Vanderbilt Law Review

Volume 75 | Issue 4 Article 6

5-2022

Finding the Boundaries of Equitable Disgorgement

Cameron K. Hood
Vanderbilt School of Law

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Cameron K. Hood, Finding the Boundaries of Equitable Disgorgement, 75 *Vanderbilt Law Review* 1307 (2023)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol75/iss4/6

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Finding the Boundaries of Equitable Disgorgement

The disgorgement of "ill-gotten gains" is a significant mechanism for enforcing the securities laws. By compelling a violator of the securities laws to forfeit their illegal proceeds, disgorgement serves as a strong deterrent for securities fraud and an important method by which investors are compensated for unjust losses in the market—and today accounts for the recovery of billions of dollars annually. Despite its importance, commentators in recent years began to call into question the availability of the disgorgement remedy for the SEC. The SEC pursues disgorgement under the agency's grant for seeking equitable relief for the benefit of investors; however, courts have arguably applied disgorgement in a manner that renders it a penalty—and thus beyond the scope of SEC enforcement.

In June 2020, the Supreme Court stepped in to provide clarity as to the future of disgorgement as an equitable remedy. In Liu v. SEC*, the Court held that while disgorgement remains available for the SEC, a disgorgement award cannot exceed the net proceeds that result from a violation of the securities laws. More specifically, the Court took issue with three instances in which lower court applications of disgorgement had tested the line between equity and penalty. First was the common practice of returning disgorged funds to the Treasury rather than to harmed investors. Second was through the imposition of joint-and-several liability, and third was the practice of denying cost and expense deductions from disgorgement awards.*

This Note proposes a method for navigating the boundary of equitable disgorgement. In particular, this Note argues that disgorged funds can be equitably returned to the Treasury to the extent that the method of remittance reflects a focus on investor compensation and an expansive view of "benefitting investors." Further, joint-and-several liability may be appropriate in the context of a fraudster's claim to proceeds held by another; and finally, equity requires that legitimate deductions include more than legitimate costs and expenses, but the subsequent disposal of profits as well. This approach to applying disgorgement can result in an equitable imposition of the remedy and the continued efficacy of an important enforcement mechanism for policing securities markets.

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INTRODUCTION

In 2019, the U.S. Securities and Exchange Commission ("SEC") brought 862 enforcement actions and obtained judgments and orders totaling more than $4.3 billion in disgorgement and monetary penalties.[1] Of that amount, nearly $3.3 billion was attributable to the disgorgement of fraudulent profits.[2] Despite its prevalence, commentators in recent years called into question the applicability of the disgorgement remedy, a critique catalyzed by the Supreme Court's decision in *Kokesh v. SEC*.[3] In *Kokesh*, the Court held that disgorgement constituted a penalty when determining the applicable statute of limitations—troublesome in that disgorgement has long been administered under the SEC's ability to seek, and a federal court's authority to grant, equitable relief.[4]

1. DIV. OF ENF'T, U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT 9 (2019), https://www.sec.gov/files/enforcement-annual-report-2019.pdf [https://perma.cc/5F4Y-AQYA]; *see Disgorgement*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "disgorgement" as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion").

2. DIV. OF ENF'T, *supra* note 1, at 16.

3. 137 S. Ct. 1635 (2017).

4. *Id.* at 1645; *see* 15 U.S.C. § 78u(d)(5); SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d. Cir. 1971) (holding that "the SEC may seek [disgorgement] . . . so long as such relief is remedial relief and is not a penalty assessment"); *see also* 28 U.S.C. § 2462 (imposing a five-year

In June 2020, the Supreme Court revisited the issue in *Liu v. SEC*, when it held that the SEC may continue to pursue disgorgement as an equitable remedy in civil cases.[5] While this decision clarified the potential of the remedy, it raised new questions of its own.[6] Namely, in identifying instances in which lower courts had tested the limits of equitable disgorgement, the Court raised questions as to how to properly apply the remedy.[7] Left unclear were the circumstances under which depositing disgorged funds with the United States Treasury ("Treasury") rather than returning them to harmed investors, imposing tort-like joint-and-several liability, and declining deductions for costs and expenses push disgorgement over the line between equitable remedy and penalty.[8]

The limits of permissible disgorgement weigh heavily on the future of SEC enforcement. As an example, the SEC in 2019 returned only $1.2 billion of the $4.3 billion obtained via disgorgement and monetary penalties to harmed investors.[9] Therefore, if the Supreme Court's ruling in *Liu* bars the SEC from seeking disgorgement in some cases—such as when harmed investors cannot be compensated—it threatens the efficacy of a valuable enforcement mechanism.[10] This Note addresses how disgorgement can operate within its equitable boundary and in line with the Court's guidance in *Liu*. Part I provides a brief background on the disgorgement remedy in civil cases, beginning with its statutory roots and common law evolution. Part II then considers the question as it has been presented by the Supreme Court, before analyzing existing approaches to the limits of disgorgement. Part III ultimately presents an equity-based solution for applying the disgorgement remedy.

I. BACKGROUND

Disgorgement is defined as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion."[11]

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statute of limitations for "an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture").

5. 140 S. Ct. 1936, 1940 (2020).

6. *See id.* at 1947–48.

7. *See id.* at 1946.

8. *Id.*

9. DIV. OF ENF'T, *supra* note 1, at 9.

10. *See* 140 S. Ct. at 1948–49.

11. BLACK'S LAW DICTIONARY, *supra* note 1. Disgorgement is often used interchangeably with "restitution" to mean the retrieval of fraudulent profits. Because restitution seeks to make investors whole, however, it differs importantly from disgorgement, which aims to deprive

In the context of securities laws, disgorgement is a remedy frequently sought by the SEC with the aim of denying fraudsters the proceeds of their "ill-gotten gains"—and as applied, provides the SEC with a significant tool.[12] One nine-year case study found that disgorgement awards accounted for nearly half of all monetary penalties imposed by the SEC—and that when disgorgement was applied, it accounted for eighty percent of the recovery.[13] Despite its value and prevalence, debate strengthened in recent years as to the legal permissibility of the remedy.[14] Much of the debate centered around whether the lack of explicit statutory authority to impose disgorgement prevented the SEC from using it and, in particular, whether the statutory grant for equitable relief "ancillary" to injunction precludes disgorgement.[15] Understanding the boundary for permissible disgorgement, and the approach this Note suggests to address it, first requires an overview of the disgorgement remedy and its equitable roots.

A. History of Securities Regulation

Securities regulation in the United States took force following the outcry from the Great Depression.[16] Until that point, the federal government took a relatively laissez-faire stance on securities regulation—instead relying on individual states to police securities markets under so-called "blue sky" antifraud and licensing laws.[17] These blue sky laws, which required evidence of fraud to take effect or applications to be completed prior to the sale of securities, proved ineffective as the variability in regulatory schemes were easy to manipulate.[18] Individuals could avoid them by operating across state lines, taking advantage of states with friendlier requirements, or

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wrongdoers of fraudulent profits. Urska Velikonja, *Public Enforcement After* Kokesh*: Evidence from SEC Actions*, 108 GEO. L.J. 389, 400 (2019).

12. John D. Ellsworth, *Disgorgement in Securities Fraud Actions Brought by the SEC*, 1977 DUKE L.J. 641, 641–42.

13. Velikonja, *supra* note 11, at 395.

14. *See, e.g.*, Stephen M. Bainbridge, Kokesh *Footnote Three Notwithstanding: The Future of the Disgorgement Penalty in SEC Cases*, 56 WASH. U. J.L. & POL'Y 17, 30 (2018) (arguing that the SEC lacks authority to seek disgorgement because disgorgement qualifies as a penalty).

15. Kokesh, 137 S. Ct. at 1640; *see, e.g.*, Patrick L. Butler, Note, *Saving Disgorgement from Itself: SEC Enforcement After* Kokesh v. SEC, 68 DUKE L.J. 333, 337–38 (2018) (advocating for disgorgement's retention).

16. Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 338–39 (1988).

17. *Id.* at 331.

18. *Id.* at 331–32.

offering refunds prior to harm—effectively preempting the enforcement of statutes that required predicate evidence of fraud.[19] An alternative to state blue sky laws came in the form of regulatory systems woven into securities exchanges.[20] These systems, exemplified by New York Stock Exchange ("NYSE") regulations, required corporate issuers to provide detailed company histories and financial statements prior to a registered offering for sale.[21] A clear obstacle, however, was the listing requirement for the regulations to take effect.[22] A company that wished to avoid these regulatory disclosures could simply forgo registering with an exchange and carry on unlisted and unregulated.[23]

The totality of the regulatory schemes that predated the modern system resulted in an unreliable market for securities.[24] Evidence of this unreliability can be found in a 1933 congressional report that noted that half of the securities issued following World War I were *worthless*—spurred, it was believed, by dishonest and unfair practices on the part of underwriters and dealers.[25] In sum, the regulatory scheme presented an opportunity for fraud. One illustrative incident saw stock in an Idaho corporation listed in Boston and sold to investors for over $200 million dollars.[26] The corporation's assets, it turned out, consisted solely of a "water-filled, abandoned mine" that was overgrown to the extent that investigators struggled to even find it.[27] The fraudster, George Graham Rice, later wrote a book about his financial escapades—and dedicated it to the "American Sucker."[28]

The fallout of the informational asymmetries made prevalent by inadequate blue sky laws and exchange regulations was the stock market crash of 1929, which led in turn to the Great Depression.[29] These events made clear the need for a more comprehensive regulatory

19. *Id.*

20. *Id.* at 334.

21. These disclosure requirements more closely resemble the requirements in place today under the Securities Act of 1933 and the Securities Exchange Act of 1934. *Id.*; 15 U.S.C. §§ 77a-77aa; 15 U.S.C. §§ 78a-78qq.

22. *See* Keller & Gehlmann, *supra* note 16, at 334.

23. *Id.*

24. *See id.*

25. *Id.* at 334–35. "Underwriters" in this context refer to financial institutions that help price and market securities offerings, while "dealers" refer to those entities participating as an intermediary for potential investors.

26. *Id.* at 335.

27. *Id.* (quoting Laylin K. James, *The Securities Act of 1933*, 32 MICH. L. REV. 624, 626 (1934)).

28. *See* GEORGE GRAHAM RICE, MY ADVENTURES WITH YOUR MONEY 3 (1911) ("To the American Damphool Speculator, surnamed the American Sucker, otherwise described herein as The Thinker Who Thinks He Knows But Doesn't—*greetings*!").

29. Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1897 (2013).

scheme for securities markets.[30] Congress responded with the enactment of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[31] These Acts aimed to regulate both securities markets and the issuers of securities through a range of mandatory disclosures.[32] The assumption behind these requirements was that giving investors access to information regarding the securities they purchased would allow them to better gauge the risks of investment and thereby reduce the potential for fraud.[33] To administer and enforce these disclosure requirements, the Exchange Act created the SEC and furnished the agency with a number of statutory remedies.[34]

B. The Growth of SEC Enforcement

Today, the SEC has by statutory authority the ability to pursue (among other remedies) injunctions, cease and desist orders, and monetary penalties, in addition to "any equitable relief that may be appropriate or necessary for the benefit of investors."[35] A forthcoming amendment to the Exchange Act will additionally grant the SEC the explicit authority to seek civil disgorgement.[36] Yet this assortment of remedies was not always available to the SEC. Instead, the available remedies grew over time from injunctive relief alone to the more comprehensive list above,[37] which the SEC can enforce through either an administrative proceeding or a judgment in federal court.[38] Noticeably absent until 2021 was disgorgement, a remedy that requires a violator of securities laws to forfeit any profits stemming from the violation.[39] Rather, for much of its history, disgorgement was a judicial

30. *Id.*

31. *Id.*; 15 U.S.C. §§ 77a-77aa; 15 U.S.C. §§ 78a-78qq.

32. *See* Velikonja, *supra* note 29, at 1897.

33. *Id.*

34. Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 2 (2013).

35. *See* 15 U.S.C. § 78u(d)(5); *id.* ("In carrying out its law enforcement role, the SEC is statutorily empowered to pursue a wide range of remedies against securities law violators. These remedies include injunctions, administrative cease-and-desist orders, monetary penalties, and various forms of bars and suspensions."); 15 U.S.C. § 78u(d)(1) ("Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter . . . [the Commission] may in its discretion bring an action in the proper district court of the United States . . . .").

36. National Defense Authorization Act, 15 U.S.C. § 78u(d)(7).

37. Butler, *supra* note 15, at 336.

38. *See, e.g.*, 15 U.S.C. § 77h-1 (allowing for a cease-and-desist order following an administrative proceeding); 15 U.S.C. § 77t (allowing for injunction via district court order).

39. Ellsworth, *supra* note 12, at 642.

creation grounded in the SEC's explicit authority to seek equitable relief—available so long as it was "appropriate or necessary for the benefit of investors."[40]

Although the SEC regularly seeks disgorgement today, it took more than thirty years for the agency to first do so—until then relying on the ability to seek injunctive and other relief.[41] Over time, however, courts began to reason that for the SEC to fulfill its function of deterring securities fraud like that which predated the Great Depression, the forfeit of "ill-gotten gains" was necessary.[42] Without the disgorgement tool, the securities regime could serve to incentivize fraud by allowing offenders to retain ownership of their illegal profits. Legal scholars in the 1960s further noted that the SEC was the entity best positioned to vindicate investor rights, particularly in cases where large numbers of investors were hurt only marginally.[43] In such cases, the costs of recovery would likely exceed the harm incurred by individual investors—resulting in a collective action problem that would disincentivize investors from seeking relief.[44]

The result of these gaps in securities enforcement was *SEC v. Texas Gulf Sulphur Co.*, where the SEC first sought and obtained disgorgement as an equitable remedy.[45] In *Texas Gulf Sulphur*, insiders from a mining company purchased and recommended large portions of company stock while knowing—but not disclosing—material information regarding a mineral discovery that would presumptively lead to an increased value of company stock.[46] The resulting damage to individual investors was relatively small, as it came in the form of forgone profits among investors rather than a more tangible loss.[47] In the aggregate, however, the fraudulent benefit accrued by the insiders

40. *Id.* at 642; 15 U.S.C. § 78u(d)(5).

41. Ellsworth, *supra* note 12, at 642.

42. *See* Porter v. Warner Holding Co., 328 U.S. 395, 400 (1946) (reasoning that recovery and restitution may be "appropriate and necessary to enforce compliance with the Act"); Schine Chain Theatres, Inc. v. United States, 334 U.S. 110, 128 (1948) ("If all that was done was to forbid a repetition of the illegal conduct, those who had unlawfully built their empires could preserve them intact.").

43. *See* Ellsworth, *supra* note 12, at 644.

44. *Id.*

45. SEC v. Tex. Gulf Sulphur Co., 312 F. Supp. 77, 93 (S.D.N.Y. 1970).

46. *Id.* at 90. "Material" in this sense means information a reasonable investor would consider important when deciding whether or not to purchase securities. *See* TCS Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). In the context of insider trading, "insiders" refers to individuals in possession of material nonpublic information. *See, e.g.*, U.S. v. O'Hagan, 521 U.S. 642, 643 (1997) (discussing the "classical theory" of insider trading).

47. *Tex. Gulf Sulphur Co.*, 312 F. Supp. at 93; see Ellsworth, *supra* note 12, at 647.

was significant.[48] This scenario set the stage for the rationales alluded to above that implicate and call for disgorgement as an exercise of equitable relief.[49] The court in *Texas Gulf Sulphur* reasoned that to prevent future violations of the securities laws (that is, to deter fraud) and protect the public interest, the situation warranted disgorgement of the fraudulent proceeds.[50] On appeal, the Second Circuit affirmed, holding that "the SEC may seek other than injunctive relief . . . so long as such relief is remedial relief and is not a penalty assessment."[51]

Over time, courts began to see the SEC's implied ability to seek disgorgement as an equitable remedy as a relative "truism" in the law.[52] For its part, the SEC continued to seek and obtain equitable disgorgement without explicit statutory authority until Congress enacted the Securities Enforcement Remedies and Penny Stock Reform Act ("Reform Act") in 1990.[53] As written, the Reform Act allowed for disgorgement only in administrative, rather than court-led, proceedings—an omission seemingly rooted in legislative assumptions that the SEC did not require statutory authority for its regular practice.[54] Adding to the growing body of statutory support for disgorgement, the Sarbanes-Oxley Act was enacted in 2002 and authorized the SEC to distribute civil fines to investors in disgorgement cases—so-called "fair funds."[55] In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") expanded the SEC's authority to impose such civil fines by allowing the civil fines' imposition on individual parties.[56]

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48. *Tex. Gulf Sulphur Co.*, 312 F. Supp. at 94–98 (requiring defendants to return profits in excess of $149,000).

49. Ellsworth, *supra* note 12, at 647.

50. *Tex. Gulf Sulphur Co.*, 312 F. Supp. at 97.

51. SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d. Cir. 1971). The SEC reiterated this point, noting that in such cases it acts not to make investors whole but to deter violations by making violations unprofitable. Ellsworth, *supra* note 12, at 649.

52. Ryan, *supra* note 34, at 3; *see, e.g.*, SEC v. Wang, 944 F.2d 80, 85 (2d. Cir. 1991) (noting that disgorgement is "by its very nature, an equitable remedy").

53. *See* Ryan, *supra* note 34, at 3 (discussing how disgorgement's equitable status became widely accepted to the point of being self-evident, or a "truism"); Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 15 U.S.C. §§ 78u-2(e), 78u-3(e).

54. *See* Velikonja, *supra* note 11, at 400.

55. Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 340 (2015). Unlike disgorgement, civil fines are not impacted by the significance of a defendant's fraudulent profits. Instead, statutes set maximum penalties (civil fines) ranging from $7,500 to $775,000 depending on the type of violation and on whether the violator was an institution or entity. *See* Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 24, 2016), https://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/ [https://perma.cc/T24C-98HS].

56. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 77h-1(g).

Taken together, these Acts illustrated a trend towards the statutory permissibility of disgorgement as an equitable remedy, for court-led and administrative proceedings alike. While court-led disgorgement was not explicitly granted by statute, disgorgement's frequent appearance in surrounding statutory contexts resulted in a strong inference that Congress supported the practice.[57] In January 2021, as this Note was being written, lawmakers took the final step. Pinned to the end of the annual military spending bill, the National Defense Authorization Act ("NDAA") was an amendment to the Exchange Act that gives the SEC explicit authority to seek civil disgorgement of "any unjust enrichment."[58]

Despite the statutory trend and disgorgement's growing importance for the SEC, some commentators had begun to call the remedy's equitable status (and thus its permissibility under the Exchange Act) into question prior to the passage of the NDAA.[59] The language of the Exchange Act indicated that disgorgement must qualify as both "equitable" and "for the benefit of investors."[60] Seemingly at odds with this explicit limit were the actions of courts—who frequently applied disgorgement in ways that arguably rendered the remedy an impermissible penalty.[61]

C. The Remedial Status of Disgorgement

The SEC has explicit statutory authority to seek civil penalties and disgorgement via administrative proceedings.[62] Until 2021, when seeking disgorgement in the civil context, the SEC had relied on 15 U.S.C. § 78u(d)(5), which allowed the SEC to seek, and any federal court to grant, "any equitable relief that may be appropriate or necessary for the benefit of investors."[63] The forthcoming amendment to the Exchange Act falls under its own section, § 78u(d)(7), which is tethered

57. *See, e.g.*, Velikonja, *supra* note 55, at 341 (discussing how the Sarbanes-Oxley Act granted courts the ability to distribute disgorgement proceeds into "fair funds" for investors).

58. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7); *supra* note 36 and accompanying text; *see also Unjust Enrichment*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "unjust enrichment" as "[a] benefit obtained from another, not intended as a gift and not legally justifiable, for which the beneficiary must make restitution or recompense").

59. *See, e.g.*, Ryan, *supra* note 34, at 14 (suggesting that disgorgement's status as an equitable remedy be revisited).

60. 15 U.S.C. § 78u(d)(5).

61. Ryan, *supra* note 34, at 5.

62. 15 U.S.C. § 78u-2.

63. 15 U.S.C. § 78u(d)(5).

instead to "unjust enrichment."[64] Unjust enrichment, however, "developed as . . . an equitable principle," and disgorgement has been bound by notions of equity since its inception in *Texas Gulf Sulfur*.[65] Therefore, while the question as to whether the SEC can seek disgorgement in civil cases has been settled with the coming amendment to the Exchange Act, under what contexts and by what process disgorgement can be applied remain unclear.[66] An important limit to the remedy, then, is the relevant definition of "equitable relief."[67]

In different contexts, the Supreme Court has indicated that a statutory grant of "equitable relief" referred to "those categories of relief . . . *typically* available in equity," which is notably different from a definition grounded in traditional notions of fairness.[68] Put differently, equitable relief is an "unmistakably technical term[ ]."[69] Historically, remedies that qualified as equitable relief were nonputative exercises of injunctions, specific performance, accounting for profits, constructive trusts, and equitable liens.[70] From this list, the remedy most closely related to disgorgement is an accounting for profits. Originally applied in trust law, this remedy required a disloyal trustee to return net profits resulting from a breach of duty to the beneficiary.[71] The important focus for the nonputative (and thus equitable) function of an accounting is returned *profits*,[72] and this distinction in turn reflects the debate over the permissibility of the disgorgement remedy.

