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Notes

SAVING DISGORGEMENT FROM ITSELF: SEC ENFORCEMENT AFTER *KOKESH v. SEC*

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ABSTRACT

Disgorgement is under threat. In Kokesh v. SEC*, the Supreme Court held that disgorgement—a routine remedy that allows the SEC to recoup ill-gotten gains from financial wrongdoers—is subject to a 5-year statute of limitations because it functions as a "penalty." This ruling threatens to upend the traditional conception of disgorgement as an ancillary remedy granted by the court's equity power, because there are no penalties at equity. With the possibility that* Kokesh*'s penalty reasoning could be adopted beyond the statute of limitations context, the future of disgorgement in federal court is in doubt.*

This Note proposes a way forward that allows for disgorgement's continued viability. The SEC should moderate its use of disgorgement for three reasons: because of a trend of suspicion toward strong government enforcement power by the Supreme Court, because it has been improperly used punitively, and because the rise of other statutory schemes has displaced disgorgement's original justification. At the same time, disgorgement should be saved because of the uncertain future of administrative disgorgement proceedings, the intuitive notion of recovering money from wrongdoers, and the much-needed ability to compensate victims. To save disgorgement, the SEC should limit its use only to restoring the status quo of injured investors, thereby ensuring a remedial—not penal—purpose.

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INTRODUCTION

In the 1987 film *Wall Street*, Gordon Gekko famously proclaims: "Greed, for lack of a better word, is good."[1] Even before Gekko captured the sentiment of an era, the world of stocks, bonds, and trading floors had seized the American public imagination.[2] Yet American popular culture seemed to be uniquely defined by corporate excess during the 1980s,[3] from gaudy fashion[4] to chillingly satirical portrayals in literature.[5]

However, if the 1980s appeared to be a boom time for bankers culturally, the ensuing decades proved to be a real-world reckoning. The name "Enron" has been seared into social consciousness as a metonym for scandalous financial fraud since 1997.[6] The dot-com bubble burst in 2000, devastating the industry.[7] More recently, the 2008 financial crisis, "the Great Recession," plunged the American economy into its most precarious position since the Great Depression.[8] And public approval of the financial industry hit a forty-year low in

1. WALL STREET (Twentieth Century Fox 1987).

2. *See* HERMAN MELVILLE, BARTELBY, THE SCRIVENER: A STORY OF WALL STREET (Dodo Press 2006) (1853) (detailing a Wall Street lawyer's interactions with his downtrodden and depressed clerk).

3. *See* William Taylor, *Crime? Greed? Big Ideas? What Were the '80s About?*, HARV. BUS. REV., Jan.–Feb. 1992, at 32–33 (noting how depictions of corporate greed pervaded the popular imagination of Americans in the 1980s).

4. *See Trend Alert: 1980s Banker's Shirt*, CLOTHES CAPTIONED (Apr. 11, 2014), http://www.clothes-captioned.com/trend-alert-1980s-bankers-shirt [https://perma.cc/LLB6-AP9A] (noting and illustrating the fashion revival of the banker shirt and its contrast collars that imply the excess associated with the 1980s).

5. *See generally* BRET EASTON ELLIS, AMERICAN PSYCHO (1991) (offering a vivid description of the life and times of a psychopathic stockbroker in Manhattan during the 1980s).

6. *See generally* BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003) (providing a narrative description of how the infamous Enron financial scandal occurred).

7. *See generally* ROGER LOWENSTEIN, ORIGINS OF THE CRASH: THE GREAT BUBBLE AND ITS UNDOING (2004) (attempting to trace the origins of the stock market's rapid rise and calamitous fall in the 1990s).

8. *See generally* MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2011) (narrating the buildup and crash of the American housing bubble in 2008).

2011.[9] Even nearly ten years after the start of the recession, railing against Wall Street remains an effective political move.[10]

Set against this backdrop, the U.S. Securities and Exchange Commission ("SEC") has proven to be one of the most vigorous tamers of Wall Street excess. As a protector of the public interest in the world of securities, the SEC has been a highly active enforcement body, filing 754 enforcement actions in 2017.[11] But after the Supreme Court's decision in *Kokesh v. SEC*,[12] the SEC may have lost one of its most powerful tools for addressing financial misconduct—disgorgement.

Disgorgement is "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion."[13] For the SEC, this tactic—implemented through a request to the courts—has become an indispensable part of its enforcement toolbox. In the 2017 fiscal year alone, disgorgement accounted for $2.9 billion of the over $3.7 billion that the SEC obtained through its administrative proceedings and court judgments.[14]

The remedy's roots can be traced back to the 1971 landmark decision *SEC v. Texas Gulf Sulphur Co.*,[15] the first instance in which a court authorized disgorgement.[16] Federal courts had previously limited the SEC largely to the relief authorized by the Securities Act of 1933[17]

9. *See* Lindsay A. Owens, *40-year Low in America's View of Wall Street*, CNN (Oct. 7, 2011, 9:34 AM), http://www.cnn.com/2011/10/07/opinion/owens-wall-street-disapproval/index.html [https://www.perma.cc/5K6Y-D3G4] ("Animosity toward Wall Street is at its highest level in at least 40 years.").

10. *See* David Weigel, *Not Much Unites Democrats and Republicans. Anger at Wall Street Does.*, WASH. POST (Jan. 18, 2016), https://www.washingtonpost.com/politics/not-much-unites-democrats-and-republicans-anger-at-wall-street-does/2016/01/18/265998e8-bdf0-11e5-83d4-42e3bceea902_story.html?utm_term=.f7aa6f7f62a4 [https://www.perma.cc/UF7C-M927] ("Eight years after the start of the Great Recession, and seven years since the Troubled Asset Relief Program was implemented, the anger at major financial institutions has only grown—in both parties.").

11. U.S. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT ANNUAL REPORT: A LOOK BACK AT FISCAL YEAR 2017, at 6 (2017), https://www.sec.gov/files/enforcement-annual-report-2017.pdf [https://perma.cc/QW9L-56YH] [hereinafter SEC 2017 ENFORCEMENT REPORT].

12. Kokesh v. SEC, 137 S. Ct. 1635 (2017).

13. *Disgorgement*, BLACK'S LAW DICTIONARY (10th ed. 2014).

14. SEC 2017 ENFORCEMENT REPORT, *supra* note 11, at 7.

15. SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971).

16. *See* Stephen M. Bainbridge, Kokesh *Footnote Three Notwithstanding: The Future of the Disgorgement Penalty in SEC Cases*, 56 WASH. U. J.L. & POL'Y 17, 20 (2018) ("There is general agreement that the penalty phase of *Texas Gulf Sulphur* was the first time a court determined that the SEC had authority to seek disgorgement of a defendant's ill-gotten gains." (citations omitted)).

17. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2012).

and the Securities Exchange Act of 1934;[18] that is, the SEC had to rely on "an injunction barring future violations of securities laws."[19] Changing that paradigm, *Texas Gulf Sulphur* invoked the court's equity power to grant disgorgement as ancillary to the primary relief of an injunction: "[T]he SEC may seek other than injunctive relief in order to effectuate the purposes of the [Securities Exchange] Act [of 1934], so long as such relief is remedial relief and is not a penalty assessment."[20] Disgorgement was thus established by the courts as a remedial measure supplemental to an injunction, created explicitly in order to "effectuate the purposes of the [Securities Exchange] Act [of 1934]."[21]

Since *Texas Gulf Sulphur*, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990[22] and section 308 of the Sarbanes-Oxley Act of 2002[23] have combined to provide the SEC with the ability to seek disgorgement through administrative proceedings.[24] When sought administratively, disgorgement is granted according to a statutory imprimatur. However, when the SEC seeks disgorgement in federal court, it is ordered through the court's equity power. Accordingly, disgorgement sought by the SEC in federal court exists as purely a judicial creation, legitimized by the Second Circuit in 1971.

