Santa Clara Law Review

Volume 63 | Number 3 Article 4

2024

UNRAVELING THE DISGORGEMENT REGIME

Piras, Alessandro

UNRAVELING THE DISGORGEMENT REGIME

*Alessandro Piras**

Disgorgement is a legal remedy requiring those who gain from illegal or wrongful acts to give up any profits they made as a result of that conduct. The current state of disgorgement is uncertain, marked by rising tension between limitations in recent Supreme Court jurisprudence and newly enacted statutory authority granted to the Securities Exchange Commission (SEC) by Congress. Problems emerging from this regime threaten to render adjudication of disgorgement actions ineffective and inconsistent, potentially damaging the integrity of the financial system and eroding public trust in the markets. A comprehensive legislative framework is needed to fill in the gaps; one that firmly delineates the bounds of the disgorgement remedy and also sheds light on its ambiguities.

This note paints a full picture of the pertinent legal landscape. In doing so, the intricate knots tying the Supreme Court's Liu v. SEC *opinion to the text of 15 U.S.C. § 78u are unraveled and disgorgement's duality as equitable and statutory is revealed. In light of the apparent bifurcation, this note proposes additional legislation on the matter in order for litigation to meaningfully move forward under a single theory in future SEC enforcement actions. Setting aside uncertainty on this topic is necessary as disgorgement awards have made up the largest monetary recovery in recent years. With clearer guidance from this legislative framework, the SEC's time and resources can be more effectively utilized in educating Main Street investors rather than spent on litigation.*

* J.D. Santa Clara University School of Law, 2023. Senior Articles Editor, SANTA CLARA LAW REVIEW, Volume 63. Many thanks to my fellow editors for their camaraderie, to my family for their endless support, and to Amber for her inimitable encouragement.

TABLE OF CONTENTS

I. INTRODUCTION

More Americans are choosing to invest in the stock market than ever before.[1] Whether this choice is for retirement, home purchases, or college education, Americans place their trust

1. *See* Neil Bhutta et al., *Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances*, 106 FED. RES. BULL. 18 (2020), https://www.federalreserve.gov/publications/files/scf20.pdf.

and money in the financial markets.[2] The stock market is made up of several exchanges—such as the New York Stock Exchange and the Nasdaq—"where shares of publicly traded companies are bought, sold, and issued."[3] The Securities and Exchange Commission (SEC) is the executive agency responsible for the regulation and oversight of these exchanges.[4] It can enforce violations of securities law and help protect investors in a number of ways.[5]

One tool at the SEC's disposal which helps it make harmed investors whole is disgorgement.[6] Disgorgement is a legal remedy that requires wrongdoers to forfeit their ill-received benefits resulting from illegal conduct.[7] Traditionally, the SEC has used this remedy liberally, calling into question its fairness to defendants who can be ordered to pay penalties in addition to disgorgement.[8] In a few recent decisions, the Supreme Court has considered the bounds and equity of this remedy, handing down opinions curtailing its use.[9] Congress then created tension on the subject by passing legislation seemingly at odds with the Supreme Court's guidance.[10] Courts have since struggled to reconcile the Supreme Court's precedent with legislative requirements and have reached inconsistent applications when adjudicating SEC enforcement actions.[11]

This note begins with a broad overview to provide context on the topic, laying out (1) the creation of the SEC and the

---

2. *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/what-we-do (last visited Feb. 10, 2023).

3. Evan Tarver, *What Are Some Examples of Financial Markets and Their Roles?*, INVESTOPEDIA (Aug. 13, 2022), https://www.investopedia.com/ask/answers/060515/what-are-some-examples-financial-markets-and-their-roles.asp.

4. *What We Do*, *supra* note 2 ("We monitor the activities of more than 28,000 entities in the securities industry, including investment advisers, broker-dealers, and securities exchanges.").

5. *See* discussion *infra* Section II.A.

6. *See* discussion *infra* Section II.A.

7. *See* JOSHUA T. LOBERT, CONG. RSCH. SERV., LSB10409, LIU V. SEC: THE SUPREME COURT TO CONSIDER WHETHER DISGORGEMENT IS AN EQUITABLE REMEDY IN SEC ENFORCEMENT ACTIONS 1 (2020).

8. *See infra* text accompanying notes 36-44; *see also Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, U.S. SEC. & EXCH. COMM'N (June 21, 2018), https://www.sec.gov/resources-investors/investor-alerts-bulletins/how-victims-securities-law-violations-may-recover-money.

9. *See infra* text accompanying notes 46-55, 70-81.

10. *See* discussion *infra* Section II.C.

11. *See* discussion *infra* Section II.E.

development of the disgorgement remedy,[12] (2) the most recent Supreme Court opinion regarding disgorgement,[13] (3) the subsequent legislative amendments and their application in one appellate court,[14] and (4) a summary of how federal trial courts have been applying the standard.[15] The note then briefly sets out the legal problem—specifically the uncertainty as to whether traditional equitable limitations apply to disgorgement awards—continuing on with a textual and historical analysis while also considering common characteristics of undefined terms.[16] The note then proposes a comprehensive legislative framework to address the problem, considering the impact it may have on policy before providing a brief conclusion.[17]

II. BACKGROUND

A. History of the SEC and the Development of Disgorgement

Before the creation of federal securities laws and the SEC, investors were afforded minimal protections when participating in the financial markets.[18] States attempted to offer investors greater disclosure and transparency in the purchase, sale, and trading of securities through Blue Sky Laws.[19] In theory, these laws would provide investors with a better understanding of the risks involved before making investment decisions.[20] However, in practice these laws lacked enforcement[21] and were ultimately unable to prevent the stock

12. *See* discussion *infra* Section II.A.
13. *See* discussion *infra* Section II.B.
14. *See* discussion *infra* Sections II.C-D.
15. *See* discussion *infra* Section II.E.
16. *See* discussion *infra* Parts III-IV.
17. *See* discussion *infra* Parts V-VI.
18. *See* Andrew Beattie, *The SEC: A Brief History of Regulation*, INVESTOPEDIA (Sept. 23, 2021), https://www.investopedia.com/articles/07/secbeginning.asp ("The level of fraud in the early financials was enough to scare off most of the casual investors . . . there were no laws to prevent issuers from selling a security with unfair terms as long as they informed potential investors about it.").
19. *Id.*
20. *See id.* ("[Blue Sky Laws] are basic disclosure laws that require a company to provide a prospectus in which the promoters (i.e., sellers/issuers) state how much interest they are getting and why.").
21. *Id.* ("Even the validity of the in-state disclosures wasn't thoroughly checked by the state regulators.").

market crash of 1929 which led to the Great Depression.[22] As a response to the economic fallout, Congress passed the Securities Act of 1933[23] and the Securities Exchange Act of 1934[24] in order to restore public confidence in the financial markets.[25]

Moving forward, the regulatory and enforcement responsibilities of the financial markets were tasked to the SEC, a federal agency whose mission is "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[26] Originally this agency's remedies were limited to injunctions barring future violations when prosecuting securities law wrongdoers.[27] Over time, Congress expanded the SEC's remedies, granting it the ability to seek monetary penalties[28] and "any equitable relief that may be appropriate or necessary for the benefit of investors."[29] Currently, the SEC operates with six divisions: corporate finance, trading and markets, examinations, economic and risk analysis, investment management, and enforcement.[30] The division of enforcement now has a broad range of remedies at

22. *Id.*

23. *The Laws That Govern the Securities Industry*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Feb. 10, 2023). The two basic objectives of the Act are "that investors receive financial and other significant information concerning securities being offered for public sale; and [to] prohibit deceit, misrepresentations, and other fraud in the sale of securities." *Id.*

24. *Id.* (this Act creates the SEC, "empower[ing] [the SEC] with broad authority over all aspects of the securities industry.").

25. *The Role of the SEC*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec (last visited Mar. 27, 2023).

26. *About the SEC*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about (last visited Feb. 10, 2023).

