
United States Court of Appeals for the Fifth Circuit Becomes First Circuit Court to Consider Post-*Liu* Disgorgement

Holds SEC May Act as De Facto Trustee for Identified Victims

In *SEC v. Blackburn*, 15 F.4th 676 (5th Cir. Oct. 12, 2021),¹ the United States Court of Appeals for the Fifth Circuit became the first circuit to consider whether a disgorgement order for violations of the securities laws met the “awarded for victims” requirement set forth by the Supreme Court of the United States in *Liu v. SEC*, 140 S. Ct. 1936 (2020).² The Fifth Circuit affirmed the district court order awarding disgorgement and held that the award satisfied the requirements of *Liu* because the order required the Securities and Exchange Commission (“SEC”) to disburse funds “to already-identified victims with court supervision to ensure compliance with that edict.”³

I. *SEC v. Liu*: The “Awarded for Victims” Requirement for Disgorgement Orders

The Securities Exchange Act of 1934 permits the SEC to seek disgorgement as a means of “equitable relief . . . for the benefit of investors.” 15 U. S. C. §78u(d)(5). In *Liu*,⁴ the Supreme Court announced several limits to the SEC’s disgorgement power. Addressing issues left unresolved by the Court’s earlier decision in *Kokesh v. SEC*, 581 U.S. ___, 137 S. Ct. 1635 (2017),⁵ the Court in *Liu* held that disgorgement is lawful under §78u(d)(5) where such relief “does not exceed a wrongdoer’s net profits and is awarded for victims.”⁶

¹ Unless otherwise specified, quoted statements in this memorandum are taken from this decision.

² In *Liu*, the Supreme Court held that a disgorgement order providing “equitable relief” is lawful under the Securities Exchange Act of 1934 only when the amount recovered is not greater than the amount the defendant gained and is “awarded for victims.” 140 S. Ct. at 1940.

³ *Blackburn*, 15 F.4th at 678, 682.

⁴ For a comprehensive discussion of the *Liu* decision and its import, see our memorandum prepared by Bradley J. Bondi, Joel Kurtzberg, Lauren Perlgut and Jason Rozbruch, entitled *Supreme Court Holds That SEC Disgorgement Is a Form of Equitable Relief*, July 27, 2020, which can be found here: <https://www.cahill.com/publications/firm-memoranda/2020-07-27-supreme-court-holds-that-sec-disgorgement-is-a-form-of-equitable-relief>.

⁵ In *Kokesh*, the Supreme Court held that disgorgement is a penalty for statute of limitations purposes but expressly did not decide “whether courts possess authority to order disgorgement in SEC enforcement proceedings or . . . whether courts have properly applied disgorgement principles in this context.” 137 S. Ct. at 1642 n.3.

⁶ *Liu*, 140 S. Ct. at 1940 (emphasis added) (citation omitted).

The Supreme Court in *Liu* did not decide how a disgorgement remedy could satisfy the “awarded for victims” requirement. The Court explained, however, that the SEC cannot use the recovered profits for the benefit of the general public.⁷ The Court warned of several SEC disgorgement practices that “test the bounds of equity practice,” including allocating funds specifically to the Treasury Department and imposing equal liability, i.e., joint and several liability, among defendants.⁸ While acknowledging the “considerable tension with equity practices” in the SEC’s practice of allocating recovered proceeds to a Treasury fund when the SEC cannot feasibly distribute funds to victims, the Court did not reach the issue of whether the practice could continue.⁹ Instead, the Court left open this question for lower courts to determine the practice’s “consisten[cy] with equitable principles.”¹⁰

The Fifth Circuit’s decision in *Blackburn* was the first from a court of appeals to address disgorgement post-*Liu*.

II. Factual Background and Procedural History of *SEC v. Blackburn*

Treaty Energy Corporation (“Treaty”), a “penny stock” company traded in the over-the-counter market, operated in the oil and gas industry. In 2014, the SEC filed an enforcement action against Treaty, its founder, and two of its officers, alleging that the defendants committed securities law violations, including: (i) failing to register securities, (ii) making misrepresentations regarding oil drilling successes in Belize, and (iii) making misrepresentations and omissions regarding the founder’s role in the company. The SEC alleged that failing to disclose the founder’s extensive role in Treaty amounted to fraud due to the founder’s history of four tax-related felony convictions, a lawsuit for misappropriating funds at a different company, and his negative reputation in the industry. As such, these were “reasons [the founder] may not have wanted th[ese] public affiliations” with Treaty. Both the SEC and the defendants moved for summary judgment.

