" in "any action or proceeding brought or instituted by the Commission under any provision of the securities laws."[24] The Senate Commission report on this provision acknowledged

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administrative cases but not in court cases.").

[23] *See, e.g.*, S. Rep. No. 101-337 at 6, 8, 10, 13, 16.

[24] 15 U.S.C. § 78u(d)(5) (2012) (emphasis added); *see also* Karmel, 71 SMU L. Rev. at 803.

that "currently an individual may be ordered to disgorge funds that he or she received as a result" of a securities law violation, and then—importantly—clarified what was meant by equitable relief that may be "appropriate or necessary for the benefit of investors":

> Rather than limiting disgorgement to these gains [i.e., the funds received by an individual as a result of a violation], the bill will permit courts to impose *any equitable relief necessary or appropriate to protect, and mitigate harm to, investors*.[25]

"Protect[ing]" and "mitigat[ing]" harm to investors provides more clarity as to the scope of possible equitable relief available to the SEC than the more general language (i.e., "for the benefit of investors") used in the statute. Certainly, the equitable relief authorized by SOX to "protect and mitigate harm" to the investing community encompasses more than simply establishing a restitution fund for an identifiable group of victims to a given securities violation. As discussed *supra*, not every securities law violation even has a "victim," although investors at large still need protection from, and can be harmed by, such violations if they are allowed to proliferate.

As one scholar and former Commissioner has observed: "when Congress enacted this provision [in SOX], it should be presumed that Congress was familiar with *Texas Gulf* and its progeny, and

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[25] S. Rep. No. 107-205, at 27 (2002) (emphasis added).

expected its enactment of § 78u(d)(5) to be interpreted in conformity with these precedents." Karmel, 71 SMU L. Rev. at 803. Indeed, as the Court noted in *Merck & Co. v. Reynolds*, 559 U.S. 633, 648 (2010), "[w]e normally assume that, when Congress enacts statutes, it is aware of relevant judicial precedent." *Id.*; *see also Cannon v. Univ. of Chi.*, 441 U.S. 677, 703 (1979) (clarifying that the Court is decidedly receptive to implying a remedy "when that remedy is necessary or at least helpful to the accomplishment of the statutory purpose.").

Far from providing the clear and unambiguous direction that would be necessary in order to narrow the courts' equitable capacity to render complete justice and effectuate the law, the foregoing examples all "evidence Congress' acknowledgment and encouragement of the SEC's long held authority to seek disgorgement in civil actions." *DiBella*, 409 F. Supp. 2d at 132. Petitioners' requested relief accordingly should be denied as running counter to the Court's clear admonitions in *Porter* and *Mitchell* that equity's power not be constrained absent a clear and unambiguous congressional instruction to that effect.

CONCLUSION

Disgorgement is an inherently limited remedy that is nonetheless highly important to the enforcement of the federal securities laws and, ultimately, the protection of the financial marketplace. Disgorgement determinations, which aim to restore parties to the *status quo* prior to a securities violation, are inherently fact-bound.

Decades of jurisprudence provide the necessary guidance for courts to make these determinations in their equitable discretion, exercising concern for both the public and private interests before them, on a case-by-case basis. Removing this discretion from the courts entirely, and eliminating the equitable disgorgement remedy from SEC civil enforcement proceedings outright, would create a gap in the enforcement of the federal securities laws that has not existed for half a century, without any signal (much less explicit direction) from Congress that this should be so.

To the contrary, Congress' actions have spoken entirely in favor of disgorgement as a means of providing complete justice and effectuating the purpose of the federal securities laws. Petitioners' requested relief should be denied, and the SEC permitted to continue using disgorgement in civil enforcement proceedings to ensure that wrongdoers do not profit from their violations of those laws.

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Respectfully submitted,

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