No. 18-1501

IN THE

Supreme Court of the United States

CHARLES C. LIU AND XIN WANG A/K/A LISA WANG,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

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

BRIEF FOR *AMICI CURIAE* BETTER MARKETS, INC., CENTER FOR RESPONSIBLE LENDING, AND NATIONAL CONSUMER LAW CENTER IN SUPPORT OF RESPONDENT

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INTERESTS OF *AMICI CURIAE*[1]

Better Markets, Inc. ("Better Markets") is a non-profit, non-partisan organization that promotes the public interest in the financial markets through comment letters, litigation, independent research, and public advocacy. It advocates for a more stable financial system, economic prosperity for all Americans, and regulatory measures that protect investors and consumers from fraud and abuse. Better Markets has submitted hundreds of comment letters to the federal financial regulators, including the SEC, advocating for strong oversight, accountability, and transparency in the financial markets. And it has argued specifically for strong enforcement under the securities laws in many forums, including *amicus* briefs filed in federal court. *See generally* Better Markets, http://www.bettermarkets.com (including archive of comment letters and briefs).

The Center for Responsible Lending ("CRL") is a non-profit, non-partisan research and policy organization that works to protect homeownership and family wealth by helping to eliminate abusive financial practices. CRL is affiliated with the Center for Community Self-Help, a non-profit community development financial institution focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through safe, afforda-

[1] Pursuant to Supreme Court Rule 37.3(a), *amici* state that all parties have consented to the filing of this brief. Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part; no counsel for a party, or any party, made a money contribution intended to fund the preparation or submission of this brief; and no person or entity, other than *amici*, their members, or their counsel, made such a monetary contribution.

ble home loans and small business loans. CRL conducts ground-breaking research focused on consumer lending: primarily mortgages, payday loans, student debt, bank overdrafts, and auto loans. Through its research and policy work, CRL seeks to ensure a fair, inclusive financial marketplace that creates opportunities for all responsible borrowers, regardless of their income.

The National Consumer Law Center ("NCLC") is a non-profit research and advocacy organization that focuses on the legal needs of low-income, financially distressed, and elderly consumers. NCLC has been a leading source of legal and public policy expertise on consumer issues for Congress, state legislatures, agencies, courts, consumer advocates, journalists, and social service providers for over fifty years. NCLC is the author of a twenty-two-volume Consumer Credit and Sales Legal Practice Series. NCLC's mission is to protect the rights of economically vulnerable consumers through education, publications, policy analysis, and advocacy.

The *amici* have an interest in this case because a ruling in favor of the Petitioners threatens investors, not only by limiting the SEC's disgorgement remedy but by abolishing it entirely in federal court enforcement actions. It would thus eliminate a long-standing, judicially favored, and critically important equitable tool that the SEC has used successfully for decades in its fight to protect investors from fraud and abuse in the securities markets. While those markets have served as extraordinary engines for economic growth and prosperity since the 1930s and before, they have also been—and continue to be—marked by significant fraud and abuse. *See, e.g., Kokesh v. SEC*, 137 S. Ct. 1635, 1639-40 (2017) (observing that "[a]fter rampant abuses in the securities industry led to the 1929 stock market crash and the Great Depression, Congress enacted the securities laws to ensure that 'the highest ethical standards prevail in every facet of the industry.'") (citations omitted). A ruling that eliminates disgorgement from the SEC's available enforcement remedies would incentivize, embolden, and unjustly enrich fraudsters suddenly graced with far better prospects of retaining their ill-gotten gains, even when they *are* subject to an SEC enforcement action. Countless investors would suffer harmful losses as a result. Furthermore, the public's confidence in the integrity of the securities markets would decline—a confidence without which those markets cannot thrive.

Such a ruling would also have more far-reaching effects, threatening the viability of the disgorgement remedy heavily relied upon by other agencies, such as the Federal Trade Commission, charged with protecting consumers in a wide variety of other markets, including credit finance and housing. The Petitioners' attempt to hobble the SEC, along with other regulatory agencies, by destroying an effective and time-honored enforcement tool is both unfounded under the law and profoundly unwise as matter of investor and consumer protection. The *amici* therefore have in interest in opposing that effort.

SUMMARY OF ARGUMENT

Disgorgement has long been firmly established as an equitable remedy, and it therefore falls squarely within the SEC's statutory authority to seek and obtain "equitable relief" in federal court. 15 U.S.C. § 78u(d)(5). Contrary to the Petitioners' sweeping claims, this Court's decision in *Kokesh* does not change that fact. Neither the Court's holding nor its rationale suddenly and fundamentally converted disgorgement for all purposes into a penalty rather than an equitable remedy. Rather, the Court acknowledged the equitable roots and purposes of disgorgement, disclaimed any intention to wholly deprive the SEC of access to this important remedy, and narrowly confined its holding to the application of the broad statute of limitations found in 28 U.S.C. § 2462, governing actions seeking civil penalties and other remedies.

The Court relied on three collateral features of disgorgement in SEC enforcement actions to explain its decision: the public versus private interest that it protects, its deterrent value, and the practical obstacles that prevent it from always being used to compensate specific victims of fraud. *Kokesh*, 137 S. Ct. at 1642-44. Logically, however, these factors do not alter the equitable character of disgorgement or its overriding role in depriving wrongdoers of their ill-gotten gains. Indeed, as illustrated by the mix of attributes shared by other unquestionably equitable remedies—including the deterrent and non-compensatory features that injunctions have in common with disgorgement—the Court's three-factor analysis cannot serve as a general litmus test for identifying authentic equitable remedies. Moreover, as to the Petitioners' claim that disgorgement is sometimes applied in a "punitive" way, the disgorgement awarded in *this* case was calculated in an equitable, not punitive manner.