While disgorgement seeks to deprive fraudsters of illegal profits, in some cases courts impose disgorgement awards against defendants

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64. 15 U.S.C. § 78u(d)(7); *see also* SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d. Cir. 1971) (granting, for the first time, a disgorgement award for the SEC as a "proper exercise . . . of the district court's equity powers").

65. *The Intellectual History of Unjust Enrichment*, 133 HARV. L. REV. 2077, 2077 (2020); *Tex. Gulf Sulphur Co.*, 446 F.2d at 1308.

66. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7); *supra* note 36 and accompanying text.

67. 15 U.S.C. § 78u(d)(5).

68. Mertens v. Hewitt Assocs., 508 U.S. 248, 256 (1993).

69. *See* Samuel L. Bray, *The Supreme Court and the New Equity*, 68 VAND. L. REV. 997, 1013–14 (2015) (outlining the distinct powers and limitations of equitable remedies).

70. *Id.* at 1052; *see* Brief of Amici Curiae Law Professors in Support of Petitioners at 3, Liu v. SEC, 140 S. Ct. 1936 (2020) (No. 18-1501). Constructive trust and equitable lien, in this context, refer to the granting of title or interest in property that is owned by the plaintiff and that can be traced to funds or property in the defendant's possession. *See* Samuel L. Bray, *The System of Equitable Remedies*, 63 UCLA L. REV. 530, 554–55 (2016) (defining the terms "constructive trust" and "equitable lien").

71. *See* Brief of Amici Curiae Law Professors, *supra* note 70, at 16–17.

72. *Id.*

who neither possess nor have access to such funds.[73] Furthermore, courts have at times held defendants jointly and severally liable and, in doing so, have potentially administered disgorgement awards that exceed the individual's fraudulent profits—both of which result in an arguably penal application.[74] Equally problematic is that disgorged funds have often been diverted to the Treasury rather than returned to defrauded investors—and this practice is seemingly at odds with disgorgement's second requirement that it be applied "for the benefit of investors."[75] These inquiries into the practical application of disgorgement speak to the nature of the remedy and thereby its legitimacy under the Securities and Exchange Acts.[76] As one commentator noted when discussing equitable relief: "[F]ederal statutes that authorize equitable relief are enabling courts to give a particular set of remedies, not just exhorting them to give whatever remedies they think best. The question is how to draw the line between the remedies that are equitable and the ones that are not."[77]

This distinction between equitable remedy and penalty came to a front in *Kokesh v. SEC*.[78] In *Kokesh*, the Supreme Court considered whether disgorgement constituted a penalty or an equitable remedy for the purpose of determining the applicable statute of limitations.[79] The Court began by defining a penalty as a punishment that addresses public—rather than private—harm and that is sought for the purpose of punishment and to deter others from similar action.[80] Applying that standard to the facts of the case, in which Charles Kokesh concealed the misappropriation of $34.9 million from several companies, the Court found disgorgement to be a penalty and thus applied the five-year

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73. *See, e.g.*, SEC v. Whittemore, 659 F.3d 1, 4 (D.C. Cir. 2011) (affirming an order of disgorgement against a defendant who previously transferred all fraudulent proceeds). Disgorgement, correctly applied, differs from restitution in that disgorgement includes only ill-gotten gains, while restitution covers the entirety of losses. *See* John C. Coffee Jr., *'Liu v. SEC': A Decade of Issues*, N.Y. L.J. (July 15, 2020, 11:42 AM) https://www.law.com/newyorklawjournal/2020/07/15/liu-v-sec-a-decade-of-issues [https://perma.cc/Q5C7-AGZV].

74. *See, e.g.*, SEC v. Calvo, 378 F.3d 1211, 1216 (11th Cir. 2004) (holding one member of a "pump and dump" scheme jointly and severally liable for his partners' involvement).

75. *See, e.g.*, SEC v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985) (allowing for disgorged funds that were in excess of claims brought to be diverted to the Treasury); 15 U.S.C. § 78u(d)(5).

76. 15 U.S.C. §§ 77a-77aa; 15 U.S.C. §§ 78a-78qq.

77. Bray, *supra* note 69, at 1014.

78. Kokesh v. SEC, 137 S. Ct. 1635 (2017).

79. *Id.* at 1643; 28 U.S.C. § 2462 (imposing a five-year statute of limitations for "an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise).

80. *Kokesh*, 137 S. Ct. at 1642.

statute of limitations for a penalty assessment.[81] The Court reasoned that, first, courts impose disgorgement in SEC cases as a consequence of violating "public laws," and therefore disgorgement addresses a public harm.[82] Second, because courts impose disgorgement to reclaim funds and thus deter violations, it likewise qualifies as a penalty, especially in light of cases indicating that deterrence is not simply incident to disgorgement but is its primary purpose.[83] Finally, the Court noted that disgorgement serves no compensatory function in many cases.[84] Courts have discretion in determining how and when to distribute funds and have repeatedly remitted them to the Treasury instead of to harmed investors.[85] The Court thus held that while disgorgement can serve compensatory goals, for the purpose of the statute of limitations and "as it is applied in SEC enforcement proceedings, [it] operates as a penalty."[86] As applied to Charles Kokesh, $29.9 million of the sought disgorgement award was unavailable as it resulted from violations outside the applicable five-year statute of limitations.[87]

The fallout of *Kokesh* was uncertain. On its face, the holding was narrow—applying only to the question of the applicable statute of limitations, which, by some measures, barred the SEC from obtaining roughly $1.1 billion in disgorgement awards over the next two years.[88] More importantly for the subject of this Note, the Court expressly disclaimed the applicability of *Kokesh* to the question of whether courts have the authority to order disgorgement—or whether they have applied it properly.[89] The paradoxical result was that the permissibility of disgorgement as an equitable remedy appeared to waver for both court-ordered and administrative proceedings.[90] In June 2020, the Supreme Court revisited the issue in *Liu v. SEC*, when it held that while disgorgement *can* qualify as equitable, in some cases "the SEC's disgorgement remedy . . . is in considerable tension with equity

81. *Id.* at 1645; 28 U.S.C. § 2462.

82. *Kokesh*, 137 S. Ct. at 1643.

83. *Id.*

84. *Id.* at 1644.

85. *Id.*

86. *Id.* at 1645.

87. *Id.* at 1641, 1645.

88. *See* DIV. OF ENF'T, *supra* note 1, at 21. Other commentators were less concerned as to the continuing presence and efficacy of the equitable remedy. *See* Velikonja, *supra* note 11, at 394.

89. *Kokesh*, 137 S. Ct. at 1642 n.3.

90. *See, e.g.*, Butler, *supra* note 1515, at 337–38 (advocating for disgorgement's retention).

practices."[91] The resulting question for courts is how to define the line between equity and penalty in the context of SEC-led disgorgement.[92]

In *Liu*, a husband and wife solicited $27 million from foreign investors through an immigrant investor program.[93] The funds, pledged towards the construction of a cancer-treatment center, ultimately found their way into the pockets of the married pair via "ostensible" marketing costs and salaries.[94] The district court both imposed civil penalties of the highest tier and ordered disgorgement of the full amount raised from investors, minus what remained in corporate accounts—totaling $35 million and roughly $8 million in excess of the fraudulent profits.[95] The Ninth Circuit affirmed, and the Supreme Court granted certiorari to determine whether the statutory authority to grant "any equitable relief that may be appropriate or necessary for the benefit of investors" extended to permit disgorgement in excess of the net profits from wrongdoing.[96] Ultimately, the Court held that while disgorgement may qualify as "equitable relief," the remedy's application may render it an unavailable penalty.[97] The Court reasoned that to remain permissible, a disgorgement award cannot exceed the defendant's net profits and must be awarded for victims.[98] The Court thus vacated the judgment and remanded the case, eschewing arguments in favor of the petitioner without moving to categorically invalidate the remedy as penal.[99]

The Court in *Liu* further noted that the disgorgement awards of lower courts had repeatedly tested the remedy's equitable boundary in three ways: (1) by ordering disgorged funds be deposited into the Treasury (as opposed to returned to investors), (2) by imposing joint-

91. Liu v. SEC, 140 S. Ct. 1936, 1940, 1946 (2020).

92. *See Disgorgement's Role in SEC Enforcement Actions: An Analysis of the Supreme Court's Decision in* Liu v. SEC, CADWALADER: CLIENTS & FRIENDS MEMO 3–5 (June 24, 2020), https://www.cadwalader.com/uploads/cfmemos/24c9c59a273aec82a0e9bf503ec3e38a.pdf [https://perma.cc/DE6W-96SX] (detailing the questions the Court left open in *Liu*).

93. *Liu,* 140 S. Ct. at 1941.

94. *Id.*

95. *Id.* at 1942; SEC v. Liu, 262 F. Supp. 3d 957, 975–76 (C.D. Cal. 2017).

96. *Liu*, 140 S. Ct. at 1942; *see also* 15 U.S.C. § 78u(d)(5).

97. *Liu*, 140 S. Ct. at 1950.

98. *Id.* at 1947–50.

99. *Id.* at 1946, 1950; *see also* Brief of Securities Law Professors as Amici Curiae in Support of Respondent at 1–3, 11, Liu v. SEC, 140 S. Ct. 1936 (2020) (No. 18-1501). While opponents argued that disgorgement was an entirely impermissible penalty, proponents argued convincingly that this problem was not sufficient to overturn decades of precedent, particularly in light of legislative history indicating that Congress intended the SEC to possess the remedy. The idea that prohibiting disgorgement could allow fraudsters to keep stolen funds, weakening the SEC's enforcement ability and having the unfortunate result of incentivizing fraud, further supported continuing the remedy. Brief of Securities Law Professors, *supra*, at 1–3, 11.

and-several liability among defendants, and (3) by declining to deduct even legitimate business expenses from the disgorgement award.[100] Rather than specify new limits that would answer the question of *when* disgorgement is permissible, the Court provided guiding principles for lower courts to apply.[101] The profits-based disgorgement remedy must "do more than . . . depriv[e] a wrongdoer of ill-gotten gains" to satisfy the requirement of benefitting investors.[102] The prospect of joint-and-several liability should turn on whether the individual is being held accountable for profits accrued to themselves.[103] And finally, courts must deduct legitimate business expenses from a disgorgement award to better reflect the "gains" made upon fraud.[104] The resulting question is how to draw practical limits on equitable, compensatory, and thus permissible disgorgement.[105]

II. ANALYSIS: *LIU*'S THREE-PART PROBLEM

After *Liu*, disgorgement remains but stands on unsound footing.[106] With the coming amendment to the Exchange Act, the SEC will have the explicit authority to continue seeking the remedy.[107] Under some circumstances, however, its application has exceeded its equitable limits.[108] Moving forward, defendants will likely argue that, as applied, the remedy operates as a penalty—impermissible under the Securities and Exchange Acts.[109] Therefore, whether and when disgorgement is enforceable will turn on the three questions left open in *Liu*.[110] The first pertains to the placement of disgorged funds, the second considers the theory of joint liability, and the third evaluates the deductions required for an accurate portrayal of profits.[111]

100. *Liu*, 140 S. Ct. at 1947.

