

Supreme Court: SEC can recoup ill-gotten profits, with caveats, Compliance Week, ft. Nancy Hendrickson

Nancy Hendrickson, partner and co-chair of KD's Financial Services Practice Group, is quoted in a Compliance Week article, written by Jaclyn Jaeger, on its coverage of the SCOTUS Liu vs. SEC opinion - published on June 22, 2020.

The U.S. Supreme Court on Monday in a long-awaited decision reaffirmed the Securities and Exchange Commission's authority to recoup profits obtained from fraudulent schemes, but limited the scope of what can be sought through disgorgement.

To punish securities fraud, the SEC is authorized to seek "equitable relief" in civil proceedings. The question posed to the Supreme Court in the case Liu v. SEC was whether disgorgement is considered equitable relief. In its decision, the majority held that a "disgorgement award that does not exceed a wrongdoer's net profits, and is awarded for victims, is equitable relief."

The Supreme Court noted in its 8-1 decision that any disgorgement order should be to return funds to harmed investors but allowed that in certain instances it may not be feasible to do so. "Section 78u(d)(5) provides limited guidance as to whether the practice of depositing a defendant's gains with the Treasury satisfies its command that any remedy be 'appropriate or necessary for the benefit of investors,' and the equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors," Justice Sonia Sotomayor wrote in delivering the opinion of the Court.

Nancy Hendrickson, co-chair of financial services practice group at Kaufman Dolowich & Voluck, says she believes the decision "will significantly change the way courts calculate disgorgement" and that "from now on, the SEC will have to make some kind of showing as to the feasibility of returning funds to victims."

"The SEC will also be limited in its ability to obtain relief from co-defendants who are not partners," Hendrickson adds. "Hence, expect more defendants to adopt an 'every man for himself' defense strategy, claiming that they were merely passive recipients of the profits. This may curtail the SEC's ability to obtain relief from so-called relief defendants."

Expect more litigation, as well, over what constitutes legitimate business expenses that must be deducted from any order of disgorgement. "This is perhaps the most significant impact of this decision, because most courts do not currently base disgorgement orders on net profits," Hendrickson says.