The Petitioners' attack on disgorgement fails on policy as well as legal grounds. A ruling in their favor would not only conflict with Congressional intent and decades of settled jurisprudence, it would also deprive the SEC of one of its most valuable enforcement tools, conferring upon wrongdoers a powerful and dangerous new incentive to commit securities fraud. It would in effect write half of the SEC's monetary remedies out of the law, leaving the SEC only with civil penalties—in contravention of Congress's decision to provide the SEC with a broad array of legal and equitable remedies that are cumulative and complementary. *See* 15 U.S.C. § 77t; 15 U.S.C. § 78u. The damage to investor protection would actually be far greater, since as a practical matter, disgorgement yields far more than penalties in federal court actions seeking monetary recovery from those who violate the securities laws.

Furthermore, the harmful impact of such a ruling would potentially extend to other agencies, such as the Federal Trade Commission, that rely heavily on disgorgement to protect consumers from financial predators under statutes allowing them to seek "equitable" relief. Finally, even the Petitioners refrain from arguing that the continued application of disgorgement in SEC enforcement actions in federal court would, as a general proposition, be unfair or unjust to those who flout the law and brazenly steal from investors and consumers.

ARGUMENT

I. DISGORGEMENT IS AN EQUITABLE REMEDY AND NOTHING IN *KOKESH* OR ITS RATIONALE ALTERS THAT CONCLUSION

Disgorgement has always been and remains a form of "equitable relief," and it was therefore properly sought by the SEC and granted by the district court in this case under the provisions of the Exchange Act, to prevent the Petitioners from retaining the financial benefits of their prodigious fraud. *See* 15 U.S.C. § 78u(d)(5) (allowing district courts to grant "any equitable relief that may be appropriate or necessary"). The SEC thoroughly demonstrates in its brief that Congress certainly intended to encompass disgorgement within the scope of the "equitable relief" it authorized in the Exchange Act. And neither the holding in *Kokesh* nor its underlying rationale alters this conclusion. *Kokesh* fully acknowledged the equitable roots of disgorgement, disavowed any intention to recategorize disgorgement for all purposes, and narrowly confined its holding to the application of the statute of limitations found in 28 U.S.C. § 2462. While the Court weighed three specific effects of disgorgement in its analysis, as a matter of logic and law, those factors cannot strip disgorgement of its status as an equitable remedy nor serve more generally as a litmus test for identifying equitable remedies.

A. Disgorgement is firmly rooted in equity and it was designed to overcome technical distinctions in the law, not yield to them

For over 150 years, disgorgement has been regarded and used as an equitable remedy to effect justice. In keeping with the most elemental principles of fairness, it requires that wrongdoers surrender their ill-gotten gains, reflecting the longstanding equitable principle "founded in reason and justice" that one "shall not profit by his wrong." *Providence Rubber Co. v. Goodyear*, 76 U.S. 788, 804 (1869); *see also MacGreal v. Taylor*, 167 U.S. 688, 700 (1897) ("A court of equity will look at the real transaction and will do justice"); Restatement (Third) of Restitution and Unjust Enrichment § 51(4) (2011) (the object of restitution being "to eliminate profit from wrongdoing"); BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "equitable" as "[j]ust; consistent with principles of justice and right").

This Court and countless other federal and state courts and have long held this view, in private litigation and government enforcement actions alike. *See Tull v. United States*, 481 U.S. 412, 424 (1987) (observing that "disgorgement of improper profits" has "traditionally [been] considered an equitable remedy"); *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77 (S.D.N.Y. 1970) (exercising inherent equitable power to grant disgorgement as ancillary to an injunction in SEC enforcement action), *aff'd in part and rev'd in part*, 446 F. 2d 1301 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971); *see also United States v. Meyer*, 376 F. Supp. 3d 1290, 1295 (S.D. Fla. 2019) (holding, in the context of a tax case, that "disgorgement . . . is an equitable remedy").[2]

[2] The states have long viewed disgorgement as equitable. Notably, for example, the Delaware Supreme Court regards disgorgement as an equitable remedy, which is a significant determination insofar as Delaware is one of the few states that maintain separate courts of law and equity, and the distinction between legal and equitable remedies is critically important to determining subject matter jurisdiction. *See* Samuel L. Bray, *The Supreme Court and the New Equity*, 68 VAND. L. REV. 997, 1054 n.3 (2015). State cases generally follow the view that disgorgement is clearly an equitable remedy. *See Thanos v. D.C.*, 109 A.3d 1084, 1093 (D.C. 2014) ("[D]isgorgement is widely viewed as an equitable remedy."); *King Mountain Condo. Ass'n v. Gundlach*, 425 So. 2d 569, 572 (Fla. Dist. Ct. App. 1982) ("[T]he disgorgement of secret profits obtained by the developer-appointed, initial officers and directors of a condominium association is an equitable remedy which does not give rise to a right of trial by jury."); *Nelson v. Tripp*, 264 Minn. 216, 220, 118 N.W.2d 805, 808 (1962) (equitable remedies compel one unjustly enriched at the expense of another to disgorge); *Peters Corp. v. New Mexico Banquest Inv'rs Corp.*, 2008-NMSC-039, ¶ 32, 144 N.M. 434, 443, 188 P.3d 1185, 1194; *People v. Ernst & Young, LLP*, 114 A.D.3d 569, 570, 980 N.Y.S.2d 456, 457 (2014) (characterizing disgorgement as an "equitable remedy"); *State ex rel. Day v. Sw. Mineral Energy, Inc.*,

Scholars who study remedies agree. *See* Caprice L. Roberts, *Supreme Disgorgement*, 68 FLA. L. REV. 1413, 1427 (2016) (observing that most courts "view disgorgement as equitable given its historical affiliation with the equitable remedy of accounting."). And the concept has settled comfortably into common understanding. *See Disgorgement*, THE MERRIAM-WEBSTER.COM DICTIONARY, MERRIAM-WEBSTER Inc., http://www.merriam-webster.com/dictionary/disgorge#legalDictionary (last visited Jan. 21, 2020) (defining disgorgement to mean "to give up (as illegally gained profits) on request, under pressure, or by court order especially to prevent unjust enrichment"); *Disgorgement Law and Legal Definition*, USLEGAL, https://definitions.uslegal.com/d/disgorgement/ (courts "can order wrongdoers to pay back illegal profits to prevent unjust enrichment. Disgorgement is a remedy and not a punishment.").

