
SUPREME COURT PERMITS SEC DISGORGEMENT OF NET PROFITS, IN *LIU V. SEC*

Today, the United States Supreme Court issued its opinion in *Liu v. SEC*, a case involving the SEC's ability to obtain disgorgement as "equitable relief" in civil enforcement proceedings under Section 21(d) of the Securities Exchange Act of 1934 (the "Act"), which allows federal courts to grant the SEC "any equitable relief that may be appropriate or necessary" in enforcement actions. No. 18-1501 (June 22, 2020). The Court held that a disgorgement award is permissible "equitable relief" if it does not exceed the wrongdoer's illicit net profits and is returned to the wrongdoer's victims.

The case involved an investment scheme to defraud foreign investors that was operated by Petitioners Charles Liu and Xin Wang, who raised nearly \$27 million from foreign investors seeking to qualify for U.S. visas by investing in U.S. businesses. Rather than invest the money as promised, Liu and Wang allegedly misspent or misappropriated a significant portion of the investors' money. The trial court found for the SEC and, among other things, ordered Petitioners to disgorge the full amount they had raised from investors. Petitioners objected that the disgorgement award failed to account for their legitimate business expenses; the trial court disagreed and held that the full amount raised was a reasonable approximation of the profits Petitioners earned as a result of their misconduct. Shortly after the trial court's decision, the Supreme Court held, in *Kokesh v. SEC*, that a disgorgement award in an SEC enforcement action constitutes a "penalty" for purposes of the applicable statute of limitations. 137 S. Ct. 1635 (2017). Notably, *Kokesh* did not address whether disgorgement qualifies as "equitable relief" under the Act, given that equity historically excludes punitive sanctions.

On appeal to the Ninth Circuit Court of Appeals, Petitioners relied heavily on *Kokesh*, arguing that the trial court lacked statutory authority to award disgorgement to the SEC, and that, even if disgorgement was an available remedy, it was limited to net profits, not gross receipts. The Ninth Circuit rejected Petitioners' argument and affirmed, concluding that the proper disgorgement amount was the entire amount raised less the money paid back to the investors. Petitioners filed a petition of review to the U.S. Supreme Court, which granted certiorari to determine whether the Act authorizes the SEC to seek disgorgement beyond a defendant's net profits from wrongdoing.

At oral argument, the Court focused on potential limits to the disgorgement remedy. For example, the Court questioned whether disgorgement should be limited to the wrongdoer's net profits rather than its gross receipts, and whether the disgorged funds should be returned to harmed investors or retained by the SEC. The Court's holding incorporates these limitations, balancing two countervailing principles of equity—that wrongdoers should not be allowed to profit from their wrongdoing, nor should they be punished by paying more than fair compensation to the harmed person. The Court held that disgorgement is permissible "equitable relief" that can be ordered in an SEC enforcement action in federal court if (1) the amount of the award does not exceed the wrongdoer's net profits, and (2) the money is awarded to the

victims (not retained by the SEC). Accordingly, the Court vacated the judgment and remanded to the trial court to ensure its disgorgement award was properly limited in light of the Court's holding.

Prior to oral argument, several members of Congress sought to ensure that the SEC could continue to seek disgorgement in civil enforcement proceedings. In November 2019, the House passed The Investor Protection and Capital Markets Fairness Act, H.R. 4344, which authorizes the SEC to seek disgorgement and sets a 14-year statute of limitations for the SEC to do so. The bill has yet to pass the Senate and was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

The Court's decision is an important holding for organizations that are defendants in civil SEC enforcement proceedings as well as organizations that are currently under SEC investigation and could be subject to further enforcement action.

The Supreme Court's opinion is available [here](#). We will continue to monitor and keep clients updated on the case on remand, the SEC's comment on the Court's decision, and other civil enforcement proceedings involving disgorgement awards.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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