101. *Id.*

102. *Id.* at 1948.

103. *Id.*

104. *Id.* at 1949–50.

105. *Id.*

106. *See supra* notes 100–105 and accompanying text.

107. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7); *supra* note 36 and accompanying text (discussing the coming amendment to the Exchange Act).

108. *See Liu*, 140 S. Ct. at 1946 (discussing circumstances under which "[t]he SEC's disgorgement remedy . . . is in considerable tension with equity practices").

109. *Id.* at 1950.

110. *Id.* at 1947.

111. *Id.*

A. The Placement Problem

The first question left unanswered by the Court in *Liu* was when, if ever, disbursing disgorged funds to the Treasury is permissible.[112] The practice has become a common one in recent years, with lower courts applying various approaches.[113] In some cases, courts have turned to the question of practicability, and in others, courts provide investors the opportunity to reclaim funds—so long as they act in a timely manner to do so—before remitting funds to the Treasury.[114] The apparent problem is that the rationales employed when placing funds with the Treasury may not always comply with the boundaries set forth in *Liu*.[115]

For example, in *SEC v. Blavin*, the SEC brought suit against an individual for recommending securities through a widely distributed newsletter representing an unincorporated, unregistered investment advisory service.[116] The individual held a stake in several of the advertised companies, resulting in fraudulent profits that the court ordered be disgorged.[117] When it came to placing the funds, the court required notice be sent to subscribers of the newsletter so that they could submit individual claims for trading losses related to the undisclosed interests of the defendant.[118] If the disgorgement fund exceeded the individual claims made, the remainder would revert to the Treasury.[119]

In *SEC v. Grossman*, the court focused on practicability as opposed to the number of volitional claims.[120] In *Grossman*, a defendant misappropriated material, nonpublic information from his employer and then tipped the information to the remaining defendants.[121] The result was a civil action for insider trading.[122] Importantly, while the case was filed in 1987, final judgment against all defendants did not conclude until 1999, and the disgorgement award remained unsettled

112. *Id.* at 1948.

113. As a telling example, the SEC secured $4.3 billion in disgorgement awards but returned only $1.2 billion of this amount to harmed investors in 2019. *See* DIV. OF ENF'T, *supra* note 1, at 9.

114. SEC v. Grossman, No. 87 Civ. 1031, 2003 WL 133237, at *1 (S.D.N.Y. Jan. 13, 2003); SEC v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985).

115. *See Liu*, 140 S. Ct. at 1946.

116. *Blavin*, 760 F.2d at 708.

117. *Id.* at 711.

118. *Id.* at 710.

119. *Id.*

120. SEC v. Grossman, No. 87 Civ. 1031, 2003 WL 133237, at *4–7 (S.D.N.Y. Jan. 13, 2003).

121. *Id.* at *1.

122. *Id.*

until 2003.[123] When confronting the placement issue, the court held that because the violation occurred fifteen years prior, the impracticability of locating victims warranted remittance to the Treasury.[124] The idea that the primary purpose of disgorgement is to prevent unjust enrichment, rather than to compensate investors, was central to the court's reasoning.[125] The court noted that while the equitable result is compensating investors, "such a distribution is not required by statute and, where distribution to victims of securities fraud is impractical, courts have permitted payment of disgorged funds to the Treasury."[126]

Grossman and *Blavin* provide two rationales for allowing the Treasury to claim disgorged funds as opposed to the victims: in one case allowing for the remittance of unclaimed funds and, in the other, placing funds when locating investors is impractical.[127] These rationales differ in that the first requires victims to actively claim their award, and the second allows victims to passively collect to the extent that they can be located—thus putting the burden of "impracticability" on the defendant; they similarly, however, require failed investor relief before remitting funds to the Treasury.[128] While these approaches seem inherently fair in that they make an attempt to compensate investors for their losses, it is not certain whether either satisfies the Court's directives.[129] In *Liu*, the lower court did not enter a specific order to remit the funds to the Treasury, and so the Court limited its discussion on the issue.[130] The guidance it did provide suggested that the permissibility of the practice turns on whether the practice inherently conflicts with the "equitable nature of the profits remedy," which "*generally requires* the SEC to return a defendant's gains to wronged investors for their benefit."[131]

123. *Id.* at *5.

124. *Id.* at *6–7.

125. *Id.*

126. *Id.* at *6; *see also* SEC v. Lorin, 869 F. Supp. 1117, 1129 (S.D.N.Y. 1994) (indicating that a deposit into the Treasury is permissible where per-investor awards were small, identifying consumers was difficult, or there are no victims entitled to damages).

127. *Grossman*, 2003 WL 133237, at *6; SEC v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985).

128. *Grossman*, 2003 WL 133237, at *6; *Blavin*, 760 F.2d at 710.

129. *See Grossman*, 2003 WL 133237, at *6 (noting that "where distribution to victims of securities fraud is impractical, courts have permitted payment of disgorged funds to the Treasury"); *Blavin*, 760 F.2d at 713 ("The district court's attempt to distribute the disgorged funds to identifiable victims of Blavin's fraud neither affects the district court's authority to confiscate Blavin's wrongful profits, nor provides Blavin with any right to challenge those victims' claims to the disgorgement fund."); Liu v. SEC, 140 S. Ct. 1936, 1948 (2020) ("The equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit.").

130. *Liu*, 140 S. Ct. at 1948.

131. *Id.* (emphasis added).

In his dissenting opinion in *Liu*, Justice Thomas argued wholesale against placing disgorged funds with the Treasury.[132] He reasoned that the funds do not belong to the government, eliminating the need for further discussion.[133] While invariably true, this argument avoids discussing the boundaries of disgorgement, and in cases such as *Grossman* and *Blavin* when funds may remain following attempts at investor relief, the fraudulent party may have the only existing claim to the funds.[134] The Court in *Liu* stressed that no common-law remedy allows for fraudulent profits to be withheld indefinitely from known victims.[135] It further noted that "equity never 'lends its aid to enforce a forfeiture or penalty.' "[136] If investors cannot be found or if they do not act to receive their award, however, there are no victims to compensate. One approach to remittance in such a situation could turn on a broad understanding of what benefits investors. That is, if the broad policing of securities violations is seen to be "for the benefit of investors," then remitting funds to the Treasury regardless of investor compensation is not necessarily at odds with the boundaries of *Liu*.[137] For example, the funds given to the Treasury may be used to pay whistleblowers of securities fraud and fund the activities of the Inspector General—as is permitted by Dodd-Frank.[138] Under these circumstances, depositing disgorged funds into the Treasury may align with the equitable requirements of the remedy and with the Court's focus on benefitting investors.[139]

The Court's emphasis on compensating investors in *Liu*, however, weighs against this application of the remedy.[140] As an example, in *Grossman*, the court indicated that at least some of its rationale for returning funds to the Treasury was grounded in the lack of a statutory directive to return funds to investors.[141] While this lack of statutory directive remains—even within the Exchange Act's amended language—there is now clear instruction from the Supreme Court in *Liu* that such disbursement is not secondary to preventing

132. *See id.* at 1955 (Thomas, J., dissenting).

133. *Id.*

134. *See Grossman*, 2003 WL 133237, at *1; *Blavin*, 760 F.2d at 710.

135. *Liu*, 140 S. Ct. at 1948.

136. *Id.* at 1941 (quoting Marshall v. City of Vicksburg, 82 U.S. 146, 149 (1872)).

137. *See id.* at 1947.

138. Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78u-6(b)(1)-(2).

139. *See id.*; *Liu*, 140 S. Ct. at 1947–49.

140. *See Liu*, 140 S. Ct. at 1947–49.

141. SEC v. Grossman, No. 87 Civ. 1031, 2003 WL 133237, at *6 (S.D.N.Y. Jan. 13, 2003).

unjust enrichment.[142] Rather than provide a mandate, the Court noted that equitable disgorgement "generally requires" funds be returned to investors—and therefore left room for remittance to the Treasury, though provided little guidance as to *when* this should occur.[143] Regardless, *Liu* likely will prevent courts from remitting funds to the Treasury on the rationale that preventing unjust enrichment supersedes investor compensation, or that it at least prevent remittance to the Treasury without at an attempt at locating harmed investors.[144]

The methods employed for locating and compensating investors may also implicate permissible disgorgement by affecting the likelihood of relief.[145] In particular, requiring individual investors to file claims for trading losses—as the court did in *Blavin*—may lead to few, or at least fewer, filings than conceivable alternatives.[146] Similar rationales have been advanced in the class action context when invalidating the requirement that minority shareholders "opt in" to quasi-appraisal suits to recover lost value from short-form mergers.[147] Requiring plaintiffs to opt in to lawsuits would "potentially burden shareholders" because the failure to do so precludes recovery, and a similar approach could reasonably follow here.[148] The Court in *Liu* noted that investor compensation is a primary goal for disgorgement, and accomplishing this would thus seem to require an approach that maximizes the likelihood of putting injured investors on notice.[149] Otherwise, disgorgement can hardly be said to be "for the benefit of investors," as they will lack the best opportunity to claim their benefit.[150]

The Court's focus in *Liu* on disgorgement "for the benefit of investors" presents another challenge in cases where there are no identifiable victims at the outset, particularly in light of the Court's indication that "simply benefit[ting] the public at large by depriving a

142. *See Liu*, 140 S. Ct. at 1948 ("The equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit.").

143. *Id.*

144. *Id.*

145. *See id.* at 1948–49 (noting that "[t]he parties have not identified authorities revealing what traditional equitable principles govern when, for instance, the wrongdoer's profits cannot practically be disbursed to the victims").

146. SEC v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985).

147. *See* Berger v. Pubco Corp., 976 A.2d 132, 145 (Del. 2009) ("[T]he majority stockholder's duty of disclosure provides important protection for minority stockholders being cashed out in a short form merger. This protection—the quasi-appraisal remedy for a violation of that fiduciary disclosure obligation—should not be restricted by opt in or escrow requirements.").