One of the cardinal virtues of the equitable remedy is its flexibility. *See Freeman v. Pitts*, 503 U.S. 467, 487 (1992) ("Equitable remedies must be flexible if these underlying principles are to be enforced with fairness."). Equity courts evolved in response to the shortcomings of courts of law governed by rigid rules, which often unfairly obstructed a party's ability to recover damages or allowed wrongdoers to retain benefits in the absence of cognizable injury to another

1980 OK 118, 617 P.2d 1334, 1338 ("[D]isgorgement, being an equitable remedy, may be tailored in each individual case, to reach the ends of justice and equity."); *Verenes v. Alvanos*, 387 S.C. 11, 17, 690 S.E.2d 771, 773 (2010) ("Restitution and disgorgement are equitable remedies."); *In re Longview Energy Co.*, 464 S.W.3d 353, 361 (Tex. 2015) ("Disgorgement is an equitable forfeiture of benefits wrongfully obtained."); *Frank Shop, Inc. v. Crown Cent. Petroleum Corp.*, 264 Va. 1, 8, 564 S.E.2d 134, 137 (2002) ("Disgorgement of profits is one such equitable remedy.").

party. *See* FEDERAL JUDICIAL CENTER, JURISDICTION: EQUITY, https://www.fjc.gov/history/courts/jurisdiction-equity ("Equity was a centuries-old system of English jurisprudence in which judges based decisions on general principles of fairness in situations where rigid application of common-law rules would have brought about injustice.") (last visited Jan. 21, 2020); *see also* Michael T. Morley, *The Federal Equity Power*, 59 B.C. L. REV. 217, 227 (2018) ("Applying this conception of equity, Chancellors exercised extremely broad discretion, doing justice in individual cases based on their personal notions of fairness, informed by natural law principles, despite the common law's limits."). Thus, equitable remedies evolved to step in and fill the gaps where legal remedies were inadequate.

Equity has also long drawn a distinction between the related remedies of disgorgement and restitution, the former singularly focused on *depriving wrongdoers* of ill-gotten gains and the latter focused on *restoring to victims* of unlawful acts what has been wrongfully taken from them. Disgorgement recognizes the fundamental unfairness of allowing wrongdoers to profit from their illegal actions, and it therefore forces them to give up that profit, even where no cognizable legal injury has been inflicted on another. *See, e.g., Kahn v. Kolberg Kravis Roberts & Co., L.P.*, 23 A.3d 831, 838 (Del. 2011) (requiring majority shareholder to disgorge profits arising from breach of fiduciary duty even where transaction caused no harm to company, based on principle that "it is inequitable to permit the fiduciary to profit from using confidential corporate information").

Restitution, in contrast, evolved to provide justice to a victim where contract remedies were inadequate, either because no contract had been formed, *see Morris*

Pumps v. Centerline Piping, Inc., 273 Mich. App. 187, 193, 729 N.W.2d 898, 903 (2006) ("Even though no contract may exist between two parties, under the equitable doctrine of unjust enrichment, [a] person who has been unjustly enriched at the expense of another is required to make restitution to the other.") (internal quotation marks omitted), or because the measure of contract damages available at law would otherwise be inadequate, as where a mistake has led to unjust enrichment but no contract breach has occurred. *Heacock v. Fly*, 14 Pa. 540, 543 (1850) ("Equity will grant relief against acts done and contracts executed under a mistake of facts.").

This is the backdrop against which the Petitioners' claims should be decided and this Court's decision in *Kokesh* should be interpreted. In all courts, and in private actions and government enforcement cases alike, disgorgement is above all aimed at achieving fairness and justice, depriving wrongdoers of their ill-gotten gains, and flexibly mitigating the harsh impact of technical legal rules. The Petitioners' claims, and their overly expansive reading of *Kokesh*, cannot be reconciled with these bedrock principles governing disgorgement. None of the three factors that shaped the Court's narrow decision in *Kokesh*—the public as opposed to private interests at stake, the ancillary deterrent effect of disgorgement, and the disposition of the funds disgorged—detract from the fundamentally equitable nature of disgorgement and its primary role in depriving wrongdoers of their ill-gotten gains.

B. The holding in *Kokesh* was limited and did not upend the traditional view of disgorgement as an equitable rather than punitive remedy

The Petitioners argue in effect that *Kokesh* swept aside the fundamental principles governing equitable remedies and purged disgorgement of its equitable character for all purposes. But *Kokesh* did no such thing. It simply found that disgorgement exhibits some of the indicia of a penalty, warranting the application of a general statute of limitations governing penalties and other forms of relief. 28 U.S.C. § 2462. Expressly and through its logic, the Court left the inherently equitable nature of disgorgement intact, providing ample room for its continued application by federal courts in SEC enforcement actions.

