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Investment Fraudsters Get a High Court Break on Legitimate Expenses

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Vacating a $26.4 million disgorgement award, the Supreme Court ruled Monday that an accounting of legitimate expenses may reduce the tab facing a couple who swindled Chinese investors.

Charles Liu and Xin Wang had solicited nearly $27 million from participants in what is known as an EB-5 Immigrant Investor Program, where foreigners who invest certain amounts in qualifying U.S. business ventures earn their shot at obtaining U.S. visas and even citizenship.

Though Liu and Wang said the money they had collected from investors would fund the construction of a cancer treatment center, only a fraction ever actually went toward a lease, proton-therapy machine and property improvements. A Securities and Exchange Commission investigation revealed roughly $20 million instead went toward marketing expenses and salaries, with some even going directly to the couple's personal accounts.

A federal judge in California had ordered the $26.4 million disgorgement in 2017, but that same year the Supreme Court ruled in the case *Kokesh v. SEC* that disgorgement qualifies as a penalty.

Liu and Wang struck out at a Ninth Circuit reversal but took their case to the Supreme Court, securing an 8-1 win Monday.

"It suffices to note that some expenses from petitioners' scheme went toward lease payments and cancer-treatment equipment," Justice Sonia Sotomayor wrote for the majority. "Such items arguably have value independent of fueling a fraudulent scheme. We leave it to the lower court to examine whether including those expenses in a profits-based remedy is consistent with the equitable principles."

Jennifer Schulp, the director of financial regulation studies at the Cato Institute, said in a statement Monday the court had "found middle ground by limiting what the SEC can seek as disgorgement."

For years, she said, the agency has "enjoyed unchallenged discretion" on the scope of disgorgement awards, "untethered to offense charged."

"The court's decision narrows the SEC's discretion, permitting the SEC to seek only awards that would deprive the wrongdoer of his net profits from the offense and requires the award to be for

the benefit of investors," Schulp said. "Whether this results in more predictable SEC awards remains to be seen, but it should force the SEC to be more clear about the basis for the awards it seeks."

The Cato Institute filed a brief supporting Liu and Wang's position last December.

Justice Clarence Thomas meanwhile called it wrong to treat disgorgement as an equitable relief, saying the remedy "invites abuse because it is a word with no fixed meaning."

Dissenting from Monday's ruling, Thomas called disgorgement "a creation of the 20th century."

"No published case appears to have used the term 'disgorgement' to refer to equitable relief until the 20th century," Thomas wrote. "Even then, the earliest cases use the word in a 'non-technical' sense … to describe the action a defendant must take when a party is awarded a traditional equitable remedy such as an accounting for profits for an equitable lien."

Sotomayor rooted the majority ruling in 19th century patent law, saying equity courts of that era "habitually awarded profits-based remedies … well before Congress explicitly authorized that form of relief."

"At bottom, even if Congress employed 'disgorgement' as a shorthand to cross-reference the relief permitted by §78u(d)(5), it did not silently rewrite the scope of what the SEC could recover in a way that would contravene limitations embedded in the statute," she wrote.

Kellogg Hansen attorney Gregory Rapawy, who represented Liu and Wang during oral arguments in March, applauded the court's ruling.

"We're pleased to see that the Supreme Court overturned the judgment against Mr. Liu and Ms. Wang and clarified that traditional equitable principles limit the SEC's authority to seek an award of net profits for the benefit of victims," Rapawy said in an email.

The Department of Justice did not immediately respond to a request for comment.

In his dissent, Thomas said the court was also wrong to not ensure that the award goes to compensating victims. The majority "cites no authority allowing a Government agency to keep equitable relief," he wrote.

Thomas took issue as well with the majority's characterization of Liu and Wang acting as partners and assigning the Ninth Circuit to assess their joint-and-several liability, writing "nothing indicates that petitioners here were legal partners" in their scheme.

The court agreed to also let the Ninth Circuit workout the couple's collective liability, and whether there are more awards to be gained from an equitable profit remedy application to both parties.

"Petitioners did not introduce evidence to suggest that one spouse was a mere passive recipient of profits," Sotomayor wrote. "Nor did they suggest that their finances were not commingled, or that one spouse did not enjoy the fruits of the scheme or that other circumstances would render a joint-and-several disgorgement order unjust."

Another securities litigator who weighed in on the Liu holding is Howard Fischer of the firm Moses & Singer.

"The fact that this was an 8-1 opinion reaffirms the centrality of the disgorgement remedy to the SEC's enforcement program," Fischer said in an email. "But in confirming that any disgorgement must allow a defendant to deduct expenses and only allow 'net profits' after deducting for 'legitimate expenses' will provide defendants strong ammunition for battling back against the SEC's tendency to seek aggressive disgorgement remedies. This decision preserves the SEC's disgorgement power while at the same time conferring on defendants a valuable tool for limiting it. Moreover, the decision contains additional limits on joint liability where there are multiple defendants that may ultimately provide defendants yet another argument for lowering disgorgement amounts awarded by courts."