Equitable disgorgement has been largely unchallenged since its conception.[25] Recently, however, the Supreme Court suddenly cast the future of the remedy into doubt when it held in *Kokesh* that disgorgement operates as a penalty for the purposes of statute of limitations described in 28 U.S.C. § 2462,[26] which requires that proceedings to initiate certain penalties be "commenced within five years from the date when the claim first accrued . . . ."[27] But the general

18. Securities Exchange Act of 1934, *id.* §§ 78a–78qq.

19. Kokesh v. SEC, 137 S. Ct. 1635, 1640 (2017).

20. *Tex. Gulf Sulphur*, 446 F.2d at 1308.

21. *Id.*

22. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (codified as amended in scattered sections of 15 U.S.C. (2012)).

23. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 308, 116 Stat. 745, 784 (codified as amended at 15 U.S.C. § 7246).

24. *See infra* Part IV.A.

25. *See* James Tyler Kirk, *Deranged Disgorgement*, 8 J. BUS. ENTREPRENEURSHIP & L. 131, 134 (2014) ("Today, the legitimacy of disgorgement in SEC enforcement actions is unchallenged.").

26. Kokesh v. SEC, 137 S. Ct. 1635, 1646 (2017).

27. 28 U.S.C. § 2462 (2012).

rule is that "there are no penalties in equity."[28] *Kokesh* thus raises a pressing question: Can disgorgement continue to be granted through the equity power of the courts?

If the *Kokesh* reasoning is adopted beyond the context of the statute of limitations, the answer would be simple: disgorgement cannot be granted by the court's equity power. But, given the lack of statutory authorization for equitable disgorgement, its invalidation would deprive the SEC of a vitally important enforcement tool. Although administrative disgorgement *is* statutorily authorized, that enforcement mechanism may also be in danger, albeit for different reasons.[29] This Note largely addresses the future of equitable disgorgement in federal court, where the SEC brings its most complex cases.[30]

In light of the threats currently facing disgorgement, this Note proposes a new framework to ensure disgorgement's continued viability. Because *Kokesh* evinced a concern about the remedy's abuse, it is through moderation that the future of disgorgement can be ensured. Echoing the warning posed by *Kokesh*, this Note argues that there are three principal reasons why the SEC should rein in its use of equitable disgorgement. First, recent Supreme Court jurisprudence has trended toward rejecting unbridled government enforcement power, like that historically shown by the SEC in disgorgement. Second, essentially punitive uses of disgorgement by the SEC have contravened equity principles. Third, the original rationale for disgorgement—the successful enforcement of federal securities laws—is no longer as persuasive given the advent of other statutory schemes and new enforcement mechanisms.

That said, equitable disgorgement is worth saving for several reasons: it cannot be entirely effectively replaced by administrative disgorgement, it embodies the intuitive notion that wrongdoers should

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28. Samuel Bray, *Equity at the Supreme Court*, WASH. POST (June 10, 2017), https://www.washingtonpost.com/news/volokh-conspiracy/wp/2017/06/10/equity-at-the-supreme-court/?utm_term=.19e10df3a48f [https://www.perma.cc/6RMN-EHWU].

29. *See* Jonathan H. Adler, *Are the SEC's Administrative Law Judges Unconstitutional?*, WASH. POST (Dec. 28, 2016), https://www.washingtonpost.com/news/volokh-conspiracy/wp/2016/12/28/are-the-secs-administrative-law-judges-unconstitutional/?utm_term=.04e7b3977397 [https://perma.cc/XF2S-2X4D] (discussing the uncertain future of SEC's Administrative Law Judges under the Appointments Clause); *see also* discussion *infra* Part IV.B.

30. *See* Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015, 10:30 PM), https://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 [https://perma.cc/YF7Y-669U] ("[M]ost of its complicated insider-trading cases have been heard in federal court, not by its in-house judges.").

not profit from their wrongdoing, and it fulfills the vital need to compensate victims. The SEC should narrow its use of disgorgement so that it restores the pre-wrongdoing status quo and compensates defrauded investors—nothing more. In this way, disgorgement would return to its remedial roots while abandoning its use as a deterrent, and thereby no longer act as a penalty under *Kokesh*'s reasoning. Ultimately, the SEC should *limit* disgorgement in order to *save* disgorgement.

Part I provides a concise background on the history of the SEC and its enforcement power and on the development of ancillary equitable remedies. Part II specifically examines disgorgement's origins and its historical development. Part III analyzes *Kokesh v. SEC*. Part IV presents the reasons for scaling back disgorgement, while also arguing that disgorgement, ultimately, is worth saving. And finally, Part V offers solutions that would save disgorgement from itself.

I. BACKGROUND ON SEC ENFORCEMENT ACTIONS

The SEC is empowered by a broad mandate to serve as the principal civil enforcement body for the securities laws. As the SEC fulfills this public mission, its ancillary equitable powers, including disgorgement, play a pivotal role.

A. The Role and Power of the SEC

Composed of twenty-three offices and five divisions,[31] the SEC claims a comprehensive mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[32] The SEC describes the period of its origin as "an era that was ripe for reform,"[33] framing its roots in conformity with its broad duty. The Great Stock Market Crash of 1929 provided the impetus for massive renovation of the regulatory framework. That crisis sparked the passage of two laws that fundamentally transformed how securities were regulated in the United States—the Securities Act of 1933 and the Securities Exchange Act of 1934.[34] The Securities Exchange Act of

31. *What We Do*, U.S. SECS. & EXCH. COMM'N (June 10, 2013), https://www.sec.gov/Article/whatwedo.html [https://perma.cc/8YR5-CUT4].

32. *Id.*

33. *Id.*

34. *Id.*

1934 formally created the Securities and Exchange Commission.[35] According to the SEC, there are "two common-sense notions" that underlie the motivation for its founding legislation: "Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing," and "[p]eople who sell and trade securities—brokers, dealers, and exchanges—must treat investors fairly and honestly, putting investors' interests first."[36]

A critical part of the SEC's mission is "interpret[ing] and enforc[ing] federal securities laws."[37] Specifically, the SEC's enforcement efforts—investigating and litigating violations—are undertaken by the Division of Enforcement, created in 1972.[38] Once a violation has been found, the SEC can pursue enforcement through the federal courts, administrative proceedings, or both. The SEC can also simultaneously refer a violation to the Department of Justice for criminal prosecution.[39] In federal courts, the Securities Act of 1933 and the Securities Exchange Act of 1934, often interpreted together, provide the statutory authorization for the SEC's Division of Enforcement to enforce these laws:

> Whenever it shall appear to the [Securities Exchange] Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provisions of this chapter, the rules or regulations thereunder . . . [the Commission] may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.[40]

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35. *See* 15 U.S.C. § 78d (2012) ("There is hereby established a Securities and Exchange Commission . . . to be composed of five commissioners to be appointed by the President by and with the advice and consent of the Senate.").

36. *What We Do*, *supra* note 31.

37. *Id.*

38. *About the Division of Enforcement*, SECS. & EXCH. COMM'N (Aug. 2, 2007), https://www.sec.gov/enforce/Article/enforce-about.html [https://perma.cc/8QQJ-EXQ5].

39. *See generally* Arthur F. Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 CATH. U. L. REV. 215 (1980) (detailing the development of the different methods of enforcement that the SEC may pursue).

40. 15 U.S.C. § 78u(d)(1) (2012); *see also id.* § 77v (providing for jurisdiction over "offenses and violations" of, as well as "suits in equity and actions at law brought under," the Securities Act of 1933).