27. LOBERT, *supra* note 7, at 1.

28. *See* Jennifer J. Schulp, *Liu v. SEC: Limiting Disgorgement, but by How Much?*, 2019-2020 CATO SUP. CT. REV. 203, 206 (2020). First, "the Insider Trading Sanctions Act of 1984 gave the SEC authority to exact monetary penalties in insider-trading cases" and later, "the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 . . . granted the SEC broad civil penalty authority . . . ." *Id.*

29. *Id.* (quoting the Sarbanes-Oxley Act of 2002 codified at 15 U.S.C. § 78u(d)(5)).

30. *Divisions and Offices*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions.shtml (last visited Feb. 10, 2023).

its disposal in both civil actions and administrative proceedings.[31]

One such remedy available to the SEC is disgorgement, "a remedy that requires securities law violators to give up 'ill-gotten gains,' or gross proceeds, from illegal conduct."[32] Courts have historically awarded this remedy through their inherent equitable authority.[33] This was first done in 1971 in *SEC v. Texas Gulf Sulphur Co.*, where the U.S. Court of Appeals for the Second Circuit determined that "the SEC may seek other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment."[34] Many courts have since followed this approach, granting disgorgement as a relief ancillary to their powers of equity.[35]

Texas Gulf Sulphur formed the foundation for disgorgement as a remedy permissible in equity, but its application has pushed some commentators to suggest otherwise.[36] For example, the SEC has obtained disgorgement awards when prosecuting violators for incorrectly accounting payments.[37] "In practice, [disgorgement awards] are often untethered from the violation in question and exceed the value of illegally obtained profits, leaving a defendant worse off."[38] Commentators note that it may be an exaggeration to consider poor recordkeeping, as opposed to willful bribery, an ill-gotten gain for which defendants must pay.[39] Additionally, other courts have said defendants may be required to pay disgorgement for profits which they no longer have access to, or even those which they never obtained.[40]

---

31. Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 2-3 (2013), https://www.hblr.org//?p=3528 (listing injunctions, administrative cease-and-desist orders, monetary penalties, various forms of bars and suspensions, and disgorgement).

32. LOBERT, *supra* note 7.

33. *See* Schulp, *supra* note 28, at 205; *see also* LOBERT, *supra* note 7, at 2.

34. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

35. *See* Ryan, *supra* note 31, at 3 & nn.14-15 (citing cases which describe disgorgement by its nature as an equitable remedy).

36. *See generally*, Ryan, *supra* note 31.

37. Schulp, *supra* note 28, at 208.

38. *Id.*

39. *Id.*

40. Ryan, *supra* note 31, at 5 n.31.

Notably, the SEC also enjoys many evidentiary and procedural advantages in disgorgement actions which it would lack if disgorgement were found not to be an equitable remedy.[41] The SEC needs to demonstrate only a "reasonable approximation" of ill-gotten gains, at which point the burden shifts to the defendant to demonstrate that the calculation is inaccurate.[42] Defendants also lack the right to a jury trial in disgorgement actions.[43] These are just some of the advantages that make disgorgement a very useful and appealing remedy for the SEC.[44]

In 2019 the SEC obtained $4.349 billion in total monetary relief, $3.248 billion of which was from disgorgement.[45] This trend of large disgorgement awards was threatened when *Kokesh v. SEC*[46] was brought before the Supreme Court. The question presented in *Kokesh* was whether disgorgement can be a penalty subject to the statute of limitations.[47] Justice Sonia Sotomayor delivered the opinion for a unanimous Court, which held that "[d]isgorgement in the securities-enforcement context is a 'penalty' within the meaning of § 2462, and so disgorgement actions must be commenced within five years of the date the claim accrues."[48] The Court reached its holding based on three characteristics of disgorgement.

First, that disgorgement is imposed as a consequence of violating public laws committed against the United States rather than against individuals.[49] Second, that because of its deterrent effects "SEC disgorgement is imposed for punitive purposes."[50] Third, that disgorgement awards often do not

41. Ryan, *supra* note 31 at 4-5.

42. SEC v. Whittemore, 659 F.3d 1, 7 (D.C. Cir. 2011) (quoting SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. 1989)).

43. United States v. Rapower-3, LLC, 294 F. Supp. 3d 1238, 1241 (D. Utah 2018); SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 94-97 (2d Cir. 1978).

44. *See* Ryan, *supra* note 31, at 5 ("Courts have also accepted the SEC's position that a disgorgement order is enforceable through contempt sanctions and is not a debt that triggers the protections normally afforded to judgment debtors under the Federal Debt Collection Procedures Act.") (footnote omitted).

45. U.S. SEC. & EXCH. COMM'N, DIV. OF ENF'T, 2019 ANN. REP. 16 (2019).

46. Kokesh v. SEC, 581 U.S. 455 (2017), *superseded by statute*, National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6501, 134 Stat. 3388, 4626 (2021).

47. *Id.* at 457.

48. *Id.*

49. *Id.* at 463.

50. *Id.*

compensate harmed individuals and are instead sometimes dispersed to the United States Treasury.[51] "When an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty."[52] The Court also recognized that, because disgorgement can exceed the amount of ill-gotten profits, "[it] does not simply restore the status quo; it leaves the defendant worse off."[53] The issue was aptly considered in plain terms here. Logically, if a disgorgement order places a defendant in a worse position than they were before the misconduct occurred, then it should be classified as punitive.

Justice Sotomayor reserved the broader question of whether courts possess authority to order disgorgement in SEC enforcement proceedings, limiting the holding of *Kokesh* to the statute of limitations issue.[54] Ultimately the penalty characteristics of disgorgement discussed in *Kokesh* invited the court to reconsider its reserved question in *Liu v. SEC*.[55]

B. Liu v. Securities and Exchange Commission

Shortly after the decision rendering disgorgement a penalty in *Kokesh*, the Supreme Court squarely considered the question of "whether, and to what extent, the SEC may seek 'disgorgement' in the first instance through its power to award 'equitable relief' under 15 U.S.C. § 78u(d)(5), a power that historically excludes punitive sanctions."[56]

This case involved an enforcement action brought by the SEC against Charles Liu and his wife Xin Wang to recover $27 million solicited from foreign investors through the allegedly

51. *Kokesh*, 581 U.S. at 464-65 ("[D]isgorged profits are paid to the district court, and it is within the court's discretion to determine how and to whom the money will be distributed. . . . Some disgorged funds are paid to victims; other funds are dispersed to the United States Treasury.") (internal quotation marks omitted).

52. *Id.*

53. *Id.* at 466.

54. *Id.* at 461 n.3 ("Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context[.] The sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period.").

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

56. *Id.* at 1940.

fraudulent EB–5 Immigrant Investor Program.[57] In his offer memorandum to private investors, Liu promised to use the bulk of any contributions to build a cancer-treatment center.[58] The SEC's investigation revealed that Liu instead spent $20 million on marketing and salaries, transferring a large portion of the funds to personal accounts and to a company under Wang's control.[59] In addition, the investigation found that "[o]nly a fraction of the funds were put toward a lease, property improvements, and a proton-therapy machine for cancer treatment."[60]

The SEC filed an action against Liu and Wang for violation of the terms of their offering documents and the misappropriation of millions of investor dollars.[61] The District Court found for the SEC and granted an injunction that barred defendants from further participating in the EB-5 Program, imposed high civil penalties, and ordered disgorgement.[62] Defendants argued that the disgorgement calculation "failed to account for their business expenses."[63] On appeal, the Ninth Circuit rejected this argument, citing precedent which reasoned that "it would be 'unjust to permit the defendants to offset . . . the expenses of running the very business they created to defraud . . . investors,'" and ultimately affirmed the District Court's disgorgement remedy.[64] The Supreme Court granted certiorari to directly address "whether § 78u(d)(5) authorizes the SEC to seek disgorgement beyond a defendant's net profits from wrongdoing."[65]

In order to determine whether disgorgement is in fact "equitable relief" under § 78u(d)(5), the Court looked at prominent precedents on equity jurisprudence.[66] From these

57. *Id.* at 1941 ("[The program] permits noncitizens to apply for permanent residence in the United States by investing in approved commercial enterprises that are based on proposals for promoting economic growth.") (internal quotation marks omitted).