The U.S. District Court for the Eastern District of Louisiana granted the SEC’s summary judgment motion in part, holding that the defendants committed the aforementioned violations. Included among the penalties the district court authorized was disgorgement of the defendants’ profits arising from the violations of law.

After the Supreme Court decided *Liu*, the SEC requested, and the Fifth Circuit granted, a limited remand of the *Blackburn* disgorgement order to the district court for consideration of the impact of *Liu*. In applying *Liu*, the district court determined that the SEC had identified the victims, so the disgorgement could be returned to them rather than to a general government fund. The district court also ordered disgorgement of \$1.5 million from the founder, \$770,000 from one officer, and \$108,000 from the other officer. The court did not impose joint and several liability. Additionally, the district court ordered a procedure which would have the SEC serve “as a *de facto* trustee . . . disburse[ing] those funds to victims but only after district court approval.” The defendants appealed.

III. The Fifth Circuit Decision

On appeal, the Fifth Circuit considered the issues of (1) whether summary judgment was properly granted and (2) whether the “disgorgement aware was ‘for the benefit of investors’” as required by *Liu*. The Fifth Circuit affirmed the district court’s rulings with respect to both summary judgment and the disgorgement order.¹¹

⁷ *Id.* at 1948.

⁸ *Id.* at 1949.

⁹ *Id.* at 1946, 1948-49.

¹⁰ *Id.* at 1949.

¹¹ This memorandum addresses only that portion of the Fifth Circuit opinion concerning disgorgement.

The Fifth Circuit examined and approved the disgorgement procedures the district court ordered. As an initial matter, the amount forfeited by the three defendants totaled nearly \$2.4 million, although the amount attributed to each defendant differed substantially. This difference led the Fifth Circuit to conclude that the district court did not apply joint and several liability for purposes of disgorgement, a practice the Supreme Court in *Liu* indicated may fail to comport with §78u(d)(5).

Turning to the method of fund distribution, the Fifth Circuit held that the disgorgement was properly “awarded for victims,” despite the SEC acting as the trustee. The Fifth Circuit observed that the SEC already had identified the victims to whom it would distribute the profits and that the SEC’s role was limited to receiving the funds and then distributing them to harmed investors only upon receiving court approval. In his brief to the court, one of the defendants claimed that *Liu* required the district court to undertake a feasibility analysis of whether disgorgement proceeds would be awarded to victims.¹² The Fifth Circuit, without referencing the defendant’s argument, observed that the SEC’s identification of harmed investors demonstrates that “it is certainly feasible – more than that, it is the plan – that money the defendants return will go to the harmed investors.” However, the Court indicated that feasibility would have been a relevant factor if the SEC intended to distribute disgorged proceeds to a Treasury fund, an issue from *Liu* not presented in this case. Due to the combined factors of district court oversight of the SEC’s fund disbursement and the presence of previously-identified victims, the Fifth Circuit reasoned that the disgorgement procedure “easily satisfie[d] *Liu*.”

IV. Implications

In *Blackburn*, the Fifth Circuit clarified the “awarded for victims” requirement announced in *Liu* and was the first federal court of appeals to do so. The Fifth Circuit did not, however, opine as to the minimum procedures required to satisfy *Liu*. For example, the Fifth Circuit observed that the *Blackburn* case did not present the yet-to-be-decided question from *Liu* concerning the legality of disbursing funds to a Treasury fund for whistleblowers or the Inspector General. It is likely that other courts of appeals will be presented with different fact patterns regarding disgorgement orders and that these issues may reach the Supreme Court for further clarification.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Brad Bondi (Partner) at 202.862.8910 or bbondi@cahill.com; Joel Kurtzberg (Partner) at 212.701.3120 or jkurtzberg@cahill.com; Peter J. Linken (Counsel) at 212.701.3715 or plinken@cahill.com; or Zach Missan (Associate) at 212.701.3577 or zmissan@cahill.com; or email publications@cahill.com.

¹² Specifically, the defendant’s brief claimed that *Liu* required a feasibility analysis “in the first instance” for a disgorgement order.

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