Taken together, these two statutes form the basis for the principal statutorily authorized relief sought in federal court by the SEC—the injunctive action.[41] In addition, section 27 of the Securities Exchange Act of 1934 provides that federal courts possess "exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."[42]

B. Ancillary Equitable Remedies in SEC Enforcement Actions

Equity jurisdiction allows courts to invoke their equity power, which "includes all power necessary to make effective the decree rendered by the court."[43] Broadly, equity can be defined as "a set of rights, remedies, and procedures available ostensibly to ameliorate defects of the common law (such as in the cases of fraud, mistake, and forgery) and to enforce equitable instruments that required the ongoing supervision of a court (such as trusts and guardianships)."[44] Equity occupies a unique position within the American legal system, largely emptied of its historical legal force while still maintaining a certain relevance.

Equity's lineage can be traced to the dual-track English legal system; common law courts and equity courts simply had different jurisdictions.[45] Importantly, in English courts, equity courts only possessed jurisdiction when legal, "common law" courts did not.[46] As with many other aspects of English common law, the nascent American legal system adopted a similar conception of equity. Equity is enshrined not only within Article III, Section 2 of the Constitution ("in Law and Equity"),[47] but also in the Judiciary Act of 1789 ("suits of a civil nature at common law or in equity").[48] However, a preference for common law is apparent in the Constitution. The Seventh Amendment

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41. *See id.* § 78u(d).

42. *Id.* § 78aa(a).

43. Comment, *Equitable Remedies in SEC Enforcement Actions*, 123 U. PA. L. REV. 1188, 1189 (1975).

44. Kristin A. Collins, *"A Considerable Surgical Operation": Article III, Equity, and Judge-Made Law in the Federal Courts*, 60 DUKE L.J. 249, 266 (2010).

45. *See id.* ("In eighteenth century England, equity was available in separate courts with equity powers but was not available in the law courts. As a doctrinal matter, a court of equity had jurisdiction only when no remedy was available in law, or when the available legal remedy was incomplete or inadequate.").

46. *Id.*

47. U.S. CONST. art. III, § 2, cl. 1.

48. Judiciary Act of 1789, ch. 20, § 11, 1 Stat. 73, 78.

guarantees a jury trial at *common law*, and it "prohibits a federal court from hearing a case in equity when the plaintiff has an adequate remedy at law."[49] The English preference thus became the American preference. Accordingly, equitable remedies exist only where common law remedies do not, or cannot, provide full relief.

In the SEC enforcement context, the equity power of the court broadens the scope of permissible relief beyond mere injunctions. Equity allows courts to grant other ancillary equitable remedies, most notably disgorgement—a principal remedy arising out of the Securities Acts.[50] That is, equity is invoked to further the enforcement of the Acts where legal remedies are not enough.

The equitable relief granted by a court can take many different forms, including "injunction, specific performance, reformation . . . , accounting for profits, constructive trust, equitable lien, subrogation, . . . equitable rescission,"[51] and, of course, disgorgement.[52] Ancillary remedies are "simply means and instruments by which primary rights may be more efficiently preserved, protected, and enforced in judicial proceedings."[53] Equitable remedies become *ancillary* equitable remedies when they are "aiding or subsidiary and supplemental to some principal relief to make the principal relief effective."[54] Viewed through a securities enforcement lens, ancillary equitable remedies are intended to add to or supplement the principal relief of an injunction barring future violations of securities laws.[55]

Ancillary equitable relief, like disgorgement, has long been held permissible under the 1933 Securities and 1934 Securities Exchange Acts. In *Los Angeles Trust Deed & Mortgage Exchange v. SEC*,[56] the Ninth Circuit articulated this principle when it stated, in reference to the Acts:

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49. Michael T. Morley, *The Federal Equity Power*, 59 B.C. L. REV. 217, 233 (2018) (citing Scott v. Neely, 140 U.S. 106, 110 (1891); Hipp v. Babin, 60 U.S. (19 How.) 271, 278 (1857); Parsons v. Bedford, 28 U.S. (3 Pet.) 433, 447 (1830)).

50. *See* Comment, *supra* note 43, at 1188–89 ("The power of the courts to grant SEC requests for relief beyond a simple injunction against further wrongdoing appears well-established.").

51. Samuel L. Bray, *The System of Equitable Remedies*, 63 UCLA L. REV. 530, 541–42 (2016).

52. *See infra* Part II.

53. 1 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 171 (4th ed. 1918).

54. George W. Dent, Jr., *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865, 867 (1983).

55. *See infra* Part II.A.

56. L.A. Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960).

> [A]s the Supreme Court has stated with respect to other regulatory statutes, . . . the Congress must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of statutory purposes. As the Supreme Court long ago recognized, there is inherent in the courts of equity a jurisdiction to give effect to the policy of the legislature.[57]

Building upon the broad historical power of equity, courts have thus granted forms of ancillary relief that serve to effectuate the larger consumer protection and preventative purposes of the 1933 Securities Act and 1934 Securities Exchange Act.[58] Accordingly, within the securities enforcement context, the courts may invoke—and the SEC may seek—the power of equity to fashion ancillary relief in three main ways: "(a) the remedying of past abuses through the grant of monetary relief; (b) the prevention of future fraud by requiring the adoption of special corporate procedures; and (c) the temporary appointment of special agents in cases of gross mismanagement requiring unusual control or wholesale replacement of existing management."[59]

These three principal categories demonstrate the wide variety of equitable relief that the SEC can pursue ancillary to its injunction. Within the first category, disgorgement[60] and rescission[61] are examples of remedial monetary relief. The second category includes a company's establishment of special committees or implementation of specific preventative policies as set out by the SEC.[62] And the third category involves the appointment of special agent-receivers who function as "officer[s] of the court who stand[] neutral among all parties and whose primary function is the protection of the property within [their] control from waste or mismanagement."[63] Moreover, the court may order independent directors to manage the company in accordance with SEC

57. *Id.* at 182.

58. *See* Dent, *supra* note 54, at 867 ("The SEC and some commentators have found justification for [courts granting] ancillary relief in the need to effectuate the purposes of the securities laws . . . .").

59. Comment, *supra* note 43, at 1188 (citations omitted).

60. *See, e.g.*, SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1307–08 (2d Cir. 1971) (requiring the restitution of profits derived from insider trading).

61. *See, e.g.*, Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 390 (2d Cir. 1973) (recognizing that the SEC "may institute an action for injunctive relief [including restitution]" (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1103–04 (2d Cir. 1972)); *Tex. Gulf Sulphur*, 446 F.2d at 1309 ("[T]he district court had the power to order the cancellation of the option so as to effect the purpose of the [Securities Exchange] Act.").

62. *See* Comment, *supra* note 43, at 1196.

63. *Id.* at 1200.

discretion,[64] or the court may even appoint special counsel with oversight and investigatory power.[65] In sum, the SEC has the ability to request a wide array of specific forms of ancillary equitable relief to further the statutory scheme aimed at securities fraud prevention.[66]

II. DISGORGEMENT IN THE SEC ENFORCEMENT CONTEXT

This Part describes the history, purpose, and operation of disgorgement. Part II.A reviews disgorgement's foundations in the landmark *Texas Gulf Sulphur* decision. Part II.B details the history of disgorgement as a remedial and deterrent tool. Part II.C explains the procedural requirements of disgorgement. Finally, Part II.D explains the SEC's use of administrative disgorgement.