148. *See id.* at 143.

149. *Liu*, 140 S. Ct. at 1947–48.

150. *Id.* at 1948.

wrongdoer of ill-gotten gains" will not suffice.[151] One example of liability without identifiable victims could result from violations of the Foreign Corrupt Practices Act ("FCPA"), which prohibits companies from paying foreign officials in exchange for business.[152] Profits disgorged on account of bribery do not reflect individual trading losses akin to the kind seen in traditional securities fraud; however, the SEC has succeeded in obtaining disgorgement awards in such cases.[153] Whether disgorgement of this kind will survive in the wake of *Liu* is uncertain.[154] On one hand, it could be argued that disgorgement without identifiable victims is inherently at odds with the Court's directive to compensate investors.[155] On the other, one could argue that the general language used by the Court allows for disgorgement even where no harmed investors are identifiable, just as it might allow for when investor relief fails.[156] Permitting disgorgement in FCPA or similar cases, then, would require accepting the idea discussed above that the broad policing of securities fraud satisfies the requirement of benefitting investors and, moreover, that such a practice falls under the umbrella of equitable remedy.[157] If disbursing funds to the Treasury is done with such a preventative purpose, the disbursement could go beyond the Court's limitation on simply depriving fraudsters of their ill-gotten gains.[158] If the disgorged amount is an accurate reflection of *profit*, it may qualify as equitable in a similar manner as the traditional equitable remedy of accounting for profits.[159] The consideration of profit then turns on the remaining questions from *Liu*.[160]

B. The Liability Problem

The second of *Liu*'s unanswered questions relates to the circumstances under which applying joint-and-several liability is

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151. *Id.*

152. *See* Joseph W. Yockey, *Solicitation, Extortion, and the FCPA*, 87 NOTRE DAME. L. REV. 781, 782 (2011).

153. *See, e.g.*, Doshi v. Gen. Cable Corp., 386 F. Supp. 3d 815, 820, 822 (E.D. Ky. 2019) (discussing a FCPA investigation and resulting disgorgement).

154. *See Liu*, 140 S. Ct. at 1948.

155. *Id.*

156. *See id.* at 1948.

157. *See, e.g.*, Doshi, 386 F. Supp. 3d at 820, 822.

158. *Liu*, 140 S. Ct. at 1948.

159. *See id.* at 1950; *see also* Brief of Amici Curiae Law Professors, *supra* note 70, at 16–17 ("Where a defendant has profited by using something that in good conscience belongs to the plaintiff, equity could require an accounting for profits.").

160. *Liu*, 140 S. Ct. at 1947–50.

permissible.[161] Courts have previously wavered on this question, employing rationales that led the Court in *Liu* to indicate that such a practice is, generally, at odds with an equitable result.[162] The common-law rule has traditionally required "individual liability for wrongful profits,"[163] and extending this to multiple parties required evidence of a "concerted wrongdoing."[164] As a result, whether joint-and-several liability functions as an equitable liability scheme turns on whether a party is personally responsible for the relevant fraud—even in the case of multiple actors.

In *SEC v. Whittemore*, for example, a previous relationship between or among defendants was not required to hold the defendants jointly and severally liable.[165] In *Whittemore*, the defendants offloaded a significant number of shares in an energy company at artificially inflated prices via a "pump and dump" scheme.[166] To facilitate the fraud, one of the defendants (who was in the business of telephone broadcasting) received payment to transmit hundreds of thousands of calls touting the prospects of a particular penny stock.[167] The defendant left voicemails under the guise of misdials, and as a result, recipients were often under the mistaken impression of receiving a lucky, valuable stock tip.[168] Increased trading followed, which led in turn to shares tripling in value.[169] The defrauding parties then "dumped" their stock, allowing them to profit on the increased price resulting from the fraudulent broadcast phone calls.[170] On the disgorgement issue, the district court held the members of the scheme jointly and severally liable.[171] It reasoned that because the defendants in question collaborated to further the single fraudulent scheme, they were equally responsible and thus equally liable for the resulting harm.[172] The defendant who paid for the broadcast was then held liable for shares given to the second defendant who transmitted the calls.[173] On appeal,

161. *Id.* at 1949.

162. *Id.*

163. *Id.*; *see also* SEC v. Clark, 915 F.2d 439, 454 (9th Cir. 1990) (holding that a tipper of material information must disgorge his tippees' profits because of their shared responsibility and because disgorgement is a necessary step to deter securities fraud).

164. *Liu*, 140 S. Ct. at 1945.

165. SEC v. Whittemore, 691 F. Supp. 2d 198, 207 (D.D.C. 2010).

166. *Id.* at 201–03.

167. *Id.* at 202.

168. *Id.*

169. *Id.*

170. *Id.* at 203.

171. *Id.* at 207.

172. *Id.*

173. *Id.*

the court rejected the argument that the lack of prior relationship between defendants, other than the scheme in question, precluded such a finding of concerted wrongdoing.[174] The court acknowledged that while such a relationship can contribute to a finding of joint-and-several liability, it is not required.[175] Such a requirement would lead to "absurd results" by precluding joint-and-several liability entirely absent a prior relationship.[176] The court therefore held for a disjunctive view of joint-and-several liability—one that allows either a close relationship or a collaborative effort between parties to suffice.[177]

SEC v. Hughes Capital Corp. presents another example of a court applying joint-and-several liability—in this case, by focusing on the relationship between the defendants and whether the proceeds could be apportioned between them.[178] In *Hughes Capital*, several defendants acquired a company ("Hughes") before taking it public and facilitating a series of press releases touting the good financial shape of proposed Hughes acquisition targets (these target companies were either essentially without revenue or recently emerging from bankruptcy).[179] The value of Hughes shares increased as a result of the misleading press releases and the defendants then profited by offloading shares.[180] The district court ultimately held the defendants jointly and severally liable for the disgorgement of roughly $1.4 million in illegal proceeds generated by the scheme.[181]

On appeal, one of the defendants from *Hughes Capital* challenged the imposition of joint-and-several liability as unfair—arguing, first, that she received just $85,000 of the fraudulent proceeds, and second, that she acted only negligently (as opposed to intentionally) in contributing to the fraudulent scheme.[182] Responding to these arguments, the court noted that joint-and-several liability is "appropriate in securities cases when two or more individuals or entities collaborate or have close relationships in engaging in the illegal conduct"—both of which were satisfied via the single scheme and the defendants' connection through Hughes and its dealings.[183] Citing to

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174. SEC v. Whittemore, 659 F.3d 1, 4 (D.C. Cir. 2011).
175. *Id.* at 11.
176. *Id.*
177. *Id.*
178. 124 F.3d 449, 455 (3d Cir. 1997).
179. *Id.* at 452.
180. *Id.*
181. *See* SEC v. Hughes Cap. Corp., 917 F. Supp. 1080, 1089 (D.N.J. 1996).
182. *Hughes Cap. Corp.*, 124 F.3d at 455.
183. *Id.*

precedent applying joint-and-several liability in the tortfeasor context, the court then reasoned that joint-and-several liability is appropriate "unless liability is reasonably apportioned."[184] Finding that the challenging defendant failed to establish that liability could be apportioned (she offered only inadmissible photocopies and her own testimony as to her $85,000 share of the profits), and thus that defendants contributed to a single and indivisible harm, the court upheld the imposition of joint-and-several liability against an "at least negligent" defendant.[185]

SEC v. Contorinis provides a final example of joint-and-several liability in the disgorgement context, where the court focused instead on the defendant's *control* of the fraudulent profits.[186] In *Contorinis*, the defendant was given material, nonpublic information regarding the acquisition of the supermarket chain Albertsons.[187] As co-manager of an investment fund, the defendant then used the information to realize over $7 million in profits and similarly avoid $5 million in losses.[188] Although the defendant did not pocket the proceeds himself, as they went to the investment fund, the court nevertheless ordered disgorgement against the defendant for the combined profits and escaped losses.[189] Relying on precedent that allowed courts to hold tippers of material, nonpublic information liable for the gains of their tippees, the court reasoned that the defendant in *Contorinis* committed a more significant offense than that in the precedent tipping case.[190] Because the defendant both obtained the nonpublic information and executed the trade, he exhibited greater control over illegal profits than in a typical tipper-tippee scheme.[191] The court thus held that disgorgement could apply not only to an individual's profits but also to gains channeled to "friends, family, or clients."[192]

The above examples focus on the relationships between parties, whether proceeds can be apportioned, and the extent of control when determining whether to apply joint-and-several liability in the disgorgement context.[193] These approaches have merit in the wake of

184. *Id.*
185. *Id.* at 453, 455–57.
186. 743 F.3d 296, 300–04 (2d Cir. 2014).
187. *Id.* at 299–300.
188. *Id.* at 300.
189. *Id.* at 307.
190. *Id.* at 303.
191. *Id.* at 303–04.
192. *Id.* at 302, 307.
193. *See, e.g.*, *id.*; SEC v. Whittemore, 659 F.3d 1, 4 (D.C. Cir. 2011).

Liu, where the Court indicated that while applying joint-and-several liability can improperly "transform any equitable profits-focused remedy into a penalty," it may remain proper in the case of "partners engaged in concerted wrongdoing."[194] An emphasis on concerted wrongdoing is rooted in common law and ultimately suggests that while holding an individual accountable for the actions of another likely functions as a penalty, requiring that partners be financially responsible for the product of the partnership's combined, fraudulent acts may not be due to the collective ownership of ill-gotten gains.[195] Therefore, while it *may* be permissible to impose joint-and-several liability on fraudulent partners, the inquiry should be fact specific and focus on the respective parties' entitlement to proceeds.

The clear issue with focusing solely on collaboration or defendant relationships in determining whether to impose joint-and-several liability is that it may result in an award at odds with the general common-law rule for "individual liability for wrongful profits."[196] One of the defendants in *Hughes Capital*, for example, participated in a collective scheme and yet was on the hook for substantially more than their individual profits—a result precluded by *Liu*.[197] Imposing joint-and-several liability in the case of a "single and indivisible harm" may similarly miss the mark unless the defendant has claim to the full extent of the collectively earned ill-gotten gains.[198] The court in *Hughes Capital* was likely correct in its dismissal of the argument that a negligent defendant cannot be held jointly and severally liable for disgorgement.[199] If they are liable for a violation of the securities laws, whether a defendant is negligent or knowing in their participation has no impact on their claim to proceeds. Instead, to make use of the above inquiries, as *Liu* suggests, the analysis into defendant collaboration or relationships should be qualified by a defendant's claims to profits—and thus whether such proceeds can be disgorged equitably.[200]

A focus on a defendant's control of fraudulent proceeds may also produce an untenable result after *Liu*.[201] As previously noted, the

194. Liu v. SEC, 140 S. Ct. 1936, 1949 (2020).

195. *Id.*

196. *Id.*; Belknap v. Schild, 161 U.S. 10, 25 (1896) ("The defendants, in any such suit, are therefore liable to account for such profits only as have accrued to themselves . . . .").