58. *Id.*

59. *Id.* at 1941-42.

60. *Liu*, 140 S. Ct. at 1942.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* (quoting SEC v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1113-14 (9th Cir. 2006)).

65. *Liu*, 140 S. Ct. at 1942.

66. *Id.* (citing Mertens v. Hewitt Associates, 508 U.S. 248, 256 (1993); CIGNA Corp. v. Amara, 563 U.S. 421, 439 (2011); Montanile v. Bd. of Trustees of Nat'l

precedents, the Court drew out two major principles: (1) "equity practice long authorized courts to strip wrongdoers of their ill-gotten gains, with scholars and courts using various labels for the remedy" and (2) "to avoid transforming an equitable remedy into a punitive sanction, courts restricted the remedy to an individual wrongdoer's net profits to be awarded for victims."[67] The Court then noted that although Congress incorporated these equity principles into § 78u(d)(5), over the years, actual awards of disgorgement have occasionally pushed the boundaries of equitable relief.[68]

The defendants in *Liu* argued that reversal was required because inequitable practices (such as failure to disburse funds to victims, application via joint-and-several liability, and failure to deduct business expenses)[69] made disgorgement an inappropriate remedy.[70] Instead of negating the defendant's claims, the SEC argued that these allegedly inequitable practices are irrelevant because Congress has provided its tacit support for disgorgement.[71] The Court quickly refuted the SEC's argument by noting that "Congress does not enlarge the breadth of an equitable, profit-based remedy simply by using the term 'disgorgement' in various statutes."[72] Even though disgorgement may be codified by Congress, it remains subject to the typical limitations on equitable remedies as created in common-law.[73]

The Court in *Liu* provided three major principles to guide the lower courts in assessing and awarding disgorgement in SEC actions. First, funds recovered under disgorgement must be returned to investors in order to equitably remedy the wrongdoing.[74] Notably, the Court chose not to decide on the issue of what the SEC must do when it is impossible to disburse the recovered funds.[75] Second, courts cannot use joint-and-

Elevator Indus. Health Benefit Plan, 577 U.S. 136, 142 (2016); Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 217 (2002)).

67. *Id.*
68. *Id.* at 1946.
69. *Id.*
70. *Liu*, 140 S. Ct. at 1946.
71. *Id.*
72. *Id.* at 1947.
73. *Id.*
74. *Id.* at 1948.
75. *Liu*, 140 S. Ct. at 1948-49.

several liability for disgorgement remedies.[76] This practice "transform[s] any equitable profits-focused remedy into a penalty" and is counter to the principle that defendants must be held personally liable for their wrongful accrual and misappropriation of profits.[77] However, the Court noted that there is some flexibility to impose collective liability when defendants have "engaged in concerted wrongdoing."[78] Third, the Court held that "a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under § 78u(d)(5)."[79] Accordingly, legitimate business expenses, including both receipts and payments, must be taken into account.[80] The matter was ultimately remanded to the Ninth Circuit for redetermination of the disgorgement remedy pursuant to these three established requirements.[81]

Justice Thomas authored the dissent in *Liu*, stating "[d]isgorgement can never be awarded under § 78u(d)(5)."[82] Justice Thomas does not view disgorgement as a traditional equitable remedy because it is a twentieth-century invention and was therefore unavailable in the English Courts of Chancery at the time of the founding.[83] Accordingly, he reasons it would not fall under the statute authorizing "equitable relief."[84]

The SEC has certainly felt the impact of the *Liu* decision, as its total awards and disgorgement orders have since declined.[85] In fiscal year 2021, disgorgement orders totaled $2.396 billion, almost one billion less than in 2019.[86] Roughly

76. *Id.* at 1949.
77. *Id.*
78. *Id.* (citing Ambler v. Whipple, 20 Wall. 546, 559 (1874)).
79. *Id.* at 1940.
80. *Liu*, 140 S. Ct. at 1949-50.
81. *Id.* at 1950.
82. *Id.* (Thomas, J., dissenting).
83. *Id.* at 1953. "[T]he settled doctrine of this court is, that the remedies in equity are to be administered . . . according to the practice of courts of equity in [England], as contradistinguished from that of courts of law[.]" *Id.* at 1951 (quoting Boyle v. Zacharie, 31 U.S. 648, 654 (1832)).
84. *Id.* at 1950.
85. *See* U.S. SEC. & EXCH. COMM'N, DIV. OF ENF'T, ADDENDUM TO DIVISION OF ENFORCEMENT PRESS RELEASE FISCAL YEAR 2021 2 (2021).
86. *Id.*; *see also supra* note 45 and accompanying text.

six months after the decision in *Liu*,[87] Congress acted to address some of the issues relating to disgorgement.

C. The National Defense Authorization Act for Fiscal Year 2021

The National Defense Authorization Act for Fiscal Year 2021 (NDAA) came into effect January 1, 2021.[88] Congress overrode a presidential veto, passing legislation which for the first time, provided express statutory authority for the SEC to pursue disgorgement in United States District Courts for violations of the federal securities laws.[89] The NDAA established a five-year statute of limitations period in which the SEC may bring disgorgement claims.[90] It also doubled this limitations period to ten years in instances where violations involve scienter.[91] The limitations period is also tolled for any time in which the defendant is outside the United States.[92]

The legislative amendments contained within the NDAA strengthen the SEC's enforcement power and directly address limitations imposed by the Supreme Court in *Kokesh* and *Liu*.[93] In addition to these expansions, the NDAA also leaves a number of questions open.[94] For example, there is still no congressional guidance on the requirement that disgorged funds be returned to injured investors, thus the problem of what the SEC must do when it cannot identify victims persists.[95] Another question not addressed in the NDAA is that

87. John A. Barker & David R. Callaway, SEC's Disgorgement Authority Expanded Under National Defense Authorization Act for Fiscal Year 2021, GOODWIN (Jan. 12, 2021), https://www.goodwinlaw.com/en/insights/publications/2021/01/01_12-securities-snapshot.

88. *Id.*

89. 15 U.S.C. § 78u(d)(3) ("[T]he Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to—require disgorgement under paragraph (7) of any unjust enrichment by the person who received such unjust enrichment as a result of such violation.").

90. 15 U.S.C. § 78u(d)(8).

91. *Id.*

92. *Id.*

93. Eric P. Christofferson et al., *Congress Expands SEC Enforcement Authority, Broadens Disgorgement Powers and Doubles Statute of Limitations Periods*, DLA PIPER (Jan. 6, 2021), https://www.dlapiper.com/en/us/insights/publications/2021/01/congress-expands-sec-enforcement-authority/.

94. THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 16:18 (2022).

95. *See id.*

of deducting legitimate business expenses.[96] There is also no guidance provided to distinguish joint and several liability from engagement in concerted wrongdoing.[97] Finally, one of the most important considerations presented by the NDAA is whether the statutory authority to seek disgorgement is subject to the limitations outlined in *Liu*, or whether the NDAA serves to obviate the decision.[98]

Courts have since wrestled with these questions and have begun to formulate answers[99] as discussed in further detail below. The Fifth Circuit is among one of these courts, as it was presented with the first SEC disgorgement action on appeal post NDAA and *Liu*, when it decided *SEC v. Blackburn*.[100]

D. Securities and Exchange Commission v. Blackburn

Against the backdrop of disgorgement limitations imposed by the Supreme Court, and Congressional expansion of the SEC's power through the NDAA, the Fifth Circuit took on the responsibility of applying an imprecise and potentially conflicting set of guidelines. At issue in *Blackburn* was a challenge to whether the District Court's disgorgement order was "for the benefit of investors" as required by *Liu*.[101] Circuit Judge Gregg Costa answered this question in the affirmative, upholding the lower court's decision and noting that the disgorgement order in question "easily satisfie[d] *Liu*."[102]

The factual background of this case centers around defendant Ronald Blackburn, founder of Treaty Energy Corporation.[103] Treaty was an oil and gas company which traded on the market as a penny stock.[104] Blackburn exercised

---

96. *Id.*

97. *Id.*

98. *See* Lydia Beyoud, *SEC Racks Disgorgement Win as Questions Linger on Relief Powers*, BLOOMBERG L. (Oct. 15, 2021), https://news.bloomberglaw.com/esg/sec-racks-disgorgement-win-as-questions-linger-on-relief-powers.

