Clients&FriendsMemo

A *Liu* Look at Disgorgement: Ninth Circuit Vacates SEC Disgorgement Award

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The U.S. Supreme Court's landmark decision in *Liu v. SEC*[1] is less than two months old, yet the ramifications of the decision on the SEC's enforcement powers are already taking shape.

In *Liu*, the Supreme Court preserved the SEC's ability to seek disgorgement of ill-gotten gains in federal court—despite the lack of an express "disgorgement" remedy in statutes—on the theory that disgorgement is one form of the "equitable relief" that statutes authorize the SEC to obtain. In upholding the disgorgement remedy, however, the Court held that disgorgement awards must be limited to wrongdoers' net profits as opposed to their gross illicit gains. The Court also cautioned that joint-and-several liability for disgorgement should be imposed only when dealing with "partners in wrongdoing." The Court also cast doubt on whether the SEC may obtain disgorgement in cases where funds will be remitted to the U.S. Treasury as opposed to returned to identifiable victims.

Litigants—and, importantly, courts—have taken note of these limitations.

A. *SEC v. Yang, et al.*

In an unpublished decision—the first appellate decision applying *Liu* in an SEC enforcement action—the Ninth Circuit reversed and remanded a multi-million-dollar judgment that included sizeable disgorgement awards.[2] In late 2015, the SEC accused Dr. Robert Yang, Claudia Kano (the administrative manager for Dr. Yang's medical practice), and their affiliated entities of raising nearly $20 million from Chinese investors in a fraudulent EB-5 Immigrant Investor Program visa scheme.[3] The SEC alleged that the pair promised to use investor funds to develop nursing care facilities in California, when in reality they diverted funds for personal use and for marketing. Yang and Kano entered into a bifurcated settlement in which they acknowledged their liability in consent

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1 *Liu v. SEC*, 140 S. Ct. 1936 (2020).

2 *SEC v. Yang, et al.*, No. 19-55289, 2020 WL 4530630 (9th Cir. Aug. 6, 2020).

3 SEC Litigation Release No. 23414 / November 27, 2015, available at https://www.sec.gov/litigation/litreleases/2015/lr23414.htm.

agreements, and agreed to have the amount of monetary penalties determined by the court.[4] The district court imposed the penalties sought by the SEC, which included disgorgement of $2,014,050 and $101,843 against Yang and Kano, respectively, and disgorgement of $839,151 against them and their entities, jointly and severally.[5]

The Ninth Circuit reversed and remanded. The appellate court noted the recent *Liu* decision and found that the district court's disgorgement award may have violated that decision in two ways. First, it was "unclear whether the district court limited its disgorgement orders imposed against the two individual defendants to their specific conduct where, for example, it made them both jointly and severally liable for the disgorgement amounts ordered against the entity defendants."[6] And second, it was unclear whether the disgorgement amounts ordered were "appropriate and necessary for the benefit of investors."[7] The Ninth Circuit therefore remanded for the district court to determine "whether its disgorgement orders comply with the Supreme Court's decision in Liu."[8]

B. Impact on Future SEC Enforcement Actions

In our June 24, 2020, Clients & Friends Memo, we noted that the impact of *Liu* is not so much an issue of *whether* the SEC may obtain disgorgement but *under what circumstances* it may obtain such relief. We noted that, going forward, the SEC must scrutinize how it applies joint-and-several liability, which may be a challenge in certain cases where the responsible parties are not easily viewed as "partners in wrongdoing." We also noted the hurdle of whether the SEC can obtain disgorgement in situations where the money collected is merely deposited in the U.S. Treasury as opposed to returned to investors.

Both of these concerns played out in the Ninth Circuit's *Yang* decision. It remains to be seen how the district court will apply the *Liu* decision on remand. Although the SEC may be hard-pressed to demonstrate that the responsible parties were "partners in wrongdoing" in certain cases (such as insider trading, where the tipper-tippee relationship may be attenuated), that would not appear to be an obstacle in *Yang*, as Yang and Kano were jointly engaged in operating affiliated entities that perpetuated their scheme. Whether funds can be effectively returned to the Chinese investors is a more difficult issue that the district court will have to grapple with here. More significantly, if the funds cannot be returned to investors, the district court may need to reach the issue of whether a disgorgement award can be "appropriate and necessary for the benefit of investors" in situations where the money goes to the U.S. Treasury. As discussed previously, the Supreme Court's

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4 *SEC v. Yang, et al.*, No. 19-55289, 2020 WL 4530630, at *1.

5 *SEC v. Yang, et al.*, No. 15-cv-02387, ECF No. 259 at 3-5 (Final Judgment as to Robert Yang, Claudia Kano, Yanrob's Medical Inc., Healthpro Capital Partners, LLC, and Suncor Care, Inc.) (C.D Cal. Jan. 8, 2019).

6 *SEC v. Yang, et al.*, No. 19-55289, 2020 WL 4530630, at *2 (citing *Liu*, 140 S. Ct. at 1945, 1949).

7 *Id.* (citing 15 U.S.C. § 78u(d)(5); *Liu*, 140 S. Ct. at 1948–49).

8 *Id.*

decision in *Liu* casts serious doubt on this proposition, and a decision concluding that the SEC cannot obtain disgorgement in these circumstances would have far-reaching implications on the SEC's enforcement program.

Yang serves as a lesson for companies and individuals facing SEC investigations, as it demonstrates the viability of arguments challenging disgorgement awards based on *Liu*. Litigants should push back on joint-and-several disgorgement awards where multiple defendants are involved, and press for strict proof of concerted wrongdoing. Companies should also challenge the SEC's planned use for disgorged funds and, if harmed investors cannot be readily identified, seek a determination that disgorgement is inappropriate. This is in addition to demanding that all legitimate business expenses be deducted from any disgorgement amount, which, although not at issue in *Yang*, was one of the limitations expressed by the Supreme Court in *Liu*.

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