Kokesh held that because disgorgement in SEC enforcement actions "operates" as a penalty in some respects, or bears its "hallmarks," it should be governed by the broad statute of limitations applicable to actions "for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise," 28 U.S.C. § 2462. The Court focused on three specific criteria, observing that (1) it "is imposed by the courts as a consequence for violating . . . public laws" as opposed to private rights; (2) it "is imposed for punitive purposes," specifically to deter would-be wrongdoers from violating the securities laws; and (3) "in many cases, [it] is not compensatory." *Kokesh*, 137 S. Ct. at 1643. On these grounds, the Court reached the limited holding that disgorgement "operates as a penalty *under § 2462*," *id.* at 1645 (emphasis added), and it should therefore be regarded as such "*within the meaning*" of that provision, *id.* at 1642 (emphasis added). The Court was swayed in part by the principles of repose underlying statutes of limitation, which apply to a broad range of cases and to the "sins" of virtually all wrongdoers, including those guilty of egregious acts of securities fraud. *Id.* at 1641-42.

Implicit in the Court's opinion is the view that disgorgement remains a valuable equitable enforcement tool even though it may *also* bear certain characteristics that warrant the application of the statute of limitation governing penalties in Section 2462. The Court never went so far as to deny the enduring equitable nature of disgorgement or its important role. In fact, it expressly recognized its equitable origins:

> In the absence of statutory authorization for monetary remedies, the Commission urged courts to order disgorgement as an exercise of their "inherent equity power to grant relief ancillary to an injunction. . . ." Disgorgement requires that the defendant give up "those gains . . . properly attributable to the defendant's interference with the claimant's legally protected rights."

Kokesh, 137 S. Ct. at 1640 (citations omitted).

Moreover, the Court never suggested that its factors-based analysis was to serve as the litmus test for defining the essential character of disgorgement for all purposes. To the contrary, the Court expressly disavowed that notion: It held that disgorgement should be treated as a penalty not in every context but solely "within the meaning of 2462," *id.* at 1642, and it reinforced the point by cautioning that "[n]othing 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." *Id.* at 1642 n.3.

C. The three factors relied upon in *Kokesh* cannot serve as the test for identifying equitable remedies

Petitioners seek to stretch the factors analysis in *Kokesh* well beyond what the Court held or intended, and well beyond a reasonable understanding of what constitutes an equitable remedy. A closer look at the three factors reveals that they cannot justify the claim that disgorgement, as applied in SEC enforcement proceedings, has lost its essential character as an equitable remedy. In short, whatever ancillary or collateral features disgorgement may have—such as protecting the broader public interest, deterring fraud, or at times benefiting the treasury instead of particular victims—it remains first and foremost a remedy that serves justice by forcing violators to return the ill-gotten gains they have taken unlawfully from others.

1. The public interest

Kokesh first observed that in its enforcement actions, the SEC seeks to remediate a harm to the public at large, not to right a private wrong. *Kokesh*, 137 S. Ct. at 1643. But whether or not the SEC seeks disgorgement to protect the broader public as opposed to specific victims of fraud has no logical bearing on the nature of disgorgement, which focuses by definition on depriving wrongdoers of their ill-gotten gains. Disgorgement is not concerned with the nature of the victim, whether it be the public writ large or specific victims of a fraud; it can serve its purpose of depriving violators of their ill-gotten gains equally well in either case. In short, neither the nature of the plaintiff nor the law on which a party grounds its claim can alter the equitable nature of the disgorgement remedy.

Turning from logic to the law, the public-versus-private interest distinction cannot serve as the dispositive test for identifying authentically equitable remedies, since other unquestionably equitable remedies often serve the broader public interest. For example, before a court may grant injunctive relief, it must be satisfied that the remedy will serve the public interest, not merely preserve an equitable balance of harms as between the private parties. "A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, *and that an injunction is in the public interest." Winter v. Nat. Res. Def. Council, Inc.*, 129 S. Ct. 365, 374 (2008) (emphasis added). By the Petitioners' own account, an injunction is "of course a quintessential equitable remedy," Pet'rs' Br. at 20, yet its equitable nature is undiminished by the requirement that it promote the public interest.

Moreover, private remedies under the securities laws have long been recognized by this Court as an important complement to the government's enforcement of the securities laws. Private actions thus help protect the larger public interest, not only the interests of individual plaintiffs or class members. For example, this Court has famously observed that:

> Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damages litigation, the possibility of civil damages or injunctive relief serves as a most effective

> weapon in the enforcement of the proxy requirements.

J.I. Case Co. v. Borak, 84 S. Ct. 1555, 1560 (1964); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (private actions are an essential supplement to criminal and civil enforcement under the securities laws). In short, both legal remedies and equitable remedies classically serve a mix of private and public interests, none of which define the nature of those forms of relief.

2. Punishment

The Court in *Kokesh* next found that "SEC disgorgement is imposed for punitive purposes," namely deterring violations of the securities laws by depriving violators of their ill-gotten gains. *Kokesh*, 137 S. Ct. at 1643.

As a threshold matter, while disgorgement plays an immensely important deterrent role by reducing the incentive to commit fraud, it is distinctly different from classically punitive or retributive measures, such as fines that extend beyond disgorgement or criminal penalties such as incarceration. In any case, however, the deterrent or even punitive effect of an equitable remedy does not alter its equitable character.

For example, injunctions—the "quintessential" equitable remedy—are designed for the very purpose of deterrence: to halt ongoing violations and prevent future violations of the law through a judicial command that is reinforced by the threat of contempt sanctions. Moreover, injunctions even have a decidedly punitive collateral effect, since their mere issuance stigmatizes the enjoined party and subjects it to onerous consequences under the securities laws, including a potential bar from the industry and a loss of livelihood. *See* 15 U.S.C. § 78c(a)(39)(F). Yet notwithstanding the clearly deterrent and punitive nature of an injunction, it unquestionably remains an equitable remedy.[3] *See also Tull v. United States*, 481 U.S. 412 (1987) (recognizing disgorgement as an equitable remedy that operates as a penalty); Daniel B. Listwa & Charles Seidell, Note, *Penalties in Equity: Disgorgement After* Kokesh v. SEC, 35 YALE L. J. 667, 679-84 (2018) (explaining that historically, equity included remedies that operated as penalties and were non-compensatory).