A. The Origins of Disgorgement

Disgorgement serves as an ancillary equitable remedy granted by the court in response to violations of federal securities laws. In some instances, disgorgement or an analogous remedy is expressly permitted by statute. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 provides for disgorgement through SEC administrative proceedings,[67] while the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform Act of 2010 allow for clawbacks of executive compensation after financial misconduct.[68] However, no statutory authorization for equitable disgorgement in federal court exists.[69] Disgorgement, like any other ancillary equitable remedy, is thus granted in accordance with a court's equity power, to further the enforcement of the Securities Act of 1933 and the Securities Exchange Act of 1934.[70]

Texas Gulf Sulphur established the modern framework for grants of disgorgement as an ancillary equitable remedy. That case marked

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64. *Id.* at 1204.

65. *Id.* at 1208.

66. *See* Dent, *supra* note 54, at 867 ("The SEC and some commentators have found justification for ancillary relief in the need to effectuate the purposes of the securities laws and in the general equity powers of the federal courts, particularly as reflected in precedents involving other administrative agencies.")

67. 15 U.S.C. § 78u–2(e) (2012).

68. *Id.* §§ 7243(a) (Sarbanes-Oxley), 78j–4(b) (Dodd-Frank).

69. *See* Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 2 (2013) ("Congress has never explicitly included disgorgement among the remedies the SEC can seek in federal court.").

70. 15 U.S.C. §§ 77v(a) (Securities Act); 78u(d)(5) (Securities Exchange Act).

the first time that disgorgement was pursued by, and granted to, the SEC as relief for violations for federal securities laws.[71] In *Texas Gulf Sulphur*, the Second Circuit held that "the SEC may seek [remedies] other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment."[72] This holding set forth two important principles: first, that disgorgement is within the ancillary equitable powers conferred upon the court, and second, that disgorgement cannot serve as a penalty.[73]

The first principle can be seen in the Second Circuit's embrace of disgorgement as necessary to fully realize a key aim of the Securities Acts—the protection of consumers from future wrongdoing.[74] That is, the court considered disgorgement as an equitable ancillary to the primary relief of an injunction, implicitly asserting that the court must move beyond merely granting an injunction in order to fully effectuate consumer protection. The *Texas Gulf Sulphur* court reasoned by analogy: Just as corporate receivers can be appointed under the Securities Exchange Act of 1934 without statutory authorization, equitable disgorgement of ill-gotten gains should be allowed as well.[75] *Texas Gulf Sulphur* also cited as rationale Supreme Court decisions granting equitable relief pursuant to other, unrelated statutory schemes,[76] such as the Fair Labor Standards Act of 1938,[77] the Housing and Rent Act of 1947,[78] and the Emergency Price Control Act of 1942.[79] Taking an expansive view of its own power, the court stated that it

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71. Ryan, *supra* note 69, at 3 n.13 ("The SEC first sought and obtained disgorgement in *SEC v. Texas Gulf Sulphur Co.*").

72. SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

73. *Id.*

74. *See supra* Part II.B.

75. *Tex. Gulf Sulphur*, 446 F.2d at 1307.

76. *Id.*

77. Mitchell v. Robert DeMario Jewelry, 361 U.S. 288, 337 (1960) (holding that "a District Court has jurisdiction to order an employer to reimburse employees, unlawfully discharged or otherwise discriminated against, for wages lost because of that discharge or discrimination" in enforcing the Fair Labor Standards Act of 1938, Pub. L. No. 75-718, c. 676, § 15(a)(3), 52 Stat. 1060, 1068 (codified at 29 U.S.C. § 215(a)(3)).

78. United States v. Moore, 340 U.S. 616, 620 (1951) (holding that restitution for rent overcharges was permissible under the Housing and Rent Act (citing Housing and Rent Act of 1947, Pub. L. No. 80-129, ch. 163, § 206(b), 61 Stat. 193, 199–200)).

79. Porter v. Warner Holding Co., 328 U.S. 395 (1946) (holding that it is within a court's equitable powers to order restitution for rent overcharges under the Emergency Price Control Standards Act of 1942 (citing Emergency Price Control Standards Act of 1942, Pub. L. No. 77-420, ch.26, § 205(e), 56 Stat. 23, 34)).

could not "infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts' power to grant appropriate remedies."[80] In other words, according to the *Texas Gulf Sulphur* court, restricting its capacity to grant disgorgement would compromise one of the court's most important roles—crafting appropriate relief.

Texas Gulf Sulphur also set out a second principle of disgorgement—it must be remedial rather than penal.[81] In rejecting arguments from the defendants that disgorgement operates as a penalty,[82] the court embraced the view that disgorgement is remedial. Although it did not use the specific term "disgorgement," the court declared that the relief granted was not penal in nature because "[r]estitution of the profits on these transactions merely deprives the appellants of the gains of their wrongful conduct."[83] For the *Texas Gulf Sulphur* court, restoring the status quo after a violation of securities laws constituted remedial relief, not a punitive measure, and the status quo was restored by seizing ill-gotten gains from wrongdoers. Accordingly, after *Texas Gulf Sulphur*, disgorgement was considered to be both within the equity power of the court and remedial in nature.[84]

B. Historical Principles of Disgorgement: Remedial and Deterrent Purposes

Although the *Kokesh* Court deemed disgorgement to be *penal* in nature for the purposes of statutes of limitations,[85] courts historically embraced it as *remedial* after *Texas Gulf Sulphur*. For example, the court in *SEC v. Manor Nursing Centers, Inc.*,[86] delineated the outer boundaries of remedial relief. That case involved a fraudulent public offering of common stock by the defendants.[87] Although the lower court allowed the SEC to obtain disgorgement of both the proceeds and the profits from the fraudulent stock offering, the Second Circuit

80. *See Tex. Gulf Sulphur*, 446 F.2d at 1308 (quoting Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 391 (1970)).

81. *See supra* note 72 and accompanying text.

82. *Tex. Gulf Sulphur*, 446 F.2d at 1308.

83. *Id.*; *see* Ryan, *supra* note 69, at 3 n.14 (noting that courts in the 1970s and 1980s often referred disgorgement as restitution, a similar equitable remedy).

84. *See* Ryan, *supra* note 69, at 3 ("Over time, courts came to accept as a truism the notion that disgorgement is inherently an ancillary equitable remedy." (citations omitted)).

85. *See supra* Part I.

86. SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082 (2d Cir. 1972).

87. *Id.* at 1094.

disagreed, explaining that "ordering the disgorging of profits and income earned on the proceeds is in fact a penalty assessment."[88]

The *Manor Nursing* court reasoned that the disgorgement at issue was not remedial because "defendants in private litigation would not be required to pay defrauded purchasers the profits on the proceeds."[89] Rather, public investors bringing suit would only receive the difference between what they paid and the value of what they received.[90] The court held that "the [district] court erred in ordering appellants to transfer to the trustee all the profits and income *earned on such proceeds*."[91] That is, the *Manor Nursing* court considered disgorgement remedial only when it took the exact amount the investors paid the wrongdoer, and the court considered disgorgement penal when it took anything more—including any money the wrongdoer earned because of those initial, illicitly gained investments. *Manor Nursing* accordingly represents an instance where a court ensured that disgorgement adhered to its remedial roots by not allowing repayment beyond the actual amount of ill-gotten gains directly tied to the defendant's fraud.

Another example of the courts' embrace of disgorgement as a remedial measure is *SEC v. Penn Central Co.*[92] In that case, the issue was whether an SEC disgorgement action was rendered punitive by the existence of a parallel private suit to recover damages against securities law violators.[93] The defendants argued that paying damages to defrauded investors and surrendering the same ill-gotten gains to the SEC would be duplicative, and thus a penalty.[94] The court rejected that reasoning, holding instead that the existence of simultaneous SEC and private suits "does not make the relief sought any less remedial."[95] The court further reinforced the nonpunitive nature of disgorgement by explaining that "[p]rivate suits do not necessarily restore the status quo," and thus SEC actions for disgorgement can work to complete the recovery of ill-gotten gains.[96] To mitigate any punitive duplicative effect, the court held that any amount of damages paid in a parallel

88. *Id.* at 1104.
89. *Id.*
90. *Id.*
91. *Id.*
92. SEC v. Penn Cent. Co., 425 F. Supp. 593 (E.D. Pa. 1976).
93. *Id.* at 596, 599.
94. *Id.* at 599.
95. *Id.*
96. *Id.*

private suit would reduce the disgorgement amount.[97] For the *Penn Central* court, disgorgement exists to ensure "total recovery from the wrongdoer,"[98] and not to impose a penalty.