197. SEC v. Hughes Cap. Corp., 124 F.3d 449, 455–56 (3d Cir. 1997); *Liu*, 140 S. Ct. at 1946.

198. *See Hughes Cap. Corp.*, 124 F.3d at 455–56.

199. *See id.* at 453, 457.

200. *Liu*, 140 S. Ct. at 1946.

201. *Id.*; SEC v. Contorinis, 743 F.3d 296, 302, 307 (2d Cir. 2014).

defendant in *Contorinis* was held liable for profits not accrued to himself—but to the investment fund he managed—and the court further held that profits channeled to "friends, family, or clients" could be disgorged under joint-and-several lability.[202] Such a holding is at odds with the common-law rule for individual liability and even more at odds with the equitable boundary of disgorgement.[203] Because the defendant in the case had no claim to the proceeds, the resulting liability exceeded the defendant's fraudulent profits and thus effectively rendered the decision a penalty.[204] While there is an argument that the defendant in *Contorinis* was responsible for the fraud and thus should bear its consequences, this departs from the focus on concerted wrongdoing endorsed by *Liu* and from the focus on profits that equitable disgorgement requires.[205]

C. The Deduction Problem

Liu's final limit for equitable disgorgement requires that "legitimate" business expenses be deducted to more accurately reflect the extent of fraudulent profits.[206] Courts have applied a number of approaches when considering deductions, often in a manner that reflects the preventative, deterrent purposes of the securities laws.[207] The Court noted in *Liu*, however, that defendants are entitled to deduct "*all* marginal costs incurred when producing revenues," with the caveat that inequitable deductions—such as those for personal services—may be denied.[208] The ultimate question, as indicated by the Court, is "whether expenses are legitimate or whether they are merely wrongful gains 'under another name.' "[209]

In *SEC v. Nadel*, the defendants provided investment advising services to clients in exchange for a fee which varied with the amount of assets under management.[210] In marketing the investment service, the defendants distributed materials in the form of brochures, quarterly updates, and other types of media to both existing and prospective

202. 743 F.3d at 302.

203. *See Liu*, 140 S. Ct. at 1948.

204. *Contorinis*, 743 F.3d at 307.

205. *See id.*; *Liu*, 140 S. Ct. at 1948.

206. *Liu*, 140 S. Ct. at 1947, 1950.

207. *See* Ellsworth, *supra* note 12, at 647.

208. *Liu*, 140 S. Ct. at 1949–50 (emphasis added) (citing RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 (AM. L. INST. 2011).

209. *Id.* at 1950 (quoting Providence Rubber Co. v. Goodyear, 76 U.S. 788, 803 (1869)).

210. 97 F. Supp. 3d 117, 120 (E.D.N.Y. 2015).

clients.[211] These materials illustrated that the company had over $400 million in investor assets, while the actual number ranged from $50 to $150 million.[212] The court awarded summary judgment to the SEC on account of the misrepresentation.[213] When determining the disgorgement sum, the defendants presented several theories to try to rebut the looming disgorgement award of almost $11 million.[214] First, the defendants reasoned that they were entitled to offset over $2.2 million in principal trading losses because trading *profits* were included, because brokerage commissions earned on those losses were included, and because they had net trading losses in the aggregate.[215] Second, defendants argued that they were entitled to over $2.8 million in deductions for "direct trading costs" in the form of brokerage payments made to third parties when executing trades.[216] They argued, third, that repayments already made to clients for defendants' noncompliance with investment policies should be deducted.[217] Finally, the defendants sought a deduction for payments made to execute "hedging trades" that were separately legal.[218]

With respect to each argument, the court disagreed. The court first reasoned that because each of the seventy-one trades made by the defendants were independently illegal, disgorgement should be applied on a "trade-by-trade" basis—in contrast to application to offenses that only constitute a violation when considered in the aggregate.[219] The defendants' theory for reduction would double-count losses if the excluded, losing trades were used to offset the disgorgement award that excluded those losses to begin with.[220] Further, the earned brokerage commissions were included in the disgorgement sum because they were independently prohibited—regardless of whether the trade resulted in a profit or loss.[221] On the trading costs paid to other brokers, the court noted that these were "ancillary payments" and, in reality, repackaged

211. *Id.*

212. *Id.* The actual value of investor assets fell from $147.28 million in January 2007 to $54.84 million in January 2010. *Id.*

213. *Id.* at 126.

214. SEC v. Nadel, 206 F. Supp. 3d 782, 783–85 (E.D.N.Y. 2016).

215. *Id.* at 785.

216. *Id.* at 786–87.

217. *Id.*

218. *Id.* at 788. The hedging trades were made to "preserve capital" and were unrelated to the misrepresentations regarding company assets under management. *See* Nadel, 97 F. Supp. 3d at 120.

219. *Nadel*, 206 F. Supp. 3d at 785–86.

220. *Id.*

221. *Id.*

fraudulent gains.[222] The payments were made on account of a profit sharing agreement, which the court characterized as closer to a "general business expense" than a brokerage commission—the latter of which may qualify for a deduction.[223] The court similarly declined to deduct the payments already made for violating client investment policies, as these payments had not been used to recompensate for any "ill-gotten gains."[224] Finally, payments made in order to execute legal trades were not used to offset profits.[225] Because these trades were not part-in-parcel with the fraudulent act, the court did not allow for a deduction as "direct trading costs may offset disgorgement only where they were made to effect a fraudulent transaction."[226]

As another example, in *SEC v. Universal Express, Inc.*, the defendant disseminated false information to investors as part of a scheme to sell 500 million shares of unregistered securities to the public.[227] The illegal trades generated almost $10 million for the defendant, and when faced with an equivalent disgorgement sum, the defendant argued that "profits" should be reduced by the $5.8 million already returned to the company.[228] Otherwise, he argued, the disgorgement award would exceed his profits from the fraud and therefore function as a penalty.[229] The court found the argument "meritless."[230] While other courts had consistently deducted transaction costs that "plainly reduce the wrongdoer's actual profit" from disgorgement awards, such discounts were distinguished from the returned funds in the present case.[231] While direct transaction costs—such as brokerage fees—may have merited deductions, "general business expenses"—such as overhead—did not.[232] The court thus held that because the returned funds could not aptly be characterized as a general business expense and because the subsequent disposal of ill-gotten gains was irrelevant to the disgorgement award, the $5.8 million would not be deducted.[233]

222. *Id.* at 786.
223. *Id.*
224. *Id.* at 787.
225. *Id.*
226. *Id.* at 788.
227. 646 F. Supp. 2d 552, 559–60 (S.D.N.Y. 2009).
228. *Id.* at 564.
229. *Id.*
230. *Id.*
231. *Id.*
232. *Id.* at 564–65.
233. *Id.*

Nadel and *Universal Express* demonstrate attempts by courts to limit deductions to expenses that accrued through the fraudulent act.[234] In *Nadel*, this limitation took shape through the court declining to deduct payments made to other participants in the fraudulent scheme, for alternative settlements, or for direct transaction costs produced by legal trades.[235] The rationale advanced by the court was that while the costs of fraud may be deducted, general business expenses may not be, due to their ancillary nature.[236] The court also distinguished between actions that are fraudulent in the aggregate versus those that are standalone violations.[237] The court in *Universal Express* used similar reasoning when it distinguished direct transaction costs from general business expenses.[238] While this kind of approach feels inherently fair in that it declines to reduce a fraudster's disgorgement by legal, seemingly separate expenses, it struggles to comply with the equitable limits set forth in *Liu*.[239]

The Court in *Liu* made explicit that "gains" should reflect both receipts and payments.[240] Therefore, a wide variety of general business expenses should likely be included in the disgorgement calculation if the calculation is to reflect this more general netting of all costs. Put differently, fraudulent acts often have legal components, as was the case with trading losses and other forgone deductions in *Nadel*.[241] While courts have at times denied "inequitable deductions" where the related expenses were in reality components of the fraud, in cases where legitimate revenues exist, deductions should follow.[242] *Liu* noted that payments to vendors and innocent third-party employees could be "legitimate" and, conversely, gave examples of extraordinary salaries and offsetting personal and living expenses as repackaged fraudulent profits that are ineligible for deduction.[243] Recognizing more legitimate expenses as available for deduction would result in a disgorgement

234. *Id.* at 559; SEC v. Nadel, 206 F. Supp. 3d 782, 788 (E.D.N.Y. 2016).

235. *Nadel*, 206 F. Supp. 3d at 786–88.

236. *Id.* at 786–87.

237. *Id.* at 788.

238. *Universal Express, Inc.*, 646 F. Supp. 2d at 564.

239. *See id.*; Liu v. SEC, 140 S. Ct. 1936, 1950 (2020) (Prior to declining to deduct a defendant's business expenses, the court should "ascertain[ ] whether [the] expenses are legitimate or whether they are merely wrongful gains 'under another name' " in order to "ensure that any disgorgement award falls within the limits of equity practice while preventing defendants from profiting from their own wrong.").

240. *Id.*

241. *Nadel*, 206 F. Supp. 3d at 785.

242. *Universal Express, Inc.*, 646 F. Supp. 2d at 564; *Liu*, 140 S. Ct. at 1950.

243. *Liu*, 140 S. Ct. at 1945–46, 1950.

award that more accurately reflects fraudulent profits and would therefore produce a more equitable result.[244]

An alternative argument could be made that denying deductions for general business expenses remains in accord with traditional equitable principles. If courts can separate fraudulent and legitimate business, then the costs of each could likely be apportioned. Disgorgement seeks to deny fraudulent profits, and so the legitimate aspects of the business could reasonably be excluded from such illegal proceeds.[245] Doing so would certainly benefit investors.[246] Denying deductions for general business expenses would ultimately lead to heightened disgorgement awards, thereby increasing the cost of fraud and acting as a stronger disincentive against violating securities laws. Where an argument for fewer deductions stalls, however, is in finding an equitable foothold. If a defendant has legitimate expenses, his ultimate profits will reflect those payments, regardless of whether profits are fraudulent or legal. In *Universal Express*,[247] then, the $5.8 million the defendant returned to the defrauded party should likely have been deducted from the ordered disgorgement. In sum, because disgorgement is bound by its equitable limits and the language of *Liu*, courts likely will need to deduct more ordinary costs and other expenses moving forward, including the subsequent disposal of such funds—so long as these ordinary expenses and disposals are not simply fraudulent gains in another form.[248]

D. The Future of Disgorgement

The upcoming amendment to the Exchange Act adds further uncertainty to the future of disgorgement.[249] While SEC-led disgorgement has, since its inception in *Texas Gulf Sulphur*, found authority as an equitable remedy, questions likely will arise as to the future applicability of this equitable limit.[250] The pending amendment

244. *Id.* at 1950.