99. *See* Deborah Meshulam et al., *Six Months After* Liu*: The SEC and Disgorgement*, DLA PIPER (Jan. 28, 2021), https://www.dlapiper.com/en/us/insights/publications/2021/01/disputes-issue-2/six-months-after-liu/; *see also* discussion *infra* Sections II.D-E.

100. SEC v. Blackburn, 15 F.4th 676 (5th Cir. 2021).

101. *Id.* at 678 (quoting Liu v. SEC, 140 S. Ct. 1936, 1949 (2020)).

102. *Id.* at 682.

103. *Id.* at 678.

104. *Id. See* SEC v. Kahlon, 873 F.3d 500, 502 n.1 (5th Cir. 2017) (explaining that a "penny stock" is one sold over the counter for less than $5/share).

significant control over the company,[105] owning roughly 400 million shares of its stock, which translated to an 86.4% interest in Treaty.[106] Despite enjoying a majority stake, Blackburn remained anonymous on the company's public filings.[107] Blackburn's history may have been the reason for his anonymity; he had previously been involved with a gravel pit company that went bankrupt, paying over $1 million to settle a claim of misappropriating company funds.[108] In addition, Blackburn's criminal history involved four convictions for federal tax felonies.[109]

The SEC filed an action against Blackburn and several of his appointed officers in the United States District Court for the Eastern District of Louisiana.[110] The SEC alleged that: (1) "the defendants failed to register millions of shares they sold, in violation of sections 5(a) and 5(c) of the Securities Act[,]"[111] (2) the defendants "misrepresented the company's drilling results to investors[,]"[112] (3) Treaty officers "deceived investors about Blackburn's role in Treaty[,]"[113] and (4) the defendants failed to accurately list Blackburn by name as an officer, director, or significant employee of Treaty in its Form 10-K public filing.[114]

The District Court granted the SEC's motion for summary judgement in part.[115] In doing so, the Court found that the defendants had sold unregistered securities, misrepresented Treaty's oil production, and failed to accurately disclose

105. *Blackburn*, 15 F.4th at 679 ("Blackburn communicated with a foreign government on behalf of Treaty, paid the company's bills with his stock proceeds, and appointed Treaty's officers and directors.").

106. *Id.* at 678.

107. *Id.* at 679-80.

108. *Id.* at 679.

109. *Id.*

110. *Id.* at 678.

111. *Blackburn*, 15 F.4th at 679.

112. *Id.* at 679 ("In 2012, [defendants] published a press release stating that Treaty had struck oil in Belize. The very next day, Belize's government released a statement categorically refut[ing] Treaty's claims of drilling success and calling the reports false and misleading.") (quotations omitted).

113. *Id.* (discussing an instance where one investor who had previously worked with Blackburn and lost money was lied to in order to obtain an investment in Treaty).

114. *Id.* The form itself may be found at https://www.sec.gov/files/form10-k.pdf.

115. *Id.* at 680.

Blackburn's role in the company.[116] The Court ordered disgorgement of profits in addition to the imposition of civil penalties and other non-monetary remedies.[117] Blackburn appealed the District Court's grant of summary judgment and disgorgement order.[118] He argued that the existence of disputed issues of fact made summary judgment improper and that the disgorgement order was also improper because the SEC failed to show that it would benefit investors as required under *Liu*.[119]

With respect to the disgorgement order, the Court of Appeals reasoned it was in fact awarded for the benefit of investors consistent with *Liu*.[120] In reaching this determination, the Court highlighted two justifications.[121] First, the disgorgement amounts accurately represented the net profits the defendants received from their securities fraud because "the district court . . . individually assessed each defendant's gain."[122] Second, these net profits were being "awarded for victims"[123] per *Liu* because the SEC "has identified the victims and created a process for the return of disgorged funds. Under the district court's supervision, any funds recovered will go to the SEC, acting as a de facto trustee. The SEC will then disburse those funds to victims but only after district court approval."[124] Therefore, in this instance the disgorged funds would return to identified investors.[125] The court further emphasized this point by distinguishing cases involving insider trading which "injure[] the market as a whole

116. *Id.*

117. *Blackburn*, 15 F.4th at 680. The District Court ordered disgorgement separately for Blackburn and his appointed officers: "$1,512,059.96 for Blackburn, $108,291.05 for Mulshine, and $772,434.90 for Gwyn." *Id.* at 682. This choice aided the Appellate Court in dismissing concerns of joint and several liability when it upheld the grant of summary judgment under the *Liu* standard. *See id.*

118. *Id.* at 680.

119. *See* Original Brief of Appellants Ronald L. Blackburn & Michael A. Mulshine at 8-20, SEC v. Blackburn, 15 F.4th 676 (5th Cir. 2021) (No. 20-30464).

120. *Blackburn*, 15 F.4th at 682.

121. *Id.*

122. *Id.* (recognizing and addressing concerns about the legality of joint and several disgorgement awards after *Liu*).

123. Liu v. SEC, 140 S. Ct. 1936, 1942 (2020).

124. *Blackburn*, 15 F.4th at 682.

125. *Id.*

rather than individual market participants . . . ."[126] The Court's distinction suggests that it may be harder to meet *Liu*'s requirements when individually harmed investors are not identified.[127]

However, the Court leaves unanswered two important questions about the application of disgorgement awards in the future. First, when it is infeasible to identify harmed individuals and the disgorged funds are subsequently deposited in the United States Treasury, as was common practice before *Liu*, are they still being properly awarded for the benefit of investors?[128] Second, what distinctions, if any, exist between the disgorgement authorized as equitable relief interpreted in *Liu*, and the subsequently added statutory disgorgement of the NDAA?[129]

A broad overview of disgorgement's application at the district court level will help illuminate its practical boundaries and possibly refine the answers to some of the questions presented above.

E. Disgorgement's Application at the District Court Level

Federal trial courts have been working to properly execute their duties by correctly applying the Supreme Court's holdings in *Liu* in addition to interpreting the effects created by the recent statutory expansions of the NDAA. These courts have begun to tackle difficult questions when presented with SEC disgorgement actions, doing so with minimal guidance on the proper course of action in certain situations.

As an initial matter, district courts have rejected the application of *Liu*'s rationale to limit government claims under

---

126. *Id.*

127. *See id. But see* Elisha Kobre, *The SEC and Disgorgement After Liu*, BLOOMBERG L. (Nov. 4, 2021, 1:00 AM), https://news.bloomberglaw.com/securities-law/the-sec-and-disgorgement-after-liu ("The key takeaway from *Blackburn* and other district court cases is that *Liu*'s 'awarded for victims' requirement will likely not be strictly interpreted to require the SEC to identify specific victims prior to the entry of an order for disgorgement. Instead, courts will allow disgorgement wherever the identification of victims is 'feasible' and will likely enter judgments that leave open the possibility that funds not otherwise returned to investors will be sent to the U.S. Treasury.").

128. *Blackburn*, 15 F.4th at 682.

129. *See Blackburn*, 15 F.4th at 681 n.4 (discussing these two forms of disgorgement and finding the District Court's order sufficient under the equitable relief provision discussed in *Liu*).

statutes other than 15 U.S.C. § 78u.[130] In addition, concerns over the applicability of such limitations to entities other than the SEC—such as the Federal Trade Commission—have been considered and addressed, with courts ruling against applying *Liu* beyond SEC disgorgement actions.[131] The disposition to keep *Liu* limited to § 78u held true even in state court determinations, where instances of disgorgement claims arose under Canadian law.[132]

In other instances, district courts have determined under what circumstances partners engaged in concerted wrongdoing may face a disgorgement order on a joint and several basis.[133] For example, the Southern District of California found that the defendants Blockvest LLC company and its founder had acted jointly to commit securities fraud violations and were therefore subject to a joint and several disgorgement order consistent with *Liu*.[134] Similarly, the Northern District of Georgia found joint and several liability between a company and its president warranted where "[defendant] transferred and used investor money in [company's] accounts for his personal benefit or for purposes that were not disclosed to the investors."[135] Finally, the Northern District of Texas allowed joint and several liability "because the evidence sufficiently shows [the president/CEO/manager] controlled [companies] so as to make them 'partners in the concerted wrongdoing.'"[136]

130. *See* Fed. Trade Comm'n v. Cardiff, No. ED CV18-2104-DMG (PLAx), 2020 WL 3867293, at *5 (C.D. Cal. July 7, 2020) ("*Liu*'s holding is cabined to disgorgement in SEC actions under a distinct provision of the [1934 Exchange] Act . . . .").

