Regulators Clash With Wall Street As Liu V. SEC Looms

By Dean Seal

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Law360 (January 27, 2020, 11:13 PM EST) -- Nineteen amicus briefs have been filed for the U.S. Supreme Court's review of the U.S. Securities and Exchange Commission's authority to seek disgorgement, demonstrating a sharp but unsurprising divide between regulators and Wall Street.

Oral arguments are less than six weeks away in Liu v. SEC, the hotly anticipated high court examination of whether the agency's high-dollar financial remedy is actually available under securities law, prompting a host of legal professors, public interest law firms, state attorneys general and even members of Congress to weigh in.

The justices agreed in November to hear the case of Charles Liu and Xin Wang, a couple ordered to disgorge almost $27 million for defrauding Chinese investors and who now argue that the Supreme Court's 2017 ruling in Kokesh v. SEC stripped the agency of its ability to seek disgorgement as a form of restitution-like "equitable relief."

While courts have historically allowed the SEC to collect disgorgement, the justices found in Kokesh that the practice is now often intended to prevent future wrongdoing rather than to compensate victims, as equitable relief is intended, and is, therefore, a civil penalty subject to a five-year statute of limitations. The justices declined to take a position at the time on whether courts have the authority to order disgorgement as equitable relief in SEC enforcement suits, or whether they've properly done so in the past, but the Liu case has put the question back to the bench.

The 19 sets of amici who filed timely friend-of-the-court briefs in the case are offering two schools of thought on the matter. Those supporting the SEC's authority call disgorgement an essential and implicitly authorized tool for policing financial markets that mustn't be restrained, while those challenging it accuse the agency of going too far with powers it was not expressly granted by Congress.

"Under the conservative approach to statutory interpretation, if the text of the statute does not specifically authorize disgorgement as a remedy, the agency has no authority to request it," Tom Gorman, a Dorsey & Whitney LLP partner and former senior counsel for the SEC's enforcement division, told Law360. "In typical SEC enforcement actions based on the Securities Act [of 1933] and the [Securities] Exchange Act [of 1934], this means the commission cannot obtain disgorgement in the sense that they typically ask for it, because there is no statutory authority."

When a Supreme Court case is slated for oral arguments, amici have seven days after the filing of a party's briefings to submit their own briefs either supporting that party or supporting neither side. In the week after Liu's attorneys handed in their briefing in December, 12 sets of amici came forward, largely decrying the agency for perceived overreach.

"Congress has supplied the SEC with many tools with which to ensure compliance with the securities laws," the Washington Legal Foundation, a conservative public interest legal organization, said in its brief. "The SEC should rely on those tools rather than resorting to the nonstatutory enforcement mechanisms it apparently finds more convenient."

Other right-leaning amici shared the WLF's critical sentiments. The Americans for Prosperity Foundation, a conservative political advocacy group, said the SEC has ignored congressional limits on monetary awards and

made "the separation of powers essentially nonexistent," while the libertarian think tank Cato Institute likened disgorgement to "The Blob" from the 1958 horror classic of the same name — "unpredictable, uncontrollable, and has struck fear in those who have had to face it."

"There have been many other similarly situated defendants and there will be more in the future unless this court becomes the Steve McQueen of the story and finally puts an end to this menace," the Cato Institute, co-founded in 1974 by one of the Koch brothers, said in its brief.

The Securities Industry and Financial Markets Association, a trade group for securities firms, banks and asset managers, was less condemnatory in its brief, writing that it "deeply respects the critical role" of the SEC in policing the securities realm but that disgorgement is not an appropriate or available remedy in addition to the civil penalties the SEC is authorized to seek. The U.S. Chamber of Commerce advanced a similar argument that disgorgement was not a power vested in the SEC by Congress.

Two dozen members of Congress, writing in one of seven amicus briefs submitted after the SEC's own briefing was filed in January, disagreed.

"Congress has repeatedly, through a series of laws passed over the past several decades, made clear that the SEC may seek disgorgement when it brings civil actions," the Democratic lawmakers said in their brief.

The lawmakers, including House Financial Services Committee Chairwoman Maxine Waters of California and Senate Banking Committee Ranking Member Sherrod Brown of Ohio, argued that Congress has been structuring securities laws around — and thereby affirming — the SEC's disgorgement authority for the past three decades.

A group of attorneys general for 23 states and the District of Columbia are siding with those Congress members and the SEC, arguing that their state-level regulatory and enforcement efforts are "fortified by having a strong federal partner," and that rescinding the SEC's disgorgement authority would only serve to frustrate the nation's enforcement patchwork at all levels.

The North American Securities Administrators Association, a nonprofit association of securities regulators in states and localities across North America, espoused a similar position in its brief, saying the courts and Congress have "consistently agreed" that nothing in the Kokesh decision "called into question the availability of disgorgement in SEC enforcement actions."

Some of the 19 briefs reveal interesting splits, particularly among legal professors, with a set arguing on each side. But according to Gorman, the dueling arguments will likely take a back seat to the conservative-majority Supreme Court's "'read the text' and 'look up the words in the dictionary' approach of statutory construction."

"While the recently filed brief by certain members of the House and Senate argues strongly that the SEC needs disgorgement, the conservative principles being applied now negate such a finding," Gorman said.

Nick Morgan, a partner at Paul Hastings LLP and former senior trial attorney at the SEC, noted that the Supreme Court has shown a willingness in recent years to "bring a halt to decadeslong practices by the SEC," invoking the Kokesh decision as well as Gabelli v. SEC , in which the high court ruled that the five-year statute of limitations for civil penalty actions starts when an alleged fraud is committed or concludes, rather than when a regulatory agency finds out about it.

"If history is any guide, the Supreme Court will not be persuaded by decades of SEC practice or parades of horribles that will purportedly come out of a ruling against the SEC," Morgan told Law360. "The most surprising aspect of Liu is how long the SEC has been able to seek disgorgement without going to Congress to obtain unambiguous statutory authority to seek disgorgement in federal court."

The case is Liu et al. v. U.S. Securities and Exchange Commission, case number 18-1501, in the Supreme Court of the United States.

--Editing by Aaron Pelc and Jay Jackson Jr.