Although not expressly stated in *Texas Gulf Sulphur*,[99] deterrence was a central principle of disgorgement doctrine in the years before *Kokesh*. For example, *Manor Nursing* declared that "[t]he deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."[100] Moreover, according to *Manor Nursing*, the statutory scheme mandates that the courts and the SEC ensure that security fraud violations do not profit wrongdoers.[101] *Penn Central* echoed this principle, declaring that disgorgement "serves to protect the investing public by providing an effective deterrent to future violations."[102] Another example is *SEC v. Golconda*,[103] wherein the court rejected an argument that an injunction provides enough of a deterrent. The court stated that not granting disgorgement "would impair the full impact of the deterrent force that is essential if adequate enforcement of the Securities Acts is to be achieved."[104] The court in *SEC v. First Jersey Sec., Inc.*,[105] went so far as to declare that deterrence is "the primary purpose of disgorgement as a remedy for federal securities laws violation."[106] And finally, the SEC itself embraced the deterrent function of disgorgement in a 2006 report, stating that "the aim of disgorgement is to deprive defendants of their ill-gotten gains in order to deter future violations."[107]

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97. *See id.* ("To the extent that defendants have made restitution, the amounts paid would serve to offset part or all of a judgment for disgorgement. In the event that we deem disgorgement appropriate, defendants will have the opportunity to prove that they have already relinquished their ill-gotten gains.").

98. *Id.*

99. *See supra* Part III.A.

100. SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1104 (2d Cir. 1972).

101. *See id.* ("The effective enforcement of federal securities laws requires that the SEC be able to make violations unprofitable.").

102. *Penn Cent. Co.*, 425 F. Supp. at 599.

103. SEC v. Golconda Mining Co., 327 F. Supp. 257 (S.D.N.Y. 1971).

104. *Id.* at 259.

105. SEC v. First Jersey Sec., Inc., 101 F.3d 1450 (2d Cir. 1996).

106. *Id.* at 1475.

107. U.S. SECS. & EXCH. COMM'N, REPORT PURSUANT TO SECTION 308(C) OF THE SARBANES OXLEY ACT OF 2002, at 19 (2006), https://www.sec.gov/news/studies/sox308creport.pdf [https://perma.cc/95F7-7JBK] [hereinafter 2006 SEC SECTION 308(C) REPORT].

C. The Mechanism for Determining Disgorgement

Federal courts have developed a series of procedural rules for granting disgorgement. First, although the SEC usually requests disgorgement, it is the district court that ultimately determines the final amount.[108] Second, disgorgement is limited to funds that are "causally related to the wrongdoing."[109] Courts cannot reach profits that were obtained through legal means.[110] Third, the amount of disgorgement sought by the SEC, and thus granted by the district court, "need only be a reasonable approximation of profits causally connected to the violation."[111] Fourth, the SEC bears the burden of showing that the amount it requested resembles a "reasonable approximation."[112] Once the SEC meets that initial burden, the burden then shifts to the defendants to prove that the amount is instead unreasonable.[113] This burden is a weighty one for defendants because courts often err on the side of granting a larger amount in disgorgement: "[T]he risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty."[114] Ultimately, the district court enjoys "wide latitude in [disgorgement] matters."[115]

Once disgorgement has been ordered, the district court must determine how the recouped money is to be distributed.[116] Typically, the district court orders the defendant to pay the disgorged amount into an escrow account overseen by a receiver or trust that "is given the task of locating those members of the public who were injured by the illegal activity and . . . [the task of] pay[ing] each injured party an amount determined by the trustee to be fair and equitable."[117] The district court then reviews the disgorgement plan set out by the

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108. *See* SEC v. Cavanagh, 445 F.3d 105, 116 (2d Cir. 2006) ("The remedy consists of factfinding by a district court to determine the amount of money acquired through wrongdoing—a process sometimes called 'accounting'—and an order compelling the wrongdoer to pay that amount plus interest to the court.").

109. SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

110. *Id.*

111. *Id.*

112. *Id.* at 1232.

113. *Id.*

114. *Id.*

115. SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995).

116. *See* SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) ("Once the profits have been disgorged, it remains within the court's discretion to determine how and to whom the money will be distributed, and the district court's distribution plan will not be disturbed on appeal unless that discretion has been abused." (citations omitted)).

117. SEC v. Lund, 570 F. Supp. 1397, 1404 (C.D. Cal. 1983).

administrator according to the "fair and reasonable" standard.[118] Notably, disgorgement plans can be ordered regardless of the presence of injured investors.[119] And the disgorged amount can be transferred directly to the U.S. Department of the Treasury in cases where it is "not feasible" to find the injured investors.[120] Although the exact amount of disgorged funds paid to the Treasury is uncertain, in 2017 the SEC transferred $1.9 billion in both disgorgement and civil penalties to the Treasury.[121] Overall, the district court has broad equity power over disgorgement, determining when it can be granted, how much can be recouped, and to whom the ill-gotten gains will be returned.

D. Forum Choice and the SEC: Federal Court or Administrative Action

The SEC can pursue enforcement of the securities laws through two main avenues: federal court or administrative action. Disgorgement doctrine has been developed by the SEC principally in federal court, as demonstrated by the *Texas Gulf Sulphur* line of cases.[122] But the SEC may also utilize administrative action to serve its public mission. The SEC's power to obtain disgorgement administratively was granted by a litany of reform bills intended to prevent financial misconduct.[123] Accordingly, the SEC is often presented with the pivotal choice of which forum is best suited for its needs and goals.

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118. *See* SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991) ("With the fair and reasonable standard firmly in mind, we must examine the district court's approval of the Revised Plan to see if its decision constituted an abuse of discretion.").

119. *See Fischbach*, 133 F.3d at 175–76 (noting that "the primary purpose of disgorgement is to deter violations of the securities laws" and that "the measure of disgorgement need not be tied to the losses suffered by defrauded investors").

120. For example, *Lund* noted:

> Any amount remaining in the escrow account [holding funds for the compensation of members of the public harmed by Lund's conduct] after one year shall be paid into the United States Treasury. If the magistrate determines that it is not feasible to locate those members of the public who were harmed by Lund's conduct, he may order the escrow funds to be paid into the United States Treasury at an earlier time.

Lund, 570 F. Supp. at 1405; *see also* U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2017 AGENCY FINAL REPORT 31 (2017), https://www.sec.gov/files/sec-2017-agency-financial-report.pdf [https://perma.cc/F673-VBB3] ("Disgorgement and penalties ordered and collected from violators of the securities laws, some of which are then returned to harmed investors and the balances are transferred to the Treasury").

121. U.S. SEC. & EXCH. COMM'N, *supra* note 120, at 69.

122. *See supra* notes 74–90 and accompanying text.