131. *See id.*; *see also* Fed. Trade Comm'n v. Noland, No. CV-20-00047-PHX-DWL, 2020 WL 4530459, at *5 (D. Ariz. Aug. 6, 2020) (rejecting the argument that *Liu* precludes the FTC from seeking restitution, pursuing asset freezes, and seeking appointment of a receiver).

132. *See* Meshulam et al., *supra* note 99 (citing Lathigee v. Brit. Columbia Sec. Comm'n, 136 Nev. 670 (2020)).

133. *See id.* (citing SEC v. Blockvest, LLC, No. 18CV2287-GPB(MSB), 2020 WL 7295837 (S.D. Cal. Dec. 10, 2020)).

134. *See id.*

135. SEC v. Craig, No. 1:18-CV-4539-LMM, 2021 WL 6102837, at *8 (N.D. Ga. Nov. 8, 2021).

136. SEC v. Gordon, No. 3:21-CV-1642-B, 2021 WL 5086556, at *10 (N.D. Tex. Nov. 1, 2021).

Courts have also addressed *Liu*'s requirement that a disgorgement order be for the benefit of investors.[137] In one case, the Southern District of New York ensured disgorgement would be used to compensate investors by considering "the detailed and extensive" declaration presented by the SEC on how the disgorged funds would be used.[138] In a different case, the District of Nevada denied the SEC's disgorgement claim finding "the SEC had failed to present sufficient proof that the award was for the benefit of the investors."[139]

Finally, courts have begun to consider when net profits and legitimate business expenses are permissibly deducted prior to a disgorgement order.[140] The Northern District of Illinois rejected a claim to deduct payments made to a company complicit with fraud in the calculation of disgorgement.[141] In comparison, the Central District of California accepted deductions for rent and investor distributions but declined to deduct loan repayments "as those loans were taken out for the purpose of facilitating the fraud on investors."[142] The uncertainty created by the *Liu* opinion and the NDAA is apparent. Legislative action to provide clarity and fill the gaps is therefore necessary to prevent a circuit split, which could result in the matter appearing before the Supreme Court once more.

III. IDENTIFICATION OF THE LEGAL PROBLEM

The discussion above has highlighted several key questions which courts must face when approaching SEC disgorgement claims. Principally, how can courts reconcile the guidelines for disgorgement as an equitable remedy handed down by the Supreme Court in *Liu* with the statutory authority for the SEC to seek disgorgement provided by the NDAA? As

137. *See* SEC v. Rinfret, No. 19-CV-6037 (AJN), 2020 WL 6559411, at *6 (S.D.N.Y. Nov. 9, 2020) ("[T]he SEC has represented that it will use almost the entirety of these funds to compensate [harmed] investors.").

138. *Id.*

139. Meshulam et al., *supra* note 99 (discussing SEC v. Bevil, No. 2:19-CV-0590-RFB-DJA, 2020 WL 7048263, at *2 (D. Nev. Nov. 30, 2020)).

140. *See* SEC v. Slowinksi, No. 1:19-CV-03552, 2020 WL 7027639 (N.D. Ill. Nov. 29, 2020).

141. *Id.* at *4. ("Because fraud permeated the . . . companies, [the defendant] is not entitled to offset their expenses.").

142. SEC v. Griffithe, No. SA CV 20-00124-DOC (JDE), 2021 WL 6551385, at *2 (C.D. Cal. Nov. 18, 2021).

a related matter, under what circumstances should courts find that a disgorgement order is for the benefit of investors and how will this requirement impact the SEC when it is infeasible to compensate harmed individuals? Additionally, how should courts calculate a defendant's net profits and legitimate business expenses? Finally, how should courts draw the line between the general rule against joint and several liability and instances where partners are engaged in concerted wrongdoing?

Lower courts will certainly struggle to reach uniformity in attempting to answer these questions. This is because the practical realities of litigation often involve unique and challenging factual circumstances. Ideally, courts should be able to use both a detailed legislative framework and guidance from the Supreme Court to apply the law consistently. Problems arise where these authorities lack clarity and can be interpreted to conflict. These problems are exacerbated where courts, who are often limited in resources, must step in to make judgments regarding complex high technology sectors such as securities regulation.[143]

IV. ANALYSIS

A. Conflicts Between Equitable and Statutory Disgorgement Awarded for the Benefit of Investors

A significant problem presented by the current legal framework encompassing disgorgement is that there is a duality in 15 U.S.C. § 78u with respect to the SEC's authority to seek that remedy.[144] As discussed above, *Texas Gulf Sulphur* originally developed disgorgement as an equitable remedy in 1971, with Congress later providing statutory authority for the SEC to seek equitable relief under the

143. *Cf.* Jo Ann S. Barefoot, *Disrupting Fintech Law*, 18 FINTECH L. REP. 3, 9 (2015) (explaining that the application of existing laws and regulations to novel developments in the financial industry generates high levels of uncertainty and inconsistency); *see generally Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets*, U.S. SEC. & EXCH. COMM'N (Nov. 26, 1997), https://www.sec.gov/news/studies/techrp97.htm.

144. *Compare* 15 U.S.C. § 78u(d)(5) (authorizing any "equitable relief" appropriate for the benefit of investors), *with* § 78u(d)(3)(A)(ii) (authorizing "disgorgement . . . of any unjust enrichment"), *and* § 78u(d)(7) (authorizing "disgorgement.").

Sarbanes-Oxley Act of 2002.[145] The decision in *Liu* served to limit and realign disgorgement consistently with equitable principles in response to concerns over its punitive applications.[146] However, the subsequent amendments of the NDAA—which provide express statutory authority for disgorgement—have created questions over the applicability of *Liu*'s equitable limitations to future SEC enforcement actions.[147]

1. Textual Analysis of the Disgorgement Statutes

Statutory interpretation begins with the text.[148] The statute at issue in *Liu* provides: "In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any *equitable relief* that may be appropriate or necessary *for the benefit of investors*."[149] With the passage of the NDAA, Congress has provided: "In any action or proceeding brought by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may order, disgorgement."[150] Also through the NDAA, Congress has given jurisdiction to United States District Courts to: "require disgorgement under paragraph (7) of any unjust enrichment by the person who received such unjust enrichment as a result of such violation."[151]

There is a strong argument to be made that disgorgement awards under § 78u(d)(7) need not be returned to harmed investors as discussed in *Liu*. This is because in passing the NDAA, Congress did not include the statutory phrase "for the benefit of investors" which was interpreted as a limitation to disgorgement in *Liu*.[152] "Congress acts intentionally and

145. *See supra* notes 26-32 and accompanying text.

146. *See supra* notes 68-77 and accompanying text.

147. *See supra* notes 90-98 and accompanying text.

148. Republic of Sudan v. Harrison, 139 S. Ct. 1048, 1056 (2019) ("[W]e begin 'where all such inquiries must begin: with the language of the statute itself.'") (citing Caraco Pharmaceutical Laboratories, Ltd. v. Novo Nordisk A/S, 566 U.S. 399, 412 (2012)).

149. 15 U.S.C. § 78u(d)(5) (emphasis added); Liu v. SEC, 140 S. Ct. 1936, 1940 (2020).

150. 15 U.S.C. § 78u(d)(7).

151. 15 U.S.C. § 78u(d)(3)(A)(ii).

