

Disgorgement Continues at the SEC

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On October 12, 2021, the Fifth Circuit Court of Appeals [upheld](#) a disgorgement order issued by the SEC, in—according to the opinion— the first appellate ruling on the topic since the Supreme Court’s 2020 decision in [Liu v. SEC](#).

In *SEC v. Blackburn et al.*, the three defendants-appellants were charged by the SEC with failing to register millions of shares sold in a penny stock company, in violation of sections 5(a) and 5(c) of the Securities Act of 1933. These sales raised millions of dollars from unsophisticated investors, all while the defendants were alleged to have misrepresented the company’s results and deceived investors. The misrepresentations and deception led to additional allegations that the defendants violated section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and section 17(a) of the Securities Act.

The district court found in favor of the SEC on summary judgment and, among other things, ordered disgorgement of profits and imposed civil monetary penalties. The defendants appealed, arguing that *Liu* had redefined the Commission’s statutory ability to order disgorgement. While the Supreme Court in *Liu* found that the SEC has the statutory authority to order disgorgement, it may not do so in a punitive manner; thus, disgorgement cannot exceed the defendants’ net profits and must be awarded for victims.

The defendant-appellants argued the disgorgement order did not satisfy these new requirements. The Fifth Circuit disagreed, finding the disgorgement amounts were the profits the individual defendants received from their fraud and the district court had properly assessed each defendant’s gain individually, rather than imposing joint-and-several liability. The Court also found it important that the SEC had identified the victims of the defendants’ fraud and created a process for the return of disgorged funds; while the Commission would initially receive the recovered funds under this process, the Commission would then distribute the funds to victims after seeking district court approval, thereby acting as a de facto trustee.

According to the Fifth Circuit, this process “easily” satisfied the requirements set forth in *Liu*. It also, however, identified a more difficult question that it did not attempt to answer: whether disgorgement is “awarded for victims” when the recovered funds are put into a Treasury fund that helps “pay whistleblowers reporting securities fraud and to fund the activities of the Inspector General.” Unlike *Blackburn*, insider trading cases do not typically involve individual, identifiable victims. Accordingly, the SEC has historically used this type of process to collect disgorged funds. It remains to be seen whether, after *Liu*, such a process will withstand judicial scrutiny.

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