Supreme Court Preserves SEC's Ability To Seek Disgorgement, With Limitations

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The U.S. Supreme Court held on June 22, 2020, in *Liu v. SEC*, No. 18-1501 (2020), that the Securities and Exchange Commission (SEC or Commission) may seek a disgorgement award in a civil action in federal court that does not exceed a wrongdoer's net profits and is awarded for the victims of the wrongdoing, as such an award constitutes "equitable relief" permissible under Section 21(d)(5) of the Securities Exchange Act of 1934 (15 U.S.C. §78u(d)(5)).

Congress expressly authorized the SEC to seek disgorgement in administrative proceedings as part of the Remedies Act of 1990 (15 U.S.C. § 78u-2(e)). On the other hand, Section 21(d)(5), which applies to civil actions in federal court, authorizes the SEC to seek "equitable relief." With disgorgement being an important tool in the SEC's enforcement arsenal, the Commission has regularly pursued disgorgement in civil federal court actions as a form of equitable relief under Section 21(d)(5). The issue of whether the SEC could obtain disgorgement in federal civil actions came into question following the Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), which held that disgorgement in an SEC enforcement action constitutes a "penalty" for the purposes of the applicable statute of limitations. The Court did not, however, address whether disgorgement can also qualify as "equitable relief" under Section 21(d)(5).

Petitioners Charles Liu and his wife, Xin Wang, solicited nearly $27 million from foreign investors under the EB-5 Immigrant Investor Program, which permits noncitizens to apply for permanent residence in the United States by investing in approved commercial enterprises that are based on proposals for promoting economic growth. Investments under this program are subject to the federal securities laws. An investigation by the SEC revealed that the petitioners misappropriated much of the funds, in violation of the terms of a private offering memorandum. The SEC brought a civil action against the petitioners, seeking, in relevant part, disgorgement equal to the full amount the petitioners had raised from investors. The petitioners argued that the disgorgement remedy failed to account for their legitimate business expenses, but the U.S. District Court for the Central District of California disagreed and ordered the petitioners jointly and severally liable for the full amount raised from investors.

The U.S. Court of Appeals for the Ninth Circuit affirmed the district court's ruling in favor of the SEC. The Ninth Circuit acknowledged that the Supreme Court had not expressly addressed whether a district court had the authority to order disgorgement. It held that the proper calculation for disgorgement under the facts of the case was "the entire amount raised less the money paid back to the investors." The petitioners appealed, and the Supreme Court granted *certiorari* to determine whether Section 21(d)(5) authorizes the SEC to seek disgorgement beyond a defendant's net profits from wrongdoing.

Justice Sonia Sotomayor delivered the opinion of the Court, in which seven other justices joined. Justice Clarence Thomas filed a dissenting opinion.

The Court rejected the petitioners' argument that the SEC lacked the authority to seek disgorgement in a civil action, which rested, in part, on the Court's *Kokesh* decision. In interpreting Section 21(d)(5)'s authorization of "equitable relief," the Court looked to the categories of relief that were typically available in equity and concluded that courts have long been authorized to strip wrongdoers of their ill-gotten gains. The Court noted that such a remedy is restricted to an individual wrongdoer's net profits, to be awarded for the victims, so as to avoid transforming the equitable remedy into a punitive sanction. The Court held that Congress incorporated these long-standing equitable principles into Section 21(d)(5).

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The petitioners argued that their disgorgement award crossed the bounds of traditional equity because it failed to return funds to the victims, imposed joint and several liability and did not deduct legitimate business expenses from the award. The Court did not decide these issues but rather set forth certain principles to guide the lower court's analysis on remand. First, the Court noted that Section 21(d)(5) provides little guidance as to whether depositing funds with the Treasury satisfies the requirement that the remedy be appropriate or necessary for the benefit of investors. The Court left it to the lower courts to evaluate whether an order directing that proceeds go to the Treasury is consistent with the equitable principles described in the opinion. Second, the Court noted that disgorgement liability through joint and several liability generally is not appropriate but that equitable principles have permitted such liability for partners engaged in concerted wrongdoing. The Court again left it to the lower courts to determine whether the petitioners can be found liable for profits as partners in wrongdoing or whether individual liability is required. Finally, the Court noted that courts must deduct legitimate business expenses before awarding disgorgement under Section 21(d)(5).

Moving forward, the SEC will be free to continue to seek disgorgement in civil enforcement actions in federal court, but it will need to ensure that any such amounts are limited to the net profits from the alleged wrongdoing. It remains to be seen how courts will handle SEC-proposed disgorgement orders directing funds to the Treasury and whether the courts conclude that such orders are consistent with the requirement that the equitable remedy be awarded "for the benefit of investors."