152. *See* Brief of Securities and Exchange Commission, Appellee at 47-48, SEC v. Blackburn, 15 F.4th 676 (5th Cir. 2021) (No. 20-30464).

purposely when it includes particular language in one section of a statute but omits it in another . . . and that presumption is even stronger when the omission is made within months of a Supreme Court decision identifying that particular language as a limitation or restriction."[153] The SEC would characterize the statutory phrase "unjust enrichment" in § 78u(d)(3)(A)(ii) as the farthest extent to which Congress was willing to give credence to *Liu*'s interpretation of disgorgement as a remedy designed to prevent wrongdoers from enjoying their ill-gotten gains.[154] Per this reasoning, § 78u(d)(7) should be interpreted as consistent with *Liu* only in the sense that it focuses on depriving wrongdoers of their profits rather than making harmed investors whole.

The counterargument which would serve to include *Liu*'s requirement that disgorged funds be returned to harmed investors under applications of § 78u(d)(7) is also compelling. In essence, because the NDAA specifically referenced the word disgorgement in the statute,[155] as opposed to a different word such as restitution, it must implicate the legal meaning of the word as interpreted in *Liu*. This is because "Congress is presumed to be familiar with the meaning of common legal terms and Supreme Court decisions when it legislates[.]"[156] Thus, the word disgorgement takes its common legal meaning as explained by the Supreme Court and the requirement to return disgorged funds to investors attaches to future SEC enforcement actions.

As previously illustrated, the issue of whether a disgorgement award was for the benefit of investors—and thus requiring a return of funds to victims per *Liu*—was central to the litigation in *Blackburn*.[157] Unfortunately, the factual circumstances in that case did not serve to shed any light on

153. *Id.* at 48 (citations and internal quotation marks omitted).

154. *See id.*

155. 15 U.S.C. § 78u(d)(7).

156. Ike Adams et al., *SEC Disgorgement Authority May Be Limited Even After Recent Amendments to the Exchange Act*, AM. BAR. ASSOC. (Jan. 27, 2021), https://www.americanbar.org/groups/business_law/publications/blt/2021/02/sec-disgorgement-authority/; *accord* Hall v. Hall, 138 S. Ct. 1118, 1128 (2018) ("The Rule contained no definition of "consolidate," so the term presumably carried forward the same meaning we had ascribed to it under the consolidation statute for 125 years, and had just recently reaffirmed in *Johnson*.").

157. *See supra* notes 120-127 and accompanying text.

the SEC's obligations to meet *Liu*'s requirements.[158] In *Blackburn* the disgorgement award was clearly for the benefit of investors because the SEC had already identified harmed individuals, and created a process under the District Court's supervision to return the disgorged funds.[159] However, this conflict will present itself again in future litigation where the SEC has not identified victims or where it chooses to deposit disgorged funds to the United States Treasury.[160] Therefore, courts must be prepared to rule one way or another on whether these funds are in fact for the benefit of investors. A comprehensive legislative framework on the topic is needed to assist courts in reaching a uniform understanding of disgorgement.[161]

Liu's remaining requirements—generally prohibiting joint and several liability and awards in excess of a defendant's net profits— should be understood as consistent with § 78u(d)(7). This is because "'statutory reference[s]' to a remedy grounded in equity 'must, *absent other indication*, be deemed to contain the limitations upon its availability that equity typically imposes.'"[162] In the original argument above, Congress decided to omit a significant statutory phrase which serves as indication to free § 78u(d)(7) from the requirement to return disgorged funds to investors. In this instance, there are no other textual indications to suggest that *Liu*'s guidance on joint and several liability and net profits can be ignored for purposes of applying § 78u(d)(7).[163]

To be sure, *Liu*'s disposition against joint and several liability is supported by the language in § 78u(d)(3)(A)(ii) which bolsters the understanding that disgorgement is measured by the unjust enrichment of "*the person* who received such unjust enrichment as a result of such violation."[164] By clearly identifying and referring to the singular "person" the statute presents an approach that is at odds with the SEC's

158. *See supra* notes 120-127 and accompanying text.
159. *See supra* notes 120-127 and accompanying text.
160. *See* SEC v. Blackburn, 15 F.4th 676, 682 (5th Cir. 2021).
161. *See* discussion *infra* Section V.A.
162. Liu v. SEC, 140 S. Ct. 1936, 1947 (2020) (citing Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 211 n.1 (2002)).
163. *See* discussion *infra* Section IV.A.2. for the significance of legislative history on the analysis.
164. 15 U.S.C. § 78u(d)(3)(A)(ii) (emphasis added).

previous broad practice of seeking joint and several liability.[165] The SEC's obligations with respect to this requirement would seem sufficiently clear. However, in practice there is irregularity in the application of § 78u(d)(7) at the district court level where even after the passage of the NDAA, some courts continue to award joint and several liability citing *Liu*'s exception to the general ban for instances of concerted wrongdoing.[166] This demonstrates that in instances where it would be beneficial, the SEC is choosing to follow *Liu* as a justification to award joint and several liability despite the statute's clear emphasis on the singular nature of the remedy. But in cases where *Liu* does not serve the interest of the SEC, it is being ignored.[167]

2. Legislative History of the NDAA in the Context of Disgorgement

An analysis on the legislative history of the NDAA suggests it was primarily enacted as a response to the Supreme Court's decision in *Kokesh*.[168] This is significant because the legislative intent of these amendments should be considered a reaction to disgorgement being labeled a penalty in *Kokesh* and not as a response to the equitable limitations imposed by *Liu*. As a practical matter, this interpretation strengthens the argument that *Liu* reigns supreme even after the enactment of the NDAA.

Section 6501 is the relevant House of Representatives resolution corresponding to the statutory amendments now codified at 15 U.S.C. § 78u. "Section 6501 was inserted into the Conference Report on the NDAA (H.R.6395) on December

165. The SEC's original approach with respect to joint and several liability was first identified as a factor making disgorgement punitive as opposed to equitable in *Kokesh*. *See* Kokesh v. SEC, 581 U.S. 455, 466 (2017), *superseded by statute*, National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6501, 134 Stat. 3388, 4626 (2021) ("SEC disgorgement sometimes exceeds the profits gained as a result of the violation. Thus, for example an insider trader may be ordered to disgorge not only the unlawful gains that accrue to the wrongdoer directly, but also the benefit that accrues to third parties whose gains can be attributed to the wrongdoer's conduct.") (internal quotation marks omitted).

166. *See, e.g.*, SEC v. Gordon, No. 3:21-CV-1642-B, 2021 WL 5086556, at *10 (N.D. Tex. Nov. 1, 2021).

167. *See supra* notes 152-54 and accompanying text.

168. *See generally* Adams et al., *supra* note 156.

3, 2020 . . . Section 6501's sources are three prior bills introduced in Congress well before *Liu* was decided."[169] The first of these bills (the Securities Fraud Enforcement and Investor Compensation Act of 2019) was introduced after the decision in *Kokesh* and it would have provided express statutory authority for the SEC to seek disgorgement of unjust enrichment.[170] The second bill (the Investor Protection and Capital Markets Fairness Act) would have authorized disgorgement in any SEC action or proceeding while making the statute of limitations at issue in *Kokesh* inapplicable to disgorgement.[171] The third bill (Improving Laundering Law and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings Act) incorporated the first bill while also extending the statute of limitations for equitable remedies from ten to twelve years.[172]

After the petition for certiorari had been granted in *Liu*, an amended version of the second bill reached the House Floor for debate.[173] Notably, the arguments of several members of the House centered around the need to pass legislation to overrule the decision in *Kokesh* and ensure that *Liu* would hold consistent with the SEC's authority to seek disgorgement in the first instance.[174] Most importantly, a letter from Jay Clayton, who was chair of the SEC at the time, was submitted for the record on the proposed legislation.[175] Mr. Clayton writes: "I respectively request that you act to ensure that we are able to seek disgorgement to the extent appropriate to protect our investors and our markets. Prompt congressional action also would remove the uncertainty regarding our general authority to seek disgorgement in district court."[176] This quotation and the remainder of the letter emphasize that legislation is needed to (1) address *Kokesh* and (2) to "confirm

