

## The Supreme Court Upholds the SEC's Ability to Obtain Disgorgement

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In a long-anticipated decision, the U.S. Supreme Court this week upheld the Securities and Exchange Commission's (SEC) ability to obtain disgorgement, provided the award does not exceed the wrongdoer's ill-gotten gains and is returned to the victims.

The Supreme Court's decision came in *Liu et al. v. SEC*,<sup>1</sup> a case challenging the Ninth Circuit's enforcement of an almost \$35 million judgment against a husband and wife who allegedly defrauded Chinese investors out of millions in an EB-5 immigrant visa scheme involving a cancer treatment center that was never built.<sup>2</sup> The SEC sued in May 2016, claiming that Charles Liu and Xin Wang misappropriated investors' money for personal use and funneled millions to Chinese marketing firms. The U.S. District Court for the Central District of California granted summary judgment for the SEC, ordering the couple to pay \$8.2 million in monetary penalties and to disgorge the nearly \$27 million in ill-gotten gains they took from EB-5 visa-seeking Chinese investors.

The Liu couple argued that, under the rationale of the Supreme Court's 2017 *Kokesh v. SEC* decision, disgorgement was not available to the SEC as a form of equitable relief because it imposes a "penalty."<sup>3</sup> In its 8-1 opinion, the Supreme Court disagreed, explaining that the SEC is authorized to seek civil penalties and "equitable relief" under the powers granted to it in 15 U.S.C. §78u(d)(5).<sup>4</sup> The

Court noted that disgorgement is routinely ordered by equity courts, which have "routinely deprived wrongdoers of their net profits from unlawful activity, even though that remedy may have gone by different names" such as "restitution," or an "accounting for profits."<sup>5</sup>

Further interpreting the SEC's statutory powers, the Supreme Court held that §78u(d)(5)'s "phrase 'appropriate or necessary for the benefits of investors' must mean something more than depriving a wrongdoer of his net profits alone" and therefore that gains must be returned to the victims.<sup>6</sup> This is an important limitation on the SEC's disgorgement powers because, under current practices, there are many instances in which disgorged profits are deposited with the U.S. Treasury Department but not returned to investors. Consequently, the ability to identify harmed investors and return disgorged profits to them is likely to become a focus point of future settlements and litigation with the SEC.<sup>7</sup>

The Supreme Court's decision to preserve the SEC's disgorgement power is a victory for the SEC, as disgorgement represents one of the agency's most powerful forms of recovery.<sup>8</sup>

<sup>1</sup> Supreme Court Case No. 18-1501.

<sup>2</sup> *SEC v. Liu*, 754 F. App'x 505, 509 (9th Cir. 2018).

<sup>3</sup> *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1644 (2017) (holding that disgorgement constitutes a penalty and, consequently, that SEC claims for disgorgement are subject to the five-year statute of limitations).

<sup>4</sup> See 15 U.S.C. §78u(d)(5) ("In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, . . . any Federal court may grant . . . any equitable relief that maybe appropriate or necessary for the benefit of investors").

<sup>5</sup> *Liu v. Sec.*, 591 U.S. \_\_\_ (2020) at \*6.

<sup>6</sup> *Id.* at \*16.

<sup>7</sup> *Id.* at \*16-17 (With respect to the practice of depositing disgorgement funds with the Treasury in cases where it is not feasible to distribute collected funds to investors, the Court noted that it is an "open question" as to whether that practice is consistent with §78u(d)(5).)

<sup>8</sup> In fiscal year 2019, the SEC obtained over \$3.2 billion in disgorgement. SEC Division of Enforcement Annual Report, Fiscal Year 2019, available at <https://www.sec.gov/files/enforcement-annual-report-2019.pdf>

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