123. *See id.*

The SEC's forum selection calculus has undergone significant change in recent years. Throughout most of securities enforcement history, the dichotomy was that "litigated cases involving registered entities such as broker-dealers and investment advisers were generally brought in administrative proceedings, while cases involving non-industry individuals and entities were brought in federal district court."[124] While the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 and the Sarbanes-Oxley Act of 2002 marked a new stage in the growth of the SEC administrative forum, the Dodd-Frank Wall Street Reform Act of 2010[125] was the high-water mark of the SEC's embrace of agency adjudication. The Dodd-Frank Wall Street Reform Act of 2010 enables the SEC to pursue enforcement actions against individuals and nonregistered entities in administrative proceedings, and not just in federal court.[126] This newfound power has been used frequently: "In 2014, for example, the SEC instituted more than 610 administrative proceedings—nearly double the number of administrative actions filed in 2005."[127] And this discretion is almost entirely the SEC's to wield.[128]

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124. Randall J. Fons, *Administrative Proceedings vs. Federal Court: The SEC Provides Limited Transparency into Its Choice of Forum*, MONDAQ (May 13, 2015), http://www.mondaq.com/unitedstates/x/396864/Securities/Administrative+Proceedings+Vs+Federal+Court+The+SEC+Provides+Limited+Transparency+Into+Its+Choice+Of+Forum [https://perma.cc/G6U9-YBFV].

125. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S. Code).

126. *See* 15 U.S.C. § 77h-1(g)(1) ("In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person . . . ."); Stephen J. Choi & A.C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment,* 34 YALE. J. REG. 1, 9 (2017) ("After Dodd-Frank, the SEC no longer needs to proceed in federal court in order to assess civil penalties.").

127. William R. Baker, III, Brian E. Kowalski, Kory S. Wilmot & Stephen P. Barry, *SEC Enforcement Division Issues Guidance on Venue Selection*, LATHAM & WATKINS 1 (2015), https://www.lw.com/thoughtLeadership/lw-sec-guidance-choice-of-venue [https://perma.cc.6R45-WDGN].

128. *See* Peter J. Henning, *Choosing the Battlefield in S.E.C. Cases*, N.Y. TIMES (May 11, 2015), https://www.nytimes.com/2015/05/12/business/dealbook/choosing-the-battlefield-in-sec-cases.html [https://perma.cc/BE3E-VGQ7] ("The S.E.C. has almost unfettered discretion to choose where a case will be litigated, much to the chagrin of defense lawyers who complain that an administrative adjudication deprives their clients of valuable rights.").

Due to negative media coverage and outcry from the white-collar defense bar,[129] the SEC published its own internal guidelines for forum selection in 2015.[130] The publication lists four factors:

> The availability of the desired claims, legal theories, and forms of relief in each forum; . . . [w]hether any charged party is a registered entity or an individual associated with a registered entity . . . the cost-, resource-, and time-effectiveness of litigation in each forum[;] . . . [and f]air, consistent, and effective resolution of securities law issues and matters.[131]

Despite SEC's public-image conscious response, the SEC still possesses the power of the final forum choice.[132] This choice might be somewhat constrained by a public perception of a "home-court advantage" and by constitutional challenges to the administrative forum, but the choice remains with the SEC. Ultimately, however, after *Kokesh v. SEC*, disgorgement remains under threat.

III. *KOKESH V. SEC*: MR. KOKESH GOES TO WASHINGTON

As the owner of two firms, Charles Kokesh advised business development companies on investments.[133] The SEC alleged that he misappropriated $34.9 million between 1995 and 2009 and that he filed false and misleading reports to conceal the misappropriation.[134] In the U.S. District Court for the District of New Mexico, Kokesh was found guilty of violating a litany of federal securities laws.[135] The court ordered Kokesh to pay $2,354,593 as a civil monetary penalty.[136] With respect to the civil penalty, all malfeasance committed by Kokesh prior to October 27, 2004, was excluded from the calculation of the total

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129. *See, e.g.*, Eaglesham, *supra* note 30 (noting fairness concerns over the SEC's administrative proceedings from defendants, members the securities bar, and a former SEC judge); Henning, *supra* note 128 (noting that defense lawyers complain that the SEC administrative adjudication "deprives their clients of valuable rights").

130. *Division of Enforcement Approach to Forum Selection in Contested Actions*, U.S. SECS. & EXCH. COMM'N (2015), https://www.millerchevalier.com/sites/default/files/resources/FCPAReview/FCPAReviewSummer2015_SEC-Guidance_Division-of-Enforcement-Approach-to-Forum-Selection.pdf [https://perma.cc/9U5H-3LTG].

131. *Id.* at 1–4.

132. Fons, *supra* note 124 ("The guidance, however, ultimately provides the Division with virtually complete discretion in choosing the playing field that will be most advantageous to its case and to its view of the 'proper development of the law.'").

133. Kokesh v. SEC, 137 S. Ct. 1635, 1640 (2017).

134. *Id.*

135. *Id.*

136. *Id.* at 1642.

penalty because of the five-year statute of limitations in 28 U.S.C. § 2462.[137] Unsurprisingly, the SEC also sought disgorgement to the fullest measure—a total of $34.9 million that included $29.9 million for misconduct before October 27, 2004.[138] The district court ruled that the five-year statute of limitations under § 2462 did not apply to the disgorgement amount because disgorgement is not a penalty.[139] On appeal, the Tenth Circuit affirmed, holding that disgorgement is neither a penalty nor a forfeiture.[140] The Supreme Court granted certiorari to determine the status of disgorgement under § 2462.[141]

At first glance, the *Kokesh* decision seems routine and limited in scope. The Supreme Court, in a 9–0 opinion, held that disgorgement is subject to the five-year statute of limitations because the SEC's use of disgorgement is a penalty for the limited purposes of § 2462.[142] That is, disgorgement is a penalty and not remedial, but only within one statute. Writing for a unanimous court, Justice Sotomayor relied upon the *Huntington v. Attrill*[143] definition of a penalty: a "penalty" is a "punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offense against its laws."[144] Justice Sotomayor also outlined two principal requirements for an action to be a penalty.[145] First, the act must seek to redress a public wrong.[146] And second, deterrence—not compensation—must be the principal purpose of the action.[147]

Disgorgement easily fulfilled the two-part penalty test according to the Court in *Kokesh*. The Court reasoned that because violations of securities laws are public law offenses against the United States,[148] the subsequent removal of illicit profits from wrongdoers serves to redress a public wrong.[149] The SEC had previously conceded the first

137. *Id.* at 1641 ("As to the civil monetary penalties, the District Court determined that § 2462's 5-year limitations period precluded any penalties for misappropriation occurring prior to October 27, 2004—that is, five years prior to the date the Commission filed the complaint.").

138. *Id.* at 1640.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.* at 1645.

143. Huntington v. Attrill, 146 U.S. 657 (1892).

144. *Id.* at 667.

145. *Kokesh*, 137 S. Ct. at 1642.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* at 1643.

Huntington penalty factor by acknowledging its role of acting in the public interest.[150] According to the Court, the public nature of SEC disgorgement is shown in the fact that the SEC may continue an enforcement action without any injured individuals as parties.[151]

The Court also found that SEC disgorgement meets the second *Huntington* characteristic of penal measures.[152] Relying on lower-court interpretations, the Court characterized disgorgement primarily as a tool to prevent future financial misconduct.[153] Despite the fact that victims many times do receive disgorged funds,[154] the Court found it dispositive that district courts are not statutorily commanded to distribute funds to victims.[155] Justice Sotomayor concluded her opinion by declaring that "SEC disgorgement thus bears all the hallmarks of a penalty."[156]

As with many Supreme Court decisions, the devil of *Kokesh* is in the footnotes. Footnote 3 states, in full:

> Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context[.] The sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period.[157]

In one footnote, the Supreme Court seemingly opened up Pandora's box. As one commentator on the decision notes, "when the Supreme Court says, 'We're not expressing an opinion on *x*,' you can be pretty sure the justices are expressing an opinion on *x*."[158] *The New York Times* published an article entitled *Supreme Court Casts Doubts*

150. *Id.* (remarking that the SEC embraced its public enforcement role in its briefs).