169. *See generally* Adams et al., *supra* note 156.
170. *See generally* Adams et al., *supra* note 156.
171. *See generally* Adams et al., *supra* note 156.
172. *Id.*
173. *See* 165 CONG. REC. H8929 (2019).
174. *See id.* at H8930 ("I am pleased that H.R. 4344 would . . . clarify[] that the SEC does indeed have disgorgement authority, and its authority reasonably extends to 14 years . . . ."); *see also id.* ("Even worse, the SEC is currently in litigation before the Supreme Court over whether it even has the authority to obtain disgorgement for investors.").
175. *See id.* at H8931-32.
176. *Id.*

and ratify" the existence of disgorgement as a remedy available to the SEC.[177]

In summary, Section 6501 was included in the NDAA and took effect after the decision in *Liu*.[178] The legislative history of Section 6501 gives legitimacy to the argument that *Liu* in its entirety still applies even after the NDAA. This is because Congress acted only to recognize the existence of disgorgement and address the statute of limitations holding in *Kokesh*. An examination of the legislative history does not support the proposition that Congress considered any equitable limitations when enacting the NDAA. Moving forward, Congress must recognize the conflicting textual and historical arguments on the relationship between *Liu* and the NDAA and must provide a clear answer for the lower courts to apply.

B. Identified Characteristics of Concerted Wrongdoing and Legitimate Business Expenses

Although the holding in *Liu* served to answer whether SEC disgorgement is permissible under the statutory authority to seek equitable relief, it created a number of additional questions with respect to the meaning of certain phrases used in the opinion.[179] The analysis below attempts to illustrate common themes, characteristics, and justifications used by courts since *Liu* to clarify the ambiguous meaning of these undefined terms.

First, the term "concerted wrongdoing" as used in the opinion represents an exception to the general limitation against joint and several liability in disgorgement awards.[180] The problem with this term is that the Supreme Court did not fully delineate what kinds of facts and relationships between partners give rise to joint and several liability under this exception.[181] One common theme used by courts to characterize the relationship of multiple defendants as "partners engaged in concerted wrongdoing" is the degree of

177. *Id.*

178. WILLIAM M. THORNBERRY NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2021, H.R. REP. NO. 116-617, at 1267-68 (2020) (Conf. Rep.).

179. *See* discussion *supra* Part III.

180. *See* Liu v. SEC, 140 S. Ct. 1936, 1949 (2020).

181. *See id.*

control one party holds over another.[182] This justification arises most often in the scenario where one defendant is a company and the other defendant is the majority owner, president, or chairman of that company.[183] In these instances, the courts easily emphasize that the individual's role often permits them to exercise a high degree of control over the company, which serves to classify their relationship as partners engaged in concerted wrongdoing.[184]

However, the SEC must exercise caution and not overly stress the connections between multiple defendants when arguing for joint and several liability. The Tenth Circuit recently opined that "because [the SEC] effectively treat[ed] [the parties] as a single entity for purposes of equitable disgorgement[,]" joint and several liability was not warranted.[185] The court points to the SEC's failure to sufficiently differentiate between each defendant's ill-gotten gains as justification for its ruling.[186]

Second, the term "legitimate business expenses," as understood in *Liu*, serves to indicate what deductions can be made to a disgorgement award from the original calculation of a wrongdoer's "net profits."[187] The key characteristic to determining when expenses are legitimate and thus deductible seems to be whether "[the] expenses might be considered wholly fraudulent[.]"[188] This may seem instructive as a principle for lower courts to apply, but in fact the guidance provided by the Supreme Court is circular. Lower courts are

182. *See, e.g.*, SEC v. Craig, No. 1:18-CV-4539-LMM, 2021 WL 6102837, at *8 (N.D. Ga. Nov. 8, 2021) ("Here, Defendant Craig was the President of OneStep and *controlled* OneStep's activities and accounts, and he transferred and used investor money in OneStep's accounts for his personal benefit or for purposes that were not disclosed to the investors. The Court finds that joint and several liability is therefore warranted in this case.") (emphasis added).

183. *See, e.g.*, SEC v. Blockvest, LLC, No. 18CV2287-GPB(MSB), 2020 WL 7295837, at *4 (S.D. Cal. Dec. 10, 2020) ("Defendant Ringgold is the chairman, founder and majority owner of Blockvest.").

184. *See, e.g.*, SEC v. Gordon, No. 3:21-CV-1642-B, 2021 WL 5086556, at *10 (N.D. Tex. Nov. 1, 2021) ("Because Gordon was the President, CEO, and Manager of Blue Rock, and the Manager of Windy City . . . Gordon's control over [these companies] makes them partners in his wrongdoing.").

185. SEC v. Camarco, No. 19-1486, 2021 WL 5985058, at *18 (10th Cir. Dec. 16, 2021).

186. *Id.*

187. *See* Liu v. SEC, 140 S. Ct. 1936, 1950 (2020).

188. *Id.*

instructed to determine the legitimacy of expenses by looking at their fraudulent nature, but that determination "requires ascertaining whether expenses are *legitimate* or whether they are merely wrongful gains 'under another name.'"[189] Absent other guidance, courts have seemed to accept the Supreme Court's instruction and often consider the fraudulent nature of expenses before deciding whether to deduct them from a disgorgement calculation.[190] In practice, courts will simply lack uniformity as the evaluation of the legitimacy and fraudulence of particular expenses is highly subjective.[191]

Although there are some common characteristics for courts to rely on when considering the meanings of "concerted wrongdoing" and "legitimate business expenses" there is still a need for clear definitions. Courts cannot solely rely on the degree of control between multiple defendants to determine the imposition of joint and several liability. This is especially true in more factually complex cases where the defendants do not represent a company and its founder.[192] In addition, the subjective evaluation of fraudulence may also prompt Congress to refine the meaning of "legitimate business expenses" to ensure that litigants across the country receive similar judgements.

V. PROPOSAL

The analysis above has illustrated some of the problems present in the current status of the law surrounding SEC disgorgement. To reiterate, a textual and historical analysis of the NDAA presents logical arguments on both sides as to whether *Liu* should apply in its entirety or in part to future SEC disgorgement actions.[193] In addition, although courts

189. *Id.* (emphasis added) (citing Rubber Co. v. Goodyear, 76 U.S. 788 (1869)).

190. *See* SEC v. Slowinksi, No. 1:19-CV-03552, 2020 WL 7027639, at *4 (N.D. Ill. Nov. 29, 2020) ("Because fraud permeated the G-Slow companies, Slowinksi is not entitled to offset their expenses.").

191. *See, e.g.*, SEC v. Griffithe, No. SA CV 20-00124-DOC (JDE), 2021 WL 6551385, at *2 (C.D. Cal. Nov. 18, 2021) (deducting rent payments but not loans because they were taken out for fraudulent purposes).

192. For example, in the context of spouses, *Liu* offered some examples where joint and several liability would not be appropriate: if "one spouse was a mere passive recipient of profits[,]" if "they suggest[ed] that their finances were not commingled[,]" or if they "did not enjoy the fruits of the [fraudulent] scheme." *Liu*, 140 S. Ct. at 1949.

193. *See supra* notes 148-77 and accompanying text.

have found common themes to guide them in the application of *Liu*'s ambiguity, they will need more concrete guidance on the meaning of certain terms to ensure consistency and fairness when adjudicating disgorgement claims.[194] The following proposal serves to present solutions to these problems by considering what a comprehensive legislative framework surrounding disgorgement might look like. Within this framework I will clarify the relationship between the disgorgement statutes analyzed above and provide definitions of ambiguous terms to help guide lower courts in factually complex circumstances. The policy implications of this proposal on companies, individual investors, and the SEC will also be considered.

A. Comprehensive Congressional Framework on Disgorgement

As it currently stands, 15 U.S.C. § 78u does not effectively explain the relationship between the SEC's original implied authorization and its subsequent express authority to seek disgorgement.[195] Two alternative amendments are presented below that will assist in clarification depending on whether Congress would like to embrace or reject the decision in *Liu*.

