

## SEC Acknowledges that Disgorgement Principles in *Liu* Apply to Administrative Proceedings

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**In a recently issued administrative order, the SEC implicitly acknowledged that the limiting principles for disgorgement that the Supreme Court outlined in *Liu v. Securities and Exchange Commission* apply to administrative proceedings. This opens the door for counsel and settling parties to use the limiting principles when negotiating an administrative order at the end of an investigation.**

### ***The Backdrop of Liu***

As discussed in a previous [client memorandum](#), the Supreme Court in *Liu v. Securities and Exchange Commission* upheld the SEC's authority to seek disgorgement in district court actions, provided that the award is (1) "for the benefit of investors," that is, distributed to investors<sup>1</sup>; (2) based on the amount accrued to the wrongdoer without recourse to joint-and-several liability; and (3) limited to "net" profits after deducting legitimate business expenses. The Supreme Court's decision was rooted in "equity jurisprudence" and the text of Section 21 of the Securities Exchange Act, 15 U.S.C. § 78u(d)(5), which authorizes the SEC to seek in federal court "any equitable relief that may be appropriate or necessary for the benefit of investors." According to the Court, disgorgement is an "equitable" award when the above conditions are satisfied.

Since the *Liu* decision, and as discussed in a previous [client memorandum](#), Congress passed the National Defense Authorization Act for Fiscal Year 2021, entered into law on **January 1, 2021**, which modified Exchange Act Section 21 to codify the *Liu* holding by giving the SEC express authority to seek "disgorgement" in district court actions. The new legislation did not appear to override *Liu*'s limiting principles, and, as discussed in our prior memorandum, we expect that courts will continue to apply them as inherent to the concept of "disgorgement."<sup>2</sup>

*Liu* involved a district court action. In administrative proceedings, Exchange Act Section 21B(e) provides that "the Commission may enter an order requiring accounting and disgorgement." The Court in *Liu* did not address whether its disgorgement principles apply to administrative proceedings.<sup>3</sup> 15 U.S.C. §77u-2.

### ***Recent SEC Order***

On February 2, the SEC issued a settled administrative order in which it appears to have acknowledged that the *Liu* principles apply to administrative proceedings. In [Lightspeed Trading LLC](#), the SEC alleged

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<sup>1</sup> The Court expressly did not address situations in which distributing funds to investors is not feasible.

<sup>2</sup> The legislation also extended the statute of limitations for disgorgement claims for scienter-based violations from five years to ten, and tolls the statute of limitations for disgorgement while the relevant party is outside of the U.S.

<sup>3</sup> See *Liu v. SEC*, 140 S.Ct. 1936, 1954 (2020). ("It is unclear whether the majority's new restrictions on disgorgement will apply to these proceedings as well. If they do not, the result will be that disgorgement has one meaning when the SEC goes to district court and another when it proceeds in-house.") (Thomas, J., dissenting).

that an introducing broker-dealer avoided market center fees by routing orders to an affiliate but continued to charge customers for those fees without disclosing the arrangement. The SEC included a paragraph in the settled order that addresses the *Liu* factors:

The disgorgement and prejudgment interest ordered . . . is consistent with equitable principles, does not exceed Respondent's net profits from its violations, and is awarded for the benefit of and will be distributed to harmed investors to the extent feasible. The Commission will hold funds paid . . . in an account at the United States Treasury pending distribution. Upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Exchange Act.

The order does not cite *Liu* but plainly tracks the Court's three principles. This appears to be the SEC's first acknowledgement that the *Liu* factors apply to administrative proceedings. The practical significance is that the SEC has opened the door for entities and individuals negotiating settled administrative proceedings to use the *Liu* factors to argue for lower disgorgement awards.

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