151. *Id.*

152. *Id.*

153. *Id.*

154. *See id.* at 1644 ("Some disgorged funds are paid to victims; other funds are dispersed to the United States Treasury." (citations omitted)).

155. *See id.* ("Even though district courts may distribute the funds to the victims, they have not identified any statutory command that they do so. When an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty.").

156. *Id.*

157. *Id.* at 1642.

158. Bray, *supra* note 28.

on a Potent S.E.C. Weapon.[159] A *Forbes* piece even went so far as to herald a world without disgorgement, in *Chronicle of Disgorgement's Death Foretold:* Kokesh v. SEC.[160] The Cato Institute, a libertarian think tank, also took notice, issuing a Shakespearean blog title: Kokesh v. SEC*: A Penalty by Any Other Name*.[161] *Kokesh* also unleashed a torrent of examination pieces on law firm websites, having prompted a quiet cheer throughout the immensely profitable and highly active white-collar defense bar.[162]

For the first time since 1971, disgorgement appears vulnerable.[163] The SEC has pushed disgorgement to its equitable limit, recovering from defendants amounts that were essentially penal—amounts that went beyond merely restoring the status quo. For example, the SEC sought disgorgement in cases where the defendants never received the profit of their misconduct,[164] and sought the full amount where the defendant's expenses reduced the illegal profit in question.[165] The reasoning of *Kokesh*, despite attempts to cabin its holding, nonetheless opens the door for a wider decision that deems disgorgement a penalty as a categorical matter. If disgorgement were held categorically to be a penalty, it could no longer be authorized by a court in equity, and federal courts would need statutory authorization to grant it. Put simply, Footnote 3 of *Kokesh* resonates because it lays bare the uneasy

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159. Peter J. Henning, *Supreme Court Casts Doubt on a Potent S.E.C. Weapon*, N.Y. TIMES (June 12, 2017), https://www.nytimes.com/2017/06/12/business/dealbook/supreme-court-casts-doubts-on-a-potent-sec-weapon.html?mcubz=0&_r=0 [https://www.perma.cc/D969-DT3T].

160. Robert Anello, *Chronicle of Disgorgement's Death Foretold:* Kokesh v. SEC, FORBES (July 11, 2017, 5:53 PM), https://www.forbes.com/sites/insider/2017/07/11/chronicle-of-disgorgements-death-foretold-kokesh-v-sec/#284bfc6861b8 [https://perma.cc/H6WX-79XF].

161. Thaya Brook Knight & Ilya Shapiro, Kokesh v. SEC*: A Penalty by Any Other Name*, CATO INST. (June 6, 2017, 8:55 AM), https://www.cato.org/blog/kokesh-v-sec-penalty-any-other-name [https://perma.cc/AP7S-EU6S].

162. *See, e.g.*, Nicolas Bourtin, Nicole Friedlander, Robert J. Giuffra, Jr., Sharon L. Nelles, Kenneth M. Raisler, Karen Patton Seymour, Samuel W. Seymour, Benjamin R. Walker & Alexander J. Willscher, Kokesh v. SEC*: U.S. Supreme Court Holds That a Five-Year Statute of Limitations Applies When the SEC Seeks Disgorgement in Enforcement Actions*, SULLIVAN & CROMWELL (June 6, 2017), https://www.sullcrom.com/kokesh-v-sec-us-supreme-court-holds-that-a-five-year-statute-of-limitations-applies-when-the-sec-seeks-disgorgement-in-enforcement-actions [https://perma.cc/9B5C-K3M9] (noting the beneficial effects of the *Kokesh* ruling for defendants).

163. *See supra* note 25 and accompanying text.

164. *See generally* SEC v. Contorinis, 743 F.3d 296 (2d Cir. 2014) (holding an inside trader liable for the gains of those to whom the illicit information was given).

165. *See* Kokesh v. SEC, 137 S. Ct. 1635, 1644 (2017) ("SEC disgorgement sometimes is ordered without consideration of a defendant's expenses that reduced the amount of illegal profit.").

doctrinal ground for disgorgement. Just as federal court disgorgement was granted by judicial authority, it may also be taken away by judicial authority.[166]

IV. Disgorgement's Double-Edged Sword

As suggested by the Supreme Court in *Kokesh*, disgorgement has undoubtedly been pushed to the limits of its power by the SEC. This Part argues that there are three principal reasons why disgorgement is under threat, and thus why it should be reined in. First, recent Supreme Court cases repudiate unbridled governmental enforcement authority. Second, disgorgement has been erroneously utilized as a penalty at equity. And third, the original rationale for equitable disgorgement—filling a crucial gap in the SEC enforcement arsenal—does not have the same force in the present day. By *limiting* its use of disgorgement, the SEC can *save* disgorgement in federal court. Equitable disgorgement should be saved for a number of reasons, including the uncertain future of disgorgement in administrative proceedings, the intuitive notion that wrongdoers should not profit from their wrongs, and the need to compensate defrauded investors.

A. Why Disgorgement Should Be Reined In

1. *Supreme Court Jurisprudence Trends Against Expansive Enforcement Power.* Recent Supreme Court jurisprudence has moved toward rejecting the type of unchecked governmental power that the expansive use of disgorgement represents. This judicial trend is best seen through the lens of cases like *Kokesh*,[167] *Gabelli v. SEC*,[168] and *Honeycutt v. United States.*[169] In each of these cases, and in others, the Court has curbed the government's ability to exercise its enforcement power seemingly without any meaningful limit. Taken together, these cases serve as a warning for the SEC that if it continues to push the limits of disgorgement, it may suffer the most significant setback of its enforcement powers to date—the complete loss of equitable disgorgement.

166. *See generally e.g.*, Francesco A. DeLuca, *Sheathing Restitution's Dagger Under the Securities Acts: Why Federal Courts are Powerless to Order Disgorgement in SEC Enforcement Proceedings*, 33 REV. BANKING & FIN. L. 899 (2014) (arguing that disgorgement is not truly an equitable remedy and thus should not be granted by the court).

167. Kokesh v. SEC, 137 S. Ct. 1635.

168. Gabelli v. SEC, 568 U.S. 442 (2013).

169. Honeycutt v. United States, 137 S. Ct. 1626 (2017).

Kokesh itself demonstrates the Supreme Court's reluctance to continue endorsing the unchecked enforcement power held by the SEC. Specifically, the Court's holding that disgorgement is subject to a five-year statute of limitations[170] offers a procedural restraint that had not bound the SEC before. No longer can the government reach deep into the past to disgorge amounts from securities violations committed long ago. For the SEC, this limitation was significant; in the *Kokesh* case, it meant the difference between receiving a non-time-barred recovery amount of $39.9 million or the five-year statutorily limited amount of $5 million.[171] Accordingly, *Kokesh* marks an instance in which the Court provided a meaningful limit on SEC enforcement power by holding the Commission to a procedural restraint.

Gabelli is another case in which the Supreme Court circumscribed the enforcement power of the SEC by holding that the five-year statute of limitations for civil penalties under § 2462 begins when the fraud occurs, not when the SEC discovers it.[172] The SEC had sought to have the five-year statute of limitations for civil monetary penalties begin when the Commission discovers the wrongdoing,[173] which would strengthen the SEC's already significant enforcement abilities. For example, if the Court had ruled that the statute of limitations commences upon the discovery of fraud, the SEC could prosecute a violation from the 1990s—or perhaps even further back—if it only found out about the fraud in the present day. The Court rejected this interpretation and noted that the SEC has several potent tools at its disposal to promptly uncover wrongdoing, including demands for detailed trading information,[174] compelled disclosure of trading books,[175] subpoena power,[176] authorization to pay whistleblowers,[177] and ability to offer "cooperation agreements" to alleged wrongdoers.[178]

170. *Kokesh*, 137 S. Ct. at 1646.