First, if Congress would like to adopt *Liu*'s limitations on the SEC's ability to seek disgorgement, it must emphasize the equitable nature of that remedy. To achieve this end, an amended § 78u may read as follows:

> 15 U.S.C. § 78u. Investigations and actions
>
> § 78u(d)(3)(A)(ii): The Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to require equitable disgorgement under paragraph (7) of any unjust enrichment by the person who received such unjust enrichment as a result of such violation.

By qualifying the word disgorgement as equitable, Congress would remove the possibility of interpreting the statute to include both an equitable and statutory grant of disgorgement. The amendment would also tie together with § 78u(d)(5), which already authorizes equitable relief for the

194. *See supra* notes 180-90 and accompanying text.
195. 15 U.S.C. § 78u.

benefit of investors, and it would serve to define § 78u(d)(7) as equitable in nature as well.

Alternatively, if Congress would like to reject *Liu* the amendments should read as follows:

> 15 U.S.C. § 78u. Investigations and actions
>
> § 78u(d)(3)(A)(ii): The Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to require disgorgement under paragraph (7) of any unjust enrichment by the person who received such unjust enrichment as a result of such violation.
>
> § 78u(d)(5): In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors. **Where the action or proceeding involves disgorgement, deposit of such funds to the United States Treasury is for the benefit of investors.**

By removing the language which measures the unjust enrichment "by the person" these amendments would clearly indicate a departure from *Liu*'s guidance against joint and several liability. Also, by providing context to the meaning of "for the benefit of investors" Congress would obviate the requirement that disgorged funds be returned to victims and the SEC could continue its practice of depositing funds to the treasury.

Undoubtably, the proposed amendments rejecting *Liu* are more complex as they still call into question the equitable nature of disgorgement. However, they allow the SEC to seek disgorgement in addition to penalties. If Congress were to adopt this approach it would have to carefully craft the language used to ensure that disgorgement is not overly punitive so as not to invite similar litigation to *Liu*.

With respect to *Liu*'s undefined terms, I propose that Congress include an additional section dedicated to the definition of terms in the context of disgorgement proceedings. This section would be more inducive to a legislative framework embracing *Liu* but would still be useful to confirm and ratify the legitimacy of disgorgement in the event that Congress would like to reject *Liu*.

The proposed section drafted in a manner rejecting *Liu* should read as follows:

15 U.S.C. § 78u. Investigations and actions

> § 78u(j) Definitions: Under this section "disgorgement" carries its common meaning as applied by the SEC since the passage of the Sarbanes-Oxley Act of 2002. "For the benefit of investors" includes the SEC's practice of depositing disgorged funds to the United States Treasury. "Net profits" are measured by unjust enrichment. "Legitimate expenses" cannot be deducted if they relate in any way to a fraudulent purpose. "Fraud" in this context is determined by using an objective standard set forth by the Investor Advisory Committee.[196] "Concerted wrongdoing" is similarly defined in an objective fashion by that same committee.

For a framework intended to accept *Liu*, "disgorgement" and "for the benefit of investors" would be defined differently to more closely mirror traditional equitable principles. "Net profits" would reference the profits of the individual and "legitimate expenses" would be defined to be deductible only if they are entirely fraudulent.

Ultimately this legislative framework is no easy task, but Congress is in a much better position than courts are to consider input from executive agencies, interest groups, and individual citizens. Regardless of whether this framework embraces or rejects *Liu,* it will provide concrete guidance for courts to follow and will address problems concerning uniformity in application.

B. Policy Implications for Companies, Individual Investors, and the SEC

Current trends in enforcement at the SEC reveal that the agency is seeking higher penalties in light of *Liu*'s recent disgorgement limitations.[197] This trend is likely to continue unless Congress provides additional clarity with respect to the SEC's ability to seek disgorgement. The resulting consequence of higher penalties means that harmed investors will suffer as

196. *See Spotlight on Investor Advisory Committee*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/spotlight/investor-advisory-committee.shtml (last visited Feb. 10, 2023).

197. *See* U.S. SEC. & EXCH. COMM'N, DIV. OF ENF'T, 2020 ANN. REP. 7 (2020) ("As a result [of *Liu*] there have been and will continue to be changes in the balance between the penalties and disgorgement that the Division seeks and recommends to the Commission. Among other things, we may recommend higher penalties in some cases where the statutory scheme permits us to do so.").

they are unlikely to recover any unjust enrichment resulting from securities law violations.[198] Additionally, the limitations on SEC disgorgement also harm investors as they call into question the agency's ability to deposit disgorged funds to the United States Treasury, which helps "pay whistleblowers reporting securities fraud and fund[s] the activities of the Inspector General."[199] Arguably, investors greatly benefit from whistleblowers, "[as they] are preyed upon . . . [by] securities fraud, insider trading, Ponzi schemes and outright theft and embezzlement[.]"[200] Investigations resulting from whistleblower tips provide harmed investors with the chance to recover against wrongdoers and furthers the importance of maintaining a strong faith in the financial markets.[201] A comprehensive legislative framework tilting against *Liu* will ensure that the SEC is able to continue seeking disgorgement for investors, pay whistleblowers, and help avoid a financial crash resulting from doubts in the market.[202]

In addition, executive regulatory agencies like the SEC would benefit most from legislative amendments clearly delineating under what parameters the agency can operate. Instead of devoting resources to combatting litigation on the topic of disgorgement,[203] the SEC could focus its efforts on improving investor education about an already complex technological sector.[204] Legislation that proscribes a uniform application of disgorgement will also help deter instances of

198. *See Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, U.S. SEC. & EXCH. COMM'N (Feb. 24, 2023), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_recovermoney.html (listing SEC fair funds, disgorgement funds, receiverships, brokerage account customer protections, corporate bankruptcy proceedings, but not penalties as a way for harmed investors to recover money).

199. SEC v. Blackburn, 15 F.4th 676, 682 (5th Cir. 2021) (quoting Liu v. SEC, 140 S. Ct. 1936, 1947 (2020)).

200. *5Reasons Why Whistleblower Tips Are So Important*, HAGENS BERMAN, https://www.hbsslaw.com/whistleblower/5-reasons-why-whistleblower-tips-are-so-important (last visited Feb. 10, 2023).

201. *See About the SEC*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about.shtml (last visited Feb. 10, 2023) ("The SEC strives to promote a market environment that is worthy of the public's trust.").

202. *See supra* notes 21-22 and accompanying text.

203. *See* 165 CONG. REC. H8929, H8930-31 (2019) ("[T]he SEC is increasingly spending time and staff resources fighting new legal challenges from bad actors claiming that the SEC shouldn't be able to seek disgorgement at all.").

204. *See Investor Education*, U.S. SEC. & EXCH. COMM'N (Apr. 6, 2023), https://www.sec.gov/education/investor-education.

securities law violations as companies will be less likely to risk committing violations if the consequences are clear and commonly understood by courts. Individual investors represent the majority of participants in the financial markets, making them subject to the greatest risk.[205] These investors deserve the assurance that instances of misconduct will be adjudicated uniformly to reach fair results.

VI. CONCLUSION

In this note I have attempted to provide the reader with a sense of the impact that the status of disgorgement holds for the majority of the American population. This was done by first providing context on the past development of the issue and its present unfolding impact.[206] An analysis of the problems presented revealed that the current framework for courts to resolve disgorgement actions is insufficient.[207] This insufficiency led to the proposal that Congress must act to legislate on the disgorgement remedy in order to provide protections to investors, clarity to courts, and reduce the amount of costly litigation on the subject.[208]

This note may assist as a starting point to craft a comprehensive legislative framework on the topic of disgorgement. It will also provide useful insights to companies and individual investors on the risks and dangers associated with participation in the financial markets.

205. *What We Do*, U.S. SEC. & EXCH. COMM'N (Apr. 6, 2023), https://www.sec.gov/about/what-we-do ("Our focus on Main Street investors reflects the fact that American households own $38 trillion worth of equities—more than 59 percent of the U.S. equity market—either directly or indirectly through mutual funds, retirement accounts and other investments.").

206. *See* discussion *supra* Part II.

207. *See* discussion *supra* Part IV.

208. *See* discussion *supra* Part V.