Consider the constructive trust, another equitable remedy[4] similar to disgorgement that also serves as a

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[3] The Court in *Kokesh* also observed that disgorgement sometimes exceeds the amount of profit the wrongdoer received, thus punishing the defendant. While this may be an argument for a more nuanced calculation of disgorgement amounts in a given case, it hardly justifies discarding the remedy in its entirety. In any event, as argued below, the formula for disgorgement in *this* case was appropriate and well-aligned with the principles that govern disgorgement amounts.

[4] *See Askew v. Trustees of Gen. Assembly of Church of Lord Jesus Christ of Apostolic Faith, Inc.*, 644 F. Supp. 2d 584, 588 (E.D. Pa. 2009) ("A constructive trust is a type of equitable remedy that courts impose when the plaintiff establishes certain types of unjust enrichment."); *In re Abell*, 549 B.R. 631, 652 (Bankr. D. Md. 2016) ("A constructive trust is an equitable remedy."); *Radenhausen v. Doss*, 819 So. 2d 616, 620 (Ala. 2001) (same); *ML Servicing Co. v. Coles*, 235 Ariz. 562, 569, 334 P.3d 745, 752 (Ct. App. 2014) (same); *Apartment Inv. & Mgmt. Co. v. Flamingo/S. Beach 1 Condo. Ass'n, Inc.*, 84 So. 3d 1090, 1093 (Fla. Dist. Ct. App. 2012) (same); *People ex rel. White v. Travnick*, 346 Ill. App. 3d 1053, 1064, 806 N.E.2d 270, 279 (2004) (same); *Bd. of Trumbull Twp. Trustees v. Rickard*, 2017-Ohio-8143, ¶ 95, 98 N.E.3d 800, 820 (same); *Lemaire v. Davis*, 79 S.W.3d 592, 601 (Tex. App. 2002) (same); *Peirce v. Peirce*, 2000 UT 7, ¶ 12, 994 P.2d 193, 197 (same); *Savage v. Walker*, 2009 VT 8, ¶ 8, 185 Vt. 603, 605, 969 A.2d 121, 124 (same).

deterrent and a punishment. *Cf. Snepp v. United States*, 444 U.S. 507, 515 (1980) ("If the agent publishes unreviewed material in violation of his fiduciary and contractual obligation, the [constructive] trust remedy simply requires him to disgorge the benefits of his faithlessness"). If "property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee." *Beatty v. Guggenheim Exploration Co.*, 122 N.E. 378, 380 (N.Y. 1919). Obviously, imposition of a constructive trust operates as both a punishment and a deterrent: It forces defendants to surrender property they would rather retain, and it stands as an example to potential wrongdoers who face the possibility they will have to forego the fruits of their misconduct. Indeed, the Supreme Court has explicitly recognized that the deterrent effect of imposing a constructive trust is an important and desirable feature of that equitable remedy. *Snepp*, 444 U.S. at 515 (holding that imposition of a constructive trust on the profits of a book published by a former CIA agent without prior authorization was an appropriate remedy because "it is tailored to deter those who would place sensitive information at risk.").[5] Whether a remedy is

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[5] *Accord Brock v. Brock*, 90 Ala. 86, 93, 8 So. 11, 13 (1890) ("Equity . . . endeavors to prevent and punish fraud by taking from the wrongdoer the fruits of his deceit, and it accomplishes this object by its beneficial and far-reaching doctrine of constructive trusts."); *Scribner v. Meade*, 10 Ariz. 143, 150, 85 P. 477, 480 (1906) (same); *Hunter v. Feild*, 114 Ark. 128, 169 S.W. 813, 817 (1914) (same); *Taylor v. Kelly*, 103 Cal. 178, 184, 37 P. 216, 218 (1894) (same); *Markham v. Katzenstein*, 209 Ill. 607, 618, 70 N.E. 1071, 1075 (1904) (same); *Turner v. Turner*, 1912 OK 507, 34 Okla. 284, 125 P. 730, 732 (same); *McIlwain v. Doby*, 238 Miss. 839, 852–53, 120 So. 2d 553, 559 (1960) (same); *Chadwick v.*

"equitable," then, cannot depend on whether it has the purpose or effect of "punishment" and "deterrence."

This series of examples could be extended indefinitely. Indeed, every form of relief imposed against a defendant operates to some degree as a deterrent and as a penalty. If "deterrence" or "punishment" were disqualifying attributes, then no remedy would be considered an equitable remedy. In short, the collateral consequence of the remedy does not define the remedy itself. And while the deterrent effects of disgorgement may have swayed the Court in *Kokesh* to regard the remedy as sufficiently punitive to warrant application of a general statute of limitations, this attribute cannot and does not define its nature. Disgorgement remains what it has always been: an insistence that wrong-doers return what they have unlawfully taken, in service of justice.

3. Compensation

Finally, the Court in *Kokesh* was swayed by the fact that disgorgement is not always compensatory, thus giving it "in many cases" a punitive rather than remedial hue: "Some disgorged funds are paid to victims; other funds are dispersed to the United States Treasury." *Kokesh*, 137 S. Ct. at 1643.