245. *See Liu*, 140 S. Ct. at 1949–50 ("Courts may not enter disgorgement awards that exceed the gains 'made upon any business or investment, when both the receipts and payments are taken into the account.' Accordingly, courts must deduct legitimate expenses before ordering disgorgement . . . ." (citations omitted)).

246. *See id.* at 1947–48 (discussing the extent to which disgorgement must benefit investors as required by § 78u(d)(5)).

247. *See Universal Express, Inc.*, 646 F. Supp. 2d at 564.

248. *See Liu*, 140 S. Ct. at 1949–50.

249. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7); *see also supra* note 36 and accompanying text (discussing the coming amendment to the Exchange Act).

250. SEC v. Texas Gulf Sulfur Co., 312 F. Supp. 77, 91–93 (S.D.N.Y. 1970).

falls under a new section in the Exchange Act and is tethered to the concept of unjust enrichment—distinct from § 78u(d)(5), which grants the SEC the right to seek equitable relief "for the benefit of investors."[251] Moving forward, the SEC will be free to argue that Congress has redefined the remedy to allow for an imposition of disgorgement that exceeds the boundaries of *Liu*.[252]

Alternatively, and perhaps more likely, disgorgement may continue to be bound by *Liu*. In amending the Exchange Act, Congress chose to permit the SEC to seek "unjust enrichment,"[253] a principle that has been "predominately categorized as 'equitable'" since the combination of law and equity.[254] Further support for maintaining *Liu*'s limits comes from the full extent of the amendment, which explicitly overruled the *Kokesh* decision by implementing a ten-year statute of limitations for many disgorgement actions—notably different from the five-year limit applied to a penalty assessment.[255] Absent from the amendment is an equivalent action to overturn the decision in *Liu*.[256] Instead, disgorgement has long been advanced as an exercise of equitable relief, and it can thus be argued that without an explicit reversal of this precedent, the practice should and will continue.

A final approach that has not been mentioned is looking elsewhere in the law. As previously noted, the SEC's enforcement toolkit is not restricted to pursuing disgorgement.[257] In particular, the SEC could use civil penalties—which often coincide with disgorgement awards—to fill the gap left by a weakened disgorgement remedy.[258] The independent restrictions on these penalties, however, are problematic if the goal is deterrence.[259] In the administrative context, judges are not permitted to calculate penalties based on pecuniary gains and instead are limited to predetermined penalties depending on the "tier" of offense and to whether an individual or entity is liable.[260] While these penalties can be applied to *each* act or omission violating the securities laws and

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251. 15 U.S.C. § 78u(d)(5), (7).

252. *See Liu*, 140 S. Ct. at 1940.

253. *See* 15 U.S.C. § 78u(d)(7); *supra* note 36 and accompanying text (discussing the coming amendment to the Exchange Act).

254. *See The Intellectual History of Unjust Enrichment*, *supra* note 65 (discussing the development of unjust enrichment in American and English law).

255. *See* 15 U.S.C. § 78u(d)(7); *supra* note 36;; *Liu*, 140 S. Ct. at 1941, 1950.

256. *See* 15 U.S.C. § 78u(d)(7); *Liu*, 140 S. Ct. at 1950.

257. *See supra* note 35 and accompanying text (listing alternative SEC enforcement remedies).

258. *See, e.g.*, SEC v. Nadel, 206 F. Supp. 3d 782, 785 (E.D.N.Y. 2016) (imposing both civil penalties and disgorgement against a fraudulent party).

259. *See, e.g.*, Eisenberg, *supra* note 55 (discussing tiers of civil penalties for administrative proceedings).

260. *Id.*

can therefore be substantial in the event that many investors are harmed, they are less useful in cases involving a limited number of harmed investors or a single fraudulent act.[261] Further, the type of offense can limit the possible penalty in the civil context. Insider trading actions, for example, allow the SEC to seek up to treble damages, which could help offset a lesser disgorgement award; treble damages, however, are not available for every manner of securities law violation.[262] Therefore, whether a civil penalty could fully offset a disgorgement award would turn on the context of the predicate violation, resulting in an unreliable enforcement mechanism and a lack of flexibility for plaintiffs. Instead, effectively deterring securities laws violations requires a functioning disgorgement remedy, and the question that remains is how to preserve disgorgement within the bounds of equity as described in *Liu*.[263]

III. SOLUTION: EQUITABLE DISGORGEMENT FOR THE BENEFIT OF INVESTORS

As the Court made clear in *Liu*, depositing disgorged funds with the Treasury, imposing joint-and-several liability, and denying deductions from disgorgement awards *can* amount to an exercise of equitable relief.[264] Whether a disgorgement award crosses the line between equitable remedy and penalty will ultimately depend on its application to the particular case.

A. A Purposeful Focus on Investor Relief

Whether disgorgement complies with the directives of *Liu* depends on disgorgement's application and the use of its resulting proceeds. While some commentators have taken issue with the ownership of disgorged funds,[265] where the proceeds of fraud should *not* remain is in the hands of the fraudster.[266] Therefore, while disgorged funds must go *somewhere*, whether courts remit those funds to the Treasury should turn on the application of a two-step process that looks

261. *See id.*

262. *See* Jerry Edward Farmer, Note, *The Role of Treble Damages in Legislative and Judicial Attempts to Deter Insider Trading*, 41 WASH. & LEE L. REV. 1069, 1071 (1984) (discussing the Insider Trading Sanctions Act).

263. Liu v. SEC, 140 S. Ct. 1936, 1950 (2020).

264. *Id.* at 1947.

265. *See id.* at 1955 (Thomas, J., dissenting) ("Finally, the award should be used to compensate victims, not to enrich the Government.").

266. *See id.* at 1948.

first to compensate investors and second to direct the use of funds. In doing so, the remedy can fall safely within the confines of *Liu* and equity.[267]

The Court in *Liu* expressed that "[t]he equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors."[268] Therefore, because investor compensation is central to the remedy, the first step in placing disgorged funds must be an attempt to compensate victims—and should likewise require significant efforts.[269] More specifically, courts should put the burden on the defendant to identify and compensate their defrauded victims, in contrast to the approach from *Blavin*—where investors were compensated only if they made volitional claims to be reimbursed.[270] This first step will maximize the chances of investor relief so long as the defendant is held accountable for good faith efforts at returning funds. As defendants were once in the position to harm these investors, it also follows that, in many cases, they may be best positioned to locate and compensate investors—as was the case in *Blavin*, where the defendant mailed out newsletters to the individual victims in order to perpetrate the fraudulent scheme.[271]

This method will not, however, uniformly produce a satisfactory result. In *Grossman*, for example, fifteen years had passed since the relevant fraud, and in FCPA violations there may not be identifiable victims.[272] While investor compensation should come first, in the case where locating and compensating investors is impracticable or impossible, courts should allow for remittance to the Treasury to avoid the problematic alternative of leaving proceeds in the hands of the fraudster. Using impracticability or impossibility as a predicate to disbursement to the Treasury allows for a flexible approach that can best serve the interests of harmed investors. While the court in *Grossman* decided that the length of time rendered compensation impracticable, situations could arise in which investor lists remain accessible, and compensating investors for fraudulent losses suffered many years earlier proves no more difficult than compensating victims of more recent offenses.[273] Courts should consider timing, the number

267. *See id.* at 1950.

268. *Id.* at 1948.

269. *See id.*

270. SEC v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985).

271. *Id.* at 708.

272. SEC v. Grossman, No. 87 Civ. 1031 (SWK), 2003 WL 133237, at *1 (S.D.N.Y. Jan. 13, 2003); Doshi v. Gen. Cable Corp., 386 F. Supp. 3d 815, 820, 822 (E.D. Ky. 2019).

273. *See Grossman*, 2003 WL 133237, at *6.

of investors, and the general accessibility of those investors when determining whether to disgorge funds to the Treasury—all with a significant emphasis on compensating investors. When locating investors is impossible, or unreasonably difficult or costly for the defendant, only then should courts deposit funds with the Treasury.

The second step, only necessary when disbursement to the Treasury is warranted, is for courts to direct the use of disgorged funds.[274] Dodd-Frank allows, for example, the use of disgorged funds to pay whistleblowers and fund the activities of the Inspector General.[275] So long as funds disgorged and deposited with the Treasury are applied to programs deterring or ameliorating securities fraud, it should be seen to qualify as "for the benefit of investors"—as the alternative of prohibiting disbursement to the Treasury would greatly reduce disgorgement sums when investors cannot be located and perhaps would incentivize fraud in such circumstances.[276] By directing the use of disgorged funds, the remedy would go beyond "simply . . . depriving a wrongdoer of ill-gotten gains" and thus would comply with the directives of *Liu*.[277]

The downside to the two-step approach outlined above results from the burden put on defendants and courts for investor relief. In some cases, the determination will be difficult and perhaps costly. Regardless, the Court in *Liu* made clear that investor compensation comes first, and this approach reflects that stated purpose, along with its inherent drawbacks.[278] A second criticism likely will be that the approach advanced in this Note is overly protective of the disgorgement remedy. Some commentators have opposed disgorgement in cases without investor harm;[279] and, as mentioned above, disgorgement is not the only option for SEC enforcement.[280] Absent legislation amplifying the availability of civil penalties, however, maintaining disgorgement is the most practical method of deterring securities fraud as the

274. Liu v. SEC, 140 S. Ct. 1936, 1948–49 (2020).

275. Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78u-6(b)(1)–(2).

276. *See Liu*, 140 S. Ct. at 1948–49.

277. *See id.* at 1948.

278. *See id.* at 1947.

279. *See id.* at 1955 (Thomas, J., dissenting) (arguing wholesale against the practice of returning disgorged funds to the Treasury); *see also* SEC v. Teo, 746 F.3d 90, 102, 104 (3d Cir. 2014) (comparing the theoretical distinctions between private suits and SEC enforcement actions).