This consideration also fails as a test for identifying equitable relief. Whether a remedy provides compensation is irrelevant to whether it is equitable. Disgorgement serves its essential purpose of depriving wrongdoers of their ill-gotten gains equally well regardless of whether the funds are used to fund the

Arnold, 34 Utah 48, 95 P. 527, 530 (1908) (same); *Moe v. Brumfield*, 27 Wash. 2d 714, 719, 179 P.2d 968, 971 (1947) (same).

Treasury or to compensate victims. Injunctions once again drive home the point: They remain quintessentially equitable even though they have little to do with compensation or the payment of funds to anyone. The law of equity reflects this basic distinction by recognizing a separate equitable remedy—restitution—that courts may use to restore funds to the victims of misconduct. *See* discussion *supra* at Section I.A.

The fundamental irrelevance of the ultimate disposition of the funds is further illustrated by the variable treatment of civil penalties, which may actually be used to *compensate* victims. *See* 15 U.S.C. § 7246(a) (providing that civil penalties awarded in any SEC enforcement action may be added to a disgorgement or other fund for the benefit of victims). Yet that remedial allocation of the money makes a fine no less painful to the wrongdoer and no less punitive. In short, the disposition of the money paid in satisfaction of either a fine or a disgorgement order does not alter the true nature of those remedies.

The "use of funds" test is also fraught with practical difficulties, rendering it an especially unsuitable metric for determining whether disgorgement is an equitable remedy. Surely the nature of the disgorgement remedy should not hinge on whether, in a given case, remedial use of the disgorged funds is "feasible" given the challenges that the SEC, a court, or a trustee often confronts in collecting on disgorgement orders, locating victims of fraud, and apportioning their losses. *See Kokesh*, 137 S. Ct. at 1644 (citing cases where courts ordered disgorged funds distributed to the Treasury because those entitled to the funds were not before the court, those with equitable claims were too dispersed for identification and payment, or payment to victims was otherwise not feasible).

To the extent the disposition of disgorged funds is relevant at all to the nature of disgorgement, it should be enough that disgorgement is frequently used to pay restitution to victims, *see Kokesh*, 137 S. Ct. at 1644 (noting that disgorged funds "may often go to compensate securities fraud victims") (citing *SEC v. Fischbach Corp*., 133 F.3d 170, 175 (2d Cir. 1997)); *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 166 (2008) (citing billions of dollars in disgorgement collected by the SEC, "much of it for distribution to injured investors"), and that the law specifically contemplates and indeed favors that outcome, *see* 15 U.S.C. § 7246 (establishing Fair Fund for investors); Oversight of the Securities and Exchange Commission Before the Senate Committee on Banking, Housing, and Urban Affairs, 116th Cong. (2019) (statement of Jay Clayton, SEC Chairman) ("[P]rotecting retail investors also means, whenever possible, putting money back in their pockets as soon as possible after they are harmed by violations of the federal securities laws. We also have continued our efforts to return funds to harmed investors as promptly as practicable.").

This analysis—encompassing 150 years of equity practice in virtually all courts, scholarly opinion, and common understanding—refutes the Petitioners' claims and shows that the disgorgement remedy as applied in SEC enforcement actions in federal court remains an equitable remedy and therefore survives this Court's decision in *Kokesh.*

II. THE COURTS BELOW USED AN APPROPRIATE STANDARD TO DETERMINE THE PETITIONERS' DISGORGEMENT OBLIGATION

In support of their argument that disgorgement has a punitive component and is therefore incapable of being equitable, the Petitioners also challenge the way courts calculate disgorgement amounts. They complain that disgorgement orders "sometimes are not offset by 'a defendant's expenses that reduced the amount of illegal profit,'" often "'leav[ing] the defendant worse off.'" Pet'rs' Br. at 6 (citation omitted); *see also id.* at 11 (complaining that the district court ordered disgorgement in the amount of "every dollar petitioners collected from investors . . . whether or not petitioners had used those dollars for legitimate expenses"). In this case, the lower courts refused to allow such offsets, and with good reason. Far from being punitive, the result was fully aligned with the equitable goal of attaining fairness and justice.

At least where the "expenses" of an enterprise are used to further the fraud, "the proper amount of disgorgement is the entire proceeds from a scheme minus amounts paid to investors." *See, e.g., SEC v. Liu*, 262 F. Supp. 3d 957, 975 (C.D. Cal. 2017), *aff'd*, 754 F. App'x 505 (9th Cir. 2018). The equitable rationale is clear, as "it would be unjust to permit the defendants to offset against the investor dollars they received the expenses of running the very business they created to defraud those investors into giving the defendants the money in the first place." *SEC v. JT*

Wallenbrock & Assocs., 440 F.3d 1109, 1114 (9th Cir. 2006).[6]

That rule and rationale were properly applied in this case. In the proceedings below, the Petitioners argued that the disgorgement amount should be offset by their "legitimate" business expenditures. *Liu*, 262 F. Supp. 3d at 975. The district court and the Ninth Circuit rejected this claim because there *were* no "legitimate" business expenditures. Liu and his cohorts spent some $12.5 million of investor money on marketing efforts designed to lure more victims into the scheme. The other expenses, such as money devoted to rent and the purchase of some medical equipment, were little more than sham transactions intended to disguise their fraudulent enterprise as a legitimate business—"half-hearted attempts to convey the illusion of progress." *Id.* at 964.[7] All of the money spent was to further the Petitioners' fraud, and it was therefore perfectly consistent with equitable principles to order disgorgement of the entire amount Petitioners took from investors, less any amounts returned to investors (of which there was none).

Requiring that courts reduce disgorgement in the amount of such illegitimate expenses would be *in*equitable and inconsistent with a court's inherent

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[6] Courts, of course, always have the discretion to reduce the amount of disgorgement if equitable principles dictate that result.

[7] Indeed, the fraud in this case was arguably worse than a Ponzi scheme, where fraudsters at least give *some* money back to *some* investors. Here, the Petitioners spent vast amounts on marketers to attract more victims and the rest on sham expenses to give the fraudulent scheme a veneer of legitimacy, without returning any funds to their investors.

discretionary authority to fashion equitable relief to effect justice. And as a practical matter, a weaker formula would incentivize scam artists to launder money and artificially reduce the amount of disgorgement or to reap the benefits of their fraud by spending lavishly on "expenses" such as posh offices, private planes, expensive cars, and other luxury items. Fraudsters would also likely attempt to conceal ill-gotten gains through expenditures that appear legitimate but actually route money back to them through entities they own or otherwise control. Indeed, the Petitioners in this case apparently deployed this very tactic, as they were extensively involved with at least one of the marketing companies. *Liu*, 262 F. Supp. 3d at 962-63.

To the extent the precise amount of ill-gotten gains cannot be calculated with precision in a given case, the burden of that uncertainly should in fairness and equity fall upon the wrongdoer, who "has only himself to blame." *Callaghan v. Myers*, 128 U.S. 617, 666 (1888). In any event, hardly can such uncertainty, based on specific facts in specific cases, justify the wholesale abandonment of disgorgement as an appropriate remedy in the SEC's enforcement actions in federal courts.

The Petitioners can find no support for their claim that disgorgement is punitive by citing to the thoroughly equitable rule that those who establish and engage in a fraudulent enterprise, and incur no legitimate expenses, must return all of the money they have taken from investors, less any amounts returned.

III. A RULING IN FAVOR OF PETITIONERS WOULD WEAKEN THE ABILITY OF THE SEC TO PROTECT INVESTORS AND UNDERMINE ENFORCEMENT EFFORTS AT OTHER AGENCIES AS WELL

The Petitioners' attack on the SEC's authority to seek and obtain disgorgement from federal courts poses a direct and substantial threat to a wide variety of investor and consumer protections. The SEC as well as other investor and consumer protection agencies depend heavily on disgorgement as a major, if not the primary, tool for recovering money from those who violate the law and prey on the public. Removing disgorgement from the ambit of equitable remedies would not only conflict with Congress's intent to equip those agencies with the uniquely effective disgorgement remedy but also expand the harm to countless additional consumers who need protection from fraud and abuse in financial transactions. Thus, the Court should reject the Petitioners' attack on disgorgement on policy as well as legal grounds.

A. Eliminating disgorgement from the SEC's enforcement remedies in federal court would significantly weaken the SEC's ability to enforce the securities laws

The Petitioners argue that the SEC can well afford to lose its authority to seek disgorgement in federal court because it has essentially the same power to recover a defendants' pecuniary gains under the *civil penalty* provisions of the Exchange Act. Pet'rs' Br. at 42-43, citing 15 U.S.C. § 78u(d)(3). This is a specious argument, one that ignores the profound importance of layered or cumulative sanctions that are necessary to effectively address violations of the securities laws.

It also glosses over the fact that the Petitioners' attempt to nullify disgorgement would in effect more than *halve* the monetary remedies available to the SEC.

In the Exchange Act, Congress deliberately set forth an array of remedial and punitive measures that it deemed essential for disincentivizing, deterring, preventing, and remediating lawless behavior in the securities markets. Among them are injunctions; equitable relief (encompassing disgorgement); and a tiered system of monetary penalties. All of these remedies were intended to complement, not substitute for, each other. *Cf.* 15 U.S.C. § 77t(d)(3)(D) (actions authorized may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring); 15 U.S.C. § 78u(d)(3)(C)(iii) (same). As it stands today, the SEC has the authority to recover all of the ill-gotten gains that a defendant has derived from a fraudulent scheme and to impose monetary penalties *in addition* to such disgorgement.

Congress determined that these cumulative remedies were essential to the effectiveness of the SEC's enforcement regime. The reason is clear: If the consequence of committing fraud were limited to disgorgement alone—or in the Petitioners' preferred world, to penalties capped under a disgorgement formula—then the deterrent effect of the law would be woefully inadequate. The SEC's monetary remedies would be cut fully in half or more. And many violators would be inclined to take the risk of engaging in fraud, facing a huge upside with little downside. "If caught, the most I'll have to pay is what I took," they would say. Far from deterring fraud, such an outcome would affirmatively incentivize it.

Congress itself recognized the need to layer penalties on top of disgorgement, not merely to assess one or the other. In 1990, it enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 ("Remedies Act") to provide the SEC with additional enforcement tools. The House and Senate Reports accompanying the law highlighted the distinct roles of disgorgement and monetary penalties and the importance of applying both in the fight against securities fraud: "Disgorgement merely requires the return of wrongfully obtained profits; it does not result in any actual economic penalty or act as a financial disincentive to engaging in securities fraud." H.R. Rep. No. 616, 101st Cong., 2d Sess. 31 (1990); S. Rep. No. 337, 101st Cong., 2d Sess. 9-10 (1990).

The SEC must therefore retain the ability to obtain disgorgement and in addition impose monetary penalties that force wrongdoers to pay a meaningful price for their violations of the law above and beyond the return of investor funds. *Cf. Lorenzo v. SEC*, 139 S. Ct. 1094, 1104 (2019) (holding that Congress wrote the antifraud provisions in Section 10(b) and Rule 10b-5 to be overlapping or cumulative, not mutually exclusive, to "root out all manner of fraud in the securities industry").