280. *See, e.g.*, Eisenberg, *supra* note 55 and accompanying text (discussing civil monetary penalties).

alternatives are inflexible and are limited in cases where few defendants are harmed.[281]

B. Emphasizing Individual Liability

The common-law rule for imposing joint-and-several liability requires "individual liability for wrongful profits."[282] The Court in *Liu* reinforced the application of this principle to SEC disgorgement proceedings, and in doing so made clear that, generally, joint-and-several liability should not apply.[283] Courts may, however, hold partners liable for the product of their concerted efforts to the extent that the theory of liability maintains an equitable foothold.[284] Therefore, when courts are considering an application of joint-and-several liability, they should apply a conjunctive analysis that looks first to whether the defendants engaged in a concerted effort and second to whether defendants have claim to the requisite funds. This focus would allow disgorgement to comply with the Court's guidance regarding the profit-focused requirement for an equitable imposition of joint-and-several liability.[285]

As mentioned, the takeaway from the process suggested here is that courts should generally be wary of applying joint-and-several liability in the disgorgement context. The court in *Whittemore* allowed for such liability in the case of either a close relationship between parties or a collaborative effort.[286] While this approach is partially supported by *Liu*, it is not a foolproof approach for identifying whether profits were actually accrued to the defendant.[287] Conversely, the court in *Hughes Capital* declined to require a prior relationship for the imposition of joint-and-several liability.[288] This approach is likewise permissible under *Liu*, within limits.[289] Close relationships and collaborative efforts are two factors that courts may turn to when determining whether a violation was the product of a concerted effort, but such a finding will need to be made on a case-by-case basis with strict adherence to the principle of individual liability. Therefore, while

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281. *See id.* (discussing limitations of civil monetary penalties in SEC enforcement).
282. *Liu*, 140 S. Ct. at 1949.
283. *Id.*
284. *Id.* at 1945.
285. *See id.*
286. SEC v. Whittemore, 659 F.3d 1, 11 (D.C. Cir. 2011).
287. *See id.*; *Liu*, 140 S. Ct. at 1949.
288. SEC v. Hughes Cap. Corp., 124 F.3d 449, 455 (3d Cir. 1997).
289. *See id.*; *Liu*, 140 S. Ct. at 1949.

relationships and collaborative efforts provide guidance, courts should make a case-specific determination as to whether the defendant was responsible for the act—for example, through direct participation—and then to whether the defendant has claim to the profits of the wrongdoing. The product of this inquiry will be joint-and-several liability only for individual profits, even in the case of partnerships, and thus will fall safely in line with *Liu*'s boundaries.[290]

Furthermore, joint-and-several liability should not be implemented in future cases analogous to *Contorinis* and *Hughes Capital*.[291] In *Contorinis*, the defendant was held liable for profits accrued to the investment fund he managed and thus he had no individual claim to the relevant funds.[292] He might be liable to the extent that he profited individually from his own ownership in the fund; imposing joint-and-several liability for the full amount, however, effectively rendered disgorgement a penalty, as it exceeded his individual benefit.[293] Similarly, in *Hughes Capital*, the defendant benefitted only marginally from the collective scheme in question and was held liable for significantly more than her own fraudulent profits, in part on account of the "single and indivisible" nature of the fraud.[294] Defendants such as the ones in *Contorinis* and *Hughes Capital* cannot be held jointly and severally liable in excess of their own profits if the disgorgement remedy is to remain equitable.[295]

The apparent advantage to this approach is that disgorgement will avoid functioning as a penalty. It will, however, inevitably result in fewer disgorgement awards moving forward. A case analogous to *Contorinis* will no longer have the full extent of fraud disgorged—at least not disgorged from the single defendant.[296] Despite this fallout, the result is necessary to prevent the imposition of liability in excess of a defendant's individual profits. A potential related problem is that this structure could provide a loophole for securities fraud. As long as you

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290. *See Liu*, 140 S. Ct. at 1949.

291. *See* SEC v. Contorinis, 743 F.3d 296, 307 (2d Cir. 2014) (permitting disgorgement from the violator for funds procured for a third party, even when the violator never controlled the funds); *Hughes Cap. Corp.*, 124 F.3d at 455 (reasoning that it is appropriate to hold individuals who collaborate in illegal conduct jointly and severally liable for the full amount of the damage).

292. *See Contorinis*, 743 F.3d at 307 (reasoning that there was nothing inequitable in requiring defendant to return illegal benefits that he never directly possessed).

293. *See id.*

294. *Hughes Cap. Corp.*, 124 F.3d at 455–56.

295. *See id.* (rejecting an argument by defendant that she would have to pay more than their actual profits); *see Contorinis*, 743 F.3d at 307.

296. *See Contorinis*, 743 F.3d at 307 (reasoning that the full extent of the fraud could be disgorged from a single defendant on equitable grounds).

commit fraud for *someone else*, the profits will not be disgorged. While this is a clear weakness of the approach advocated for in this Note, considering the limits of *Liu* and the effects of the alternative, this weakness is necessary. Additionally, and perhaps lessening the effect of such a gap, disgorgement is not the only tool the SEC possesses. The SEC can still seek monetary damages against defendants, among other options.[297] While these options may not provide a suitable replacement for the disgorgement remedy, in cases where disgorgement awards are limited, they will continue to provide an additional level of deterrence.

C. Expanding Legitimate Deductions

Finally, courts should rethink their approaches to valuing disgorgement awards. As a profits-based remedy, the ultimate amount disgorged cannot exceed the profits accrued to the fraudulent party. The Court in *Liu* established that this process includes the deduction of legitimate business expenses, and the result is that courts should no longer attempt to separate fraudulent expenses from legitimate ones.[298] Instead, the inquiry should be rephrased so that the deductions denied are *only* those functioning as fraudulent profits under a different name. The actions of the defendant following a violation of the securities laws should be relevant to this process, which is at odds with the decisions of lower courts.[299]

To comply with such a limit, courts should generally allow for legitimate deduction of business expenses—such as the deductions denied to the defendants in *Nadel*.[300] There, the court declined to allow deductions for, among other expenses, payments to clients for violating investment policies and ancillary brokerage fees for separately legal trades.[301] In the first instance, the profits made upon fraud were directly impacted by the actions of the defendant and therefore should have been deducted.[302] Similarly, in *Universal Express*, the defendant returned funds to the defrauded company in advance of the disgorgement proceeding.[303] Because the profits accrued to the defendant were directly reduced as a product of the repayment, the

297. *See* Eisenberg, *supra* note 55 and accompanying text (explaining civil fines).

298. Liu v. SEC, 140 S. Ct. 1936, 1949–50 (2020).

299. *See, e.g.*, SEC v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009) (characterizing how defendant chose to use gains from the violation as immaterial).

300. SEC v. Nadel, 206 F. Supp. 3d 782, 786 (E.D.N.Y. 2016).

301. *Id.* at 788.

302. *Id.*

303. *Universal Express*, 646 F. Supp. 2d at 564.

amount should have been deducted from the resulting disgorgement award to comply with an equitable result.[304] Without this deduction, the defendant would effectively be double paying for the violation and thus be impermissibly penalized.

It is important to note that while the subsequent disposal of fraudulent profits can merit a deduction, that will not always result. If the profits are disposed of in a manner that fails to address the predicate violation, the deduction should be denied. For instance, exorbitant salaries, living expenses, loan repayments, and other uses that directly benefit the defendant will not give rise to a deduction under the above framework. This change in thinking will, as a result, paint a more accurate picture of the profits made upon fraud and similarly conform with *Liu*.[305]

While the above approach reflects a more expansive understanding of "net profits" from securities fraud, the apparent drawback is that defendants who wish to avoid the imposition of disgorgement can simply return the money. This, however, is not an undesirable result. Defendants *should* be incentivized to return disgorged profits and allowing for expanded deductions serves this purpose. Disgorgement is an equitable remedy—and continuing to function as such requires deductions beyond what has become customary for courts. While the result may seem unsatisfying, it is again important to note that the SEC can seek, and courts are free to impose, monetary penalties on defendants in such cases, within limits. Disgorgement is simply the incorrect tool to seek those monetary penalties.[306]

D. The Future of § 78u(d)(7)

A final consideration for the future of disgorgement concerns the forthcoming amendment to the Exchange Act.[307] While the SEC will have the opportunity to seek disgorgement that exceeds the boundaries of *Liu*, courts should not accept the invitation. Disgorgement has long been an equitable remedy, and further, the SEC is already free to seek the aforementioned monetary damages. It is unlikely that such a

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304. *Id.*

305. *See* Liu v. SEC, 140 S. Ct. 1936, 1950 (2020) (reasoning that courts should ascertain whether or not expenses are legitimate before denying deductions).

306. *See* BLACK'S LAW DICTIONARY, *supra* note 1 and accompanying text (defining disgorgement as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion").

307. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7)–(8); § 6501(a)(1)(B), (a)(3).

fundamental change was Congress's intent when it amended the Exchange Act, a rationale strengthened by the lack of explicit language overturning *Liu* in the NDAA.[308] Congress *did* explicitly overrule *Kokesh* in the NDAA by extending the statute of limitations for seeking disgorgement to ten years in many cases.[309] Put simply, disgorgement addressing unjust enrichment should continue to be bound by what is equitable and what is for the benefit of investors.[310]

CONCLUSION

In the fallout of *Liu*, the future of the disgorgement remedy stands on unsure footing. At stake is a valuable enforcement mechanism for the SEC, as disgorgement was responsible for a significant portion of the funds reclaimed from securities violations over the past decade. For the remedy to continue, courts will need to apply disgorgement in line with its equitable, statutory roots and within the boundaries set by the Supreme Court in *Liu*.[311] Maintaining an equitable characterization will require courts to take a more measured approach to the common practice of ordering disgorgement—one that allows only for impractical, purposeful disbursement to the Treasury, a focus on individual liability, and an expanded allowance for legitimate deductions.

Cameron K. Hood[*]

308. *See* National Defense Authorization Act, 15 U.S.C. § 78u(d)(7)–(8); § 6501(a)(1)(B), (a)(3); *see also* Kokesh v. SEC, 137 S. Ct. 1635 (2017) (applying the five-year statute of limitations for penalty assessments under 28 U.S.C. § 2462 to disgorgement).

309. *Id.*

310. *See Liu*, 140 S. Ct. at 1947.

311. *Id.* at 1947–50.

* J.D. Candidate, 2022, Vanderbilt University Law School; B.A., 2017, University of Florida. I would like to thank Caylyn Harvey, Erin Embrey, Peter Byrne, and the rest of the *Vanderbilt Law Review* staff for their thoughtful contributions and guidance throughout the process of editing and writing this Note. I would also like to thank my roommates Peyton and Xander, and my girlfriend, Kasondra, for their constant support.