Eliminating disgorgement from the SEC's enforcement toolkit would actually have even more severe consequences on a quantitative level. The SEC's enforcement data show that disgorgement in federal court actions has been an extremely important tool, complementing and in fact substantially exceeding the amounts the SEC has obtained through civil penalties. For example, over the last three years, from 2017 through 2019, the amount of disgorgement the SEC obtained in civil actions was *three times* the amount it obtained in civil penalties: $5.4 billion versus $1.8 billion.[8] And cases involving SEC enforcement actions confirm the importance of disgorgement in addressing some of the largest and most damaging securities frauds in history. *See, e.g., SEC v. Stanford Int'l Bank, Ltd.*, No. 3:09-CV-0298-N, 2013 WL 12360438, at *5 (N.D. Tex. Apr. 25, 2013) (ordering disgorgement of $5.9 billion in massive Ponzi fraud scheme). Thus, depriving the SEC of its disgorgement remedy would have a devastating impact on the agency's ability to effect justice, deter fraud, and help victims recover their losses.

B. Eliminating the SEC's disgorgement remedy on the grounds advanced by Petitioners would also undermine the ability of other regulators to protect consumers from fraud and abuse

Petitioners take no account of the far-reaching implications of their challenge to the SEC's disgorgement authority, as they focus exclusively on the securities markets. However, a decision declaring that disgorgement is not an equitable remedy would potentially undermine the enforcement powers of other agencies that rely on the statutory authority to obtain "equitable relief" in their own enforcement actions against all manner of predators.

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[8] These disgorgement and penalty figures for the years 2017 through 2019 were derived from data set forth in the U.S. SECURITIES AND EXCHANGE COMMISSION, DIVISION OF ENFORCEMENT 2019 ANNUAL REPORT, at 19 (Nov. 6, 2019), available at https://www.sec.gov/enforcement-annual-report-2019.pdf, and data set forth in the SEC's Administrative Proceedings database, for the period from October 1st 2016 to September 30th 2019, available at https://www.sec.gov/litigation/admin.shtml (last visited Jan. 21, 2020).

For example, a ruling in Petitioners' favor could severely impair the ability of the Federal Trade Commission ("FTC") to hold wrongdoers accountable for unfair and deceptive trade practices and to adequately protect consumers. The FTC has a mandate to protect "consumers and competition by preventing anticompetitive, deceptive, and unfair business practices." Federal Trade Commission, About the FTC, https://www.ftc.gov/about-ftc (last visited Jan. 21, 2020). The FTC routinely pursues wrongdoers engaged in unconscionable acts, from scammers who peddle bogus cures for people suffering from cancer, Press Release, *FTC Sweep Stops Peddlers of Bogus Cancer Cures*, Federal Trade Commission (Sept. 18, 2008), https://www.ftc.gov/news-events/press-releases/2008/09/ftc-sweep-stops-peddlers-bogus-cancer-cures, to individuals running fake charities that use stolen donations to fund lavish lifestyles, Press Release, *FTC, States Settle Claims Against Two Entities Claiming to Be Cancer Charities; Orders Require Entities to Be Dissolved and Ban Leader from Working for Non-Profits*, Federal Trade Commission (Mar. 30, 2016), https://www.ftc.gov/news-events/press-releases/2016/03/ftc-states-settle-claims-against-two-entities-claiming-be-cancer. In such cases, the FTC may obtain "injunctions and such other and further *equitable relief* as they deem appropriate in the enforcement of such final orders of the Commission." 15 U.S.C.§ 45(l) (emphasis added). The FTC routinely seeks disgorgement as well as restitution in its enforcement actions.

If the Court were to rule in Petitioners' favor, then the FTC's ability to seek disgorgement would be in peril. The impact on the FTC would be especially grave, as the FTC's monetary penalty provisions are very limited as a practical matter. Under those provisions, the FTC generally does not have the authority to seek civil penalties for first violations of Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive practices. *See* GAO, Internet Privacy: Additional Federal Authority Could Enhance Consumer Protection and Provide Flexibility 10 (Jan. 2019) ("The commission lacks authority to seek direct civil penalties for violations of section 5 of the FTC Act.").

The FTC's ability to recover civil penalties is hampered in two respects. One of its fining authorities is limited to violations of previously issued cease and desist orders. The other is limited to violations of rules, 15 U.S.C. § 45(m), but the FTC's rulemaking process is exceptionally cumbersome and therefore rare. The FTC can only issue a rule declaring a particular act or practice unfair or deceptive if, among other things, it makes a finding that the practice is "prevalent." To establish prevalence, in turn, the FTC must have already "issued cease and desist orders regarding such acts or practices" or it must develop other information indicating "a widespread pattern of unfair or deceptive acts or practices." 15 U.S.C. § 57a(b)(3). Because of these onerous procedural requirements, the FTC rarely issues rules pursuant to Section 5 of the FTC Act, and the statutory predicate for civil penalties is therefore scarce. Cooper J. Spinelli, *Far from Fair, Farther from Efficient: The FTC and the Hyper-Formalization of Informal Rulemaking*, 6 Legis. & Pol'y Brief 129, 143 (2014). As a result, the FTC relies principally on equitable relief for violations of Section 5, including disgorgement and restitution. *Id.*

If the Court holds that disgorgement is no longer an "equitable remedy," it would essentially afford scam artists subject to the FTC's jurisdiction one free bite at the "unfair or deceptive claims" apple, allowing them to rip off consumers by falsely promising to cure their cancer, fund a favorite charity, or ship them a miraculous weight loss drug—without having to surrender their ill-gotten gains. That cannot be what Congress intended.

In essence, a ruling in favor of the Petitioners portends a substantial and widespread erosion in the ability of federal agencies to protect the public from a wide variety of predatory activities in the financial and consumer marketplace.

CONCLUSION

The judgment of the United States Court of Appeals for the Ninth Circuit should be affirmed and the SEC's disgorgement remedy should remain fully intact.

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