171. *Id.* at 1641.

172. *Gabelli*, 568 U.S. at 454.

173. *Id.* at 449.

174. *See id.* at 451 ("It can demand that securities brokers and dealers submit detailed trading information.").

175. *See id.* ("It can require investment advisers to turn over their comprehensive books and records at any time.").

176. *See id.* ("And even without filing suit, it can subpoena any documents and witnesses it deems relevant or material to an investigation.").

177. *See id.* ("The SEC is also authorized to pay monetary awards to whistleblowers, who provide information relating to violations of the securities laws.").

178. *See id.* ("In addition, the SEC may offer 'cooperation agreements' to violators to procure information about others in exchange for more lenient treatment.").

In fact, the Court declared that "the SEC as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect."[179] The Court's ruling demonstrated that allowing the SEC to enjoy the benefits of the statute of limitations discovery rule would be a step too far in terms of permitting unbridled enforcement authority.

Although it did not involve securities fraud, *Honeycutt* also serves as an example of the Supreme Court reining in unbridled government enforcement power.[180] In *Honeycutt*, the Court held that joint and several liability does not apply to the criminal asset forfeiture statute, 21 U.S.C. § 853(a)(1).[181] Tony Honeycutt pled guilty to several federal drug crimes for distributing iodine—a product used in methamphetamine production—through the hardware store he owned.[182] As part of his guilty plea, Tony was ordered to pay $200,000 of the $269,751.98 he had received in illicit profits.[183] Terry Honeycutt, Tony's brother, was indicted as a co-conspirator, and the Government sought to use the Criminal Asset Forfeiture Act of 1984 to recoup the remaining $69,751.98 of profit from Terry.[184] This Act allows the government to pursue "any property constituting, or derived from, any proceeds the person obtained, directly or indirectly, as the result of" the crimes in question.[185] The government used a theory of joint and several liability to force Terry—who had been indicted as a co-conspirator but who notably neither owned the store nor saw any of Tony's profits—to pay the remaining illicit profits.[186]

179. *Id.*

180. *See* Dixie L. Johnson, Carmen Lawrence, M. Alexander Koch, Matthew H. Baughman and Abraham N.M. Shashy, Jr., *King & Spalding Discusses Potential Effects of SEC Disgorgement As a Penalty*, THE CLS BLUE SKY BLOG (June 21, 2017) http://clsbluesky.law.columbia.edu/2017/06/21/king-spalding-discusses-potential-effects-of-sec-disgorgement-as-penalty/#_edn25 [https://perma.cc/YWH2-MZWR] (arguing that *Kokesh* and *Honeycutt* "signal a clear desire by the Court to rein in the government's more aggressive theories of monetary remedies").

181. Honeycutt v. United States, 137 S. Ct. 1626, 1628 (2017).

182. *Id.*

183. *Id.*

184. *Id.*

185. Section 853(a)(1)–(2) provides:

> Any person convicted of a violation of this subchapter or subchapter II of this chapter punishable by imprisonment for more than one year shall forfeit to the United States, irrespective of any provision of State law—(1) any property constituting, or derived from, any proceeds the person obtained, directly or indirectly, as the result of such violation; (2) any of the person's property used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, such violation . . . .

21 U.S.C. § 853(a)(1) (2012).

186. *Honeycutt*, 137 S. Ct. at 1628.

Rejecting the application of joint and several liability in this instance, the Court held that permissible forfeitures are limited to what the defendant himself acquired as a result of his crime, not what his co-conspirator acquired.[187] In simple terms, Terry Honeycutt was not responsible for forfeiting profits that his brother Tony made because Terry had "no ownership interest in his brother's store and did not personally benefit from the illegal sales."[188] *Honeycutt* held that the text of the statute limits forfeiture to tainted property that a defendant personally procured,[189] noting that joint liability runs counter to other forfeiture statutes and is not reflected in congressional intent.[190]

Honeycutt is troubling for the SEC's use of disgorgement because it demonstrates that the Court's recent limits on discretionary governmental power have been extended beyond the securities enforcement context. The drug crime context of *Honeycutt* illustrates a much broader Supreme Court repudiation of the government using its power without any meaningful limit. Specifically, the Court stated that forcing Terry Honeycutt to forfeit profits that his brother Tony made would constitute an "end run" of the Criminal Asset Forfeiture Statute.[191] According to *Honeycutt*, Congress explicitly "contemplated situations where the tainted property itself would fall outside the Government's reach."[192] Therefore, in attempting to hold Terry Honeycutt liable for gains he never received, the Government was exercising its power beyond its statutory bounds. The Court rejected the Government's attempt to "circumvent Congress' carefully constructed statutory scheme . . . ."[193] The *Honeycutt* decision marks a concerted effort by the Court to tame excessive governmental power, demonstrating that the force of its disapproval of expansive enforcement power is not limited to the realm of securities.

2. *SEC Use of Disgorgement as a Penalty Violates Notions of Equity.* Disgorgement should also be reined in because the SEC has violated the principles of equity by using disgorgement punitively. *Kokesh* defines disgorgement as a type of "restitution measured by the

187. *Id.*
188. *Id.* at 1628–29.
189. *Id.* at 1633.
190. *Id.* at 1633–34.
191. *Id.*
192. *Id.*
193. *Id.*

defendant's wrongful gain."[194] The Supreme Court, however, noted several instances where the amount recovered by the SEC "exceed[ed] the profits gained as a result of the violation."[195] In these cases, disgorgement transforms from a remedial measure into a punitive sanction. First, to demonstrate overzealous disgorgement in insider trading cases, *Kokesh* disapprovingly cited *SEC v. Contorinis*[196] that SEC had been able to recover third-party profits from an insider trader who never actually *received* such profits.[197] Next, the Court made an example of *SEC v. Warde*,[198] wherein the SEC received disgorgement from a tipper (the person who illegally released confidential information that affects stock price), even though the disgorged gains had been the tippees' (the people who received the confidential information).[199] Both examples show that the SEC has used disgorgement to *penalize* the wrongdoer for misconduct, as the amounts recovered exceeded the restoration of the status quo and were not limited to solely the amount gained by the wrongdoer. In using disgorgement punitively, the SEC has been contravening basic equity principles, as "there are no penalties at equity."[200]

3. *The Original Rationale for Disgorgement Is No Longer As Persuasive.* Disgorgement should also be narrowed because the SEC's enforcement power has expanded significantly since *Texas Gulf Sulphur*. When first instituted, disgorgement fulfilled a reasonable need: "to effectuate the purposes of the [Securities Exchange] Act [of 1934]."[201] Previously, the SEC had the limited remedy of an injunction at its disposal in order to deter wrongdoing,[202] as well as other, less potent ancillary equitable remedies.[203] Disgorgement thus served a unique purpose at the time as the only remedy in the SEC arsenal that allowed the Commission to recoup profits from wrongdoers.[204]

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194. Kokesh v. SEC, 137 S. Ct. 1635, 1640 (2017) (quoting RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51, cmt. a (AM. LAW INST. 2010)).

195. *Id.* at 1644.

196. SEC v. Contorinis, 743 F.3d 296 (2d Cir. 2014).

197. *Kokesh*, 137 S. Ct. at 1644.

198. SEC v. Warde, 151 F.3d 42 (2d Cir. 1998).

199. *Id.* at 47.

200. Bray, *supra* note 28.

201. SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

202. *See supra* Part III.A.

203. *See supra* Part II.B.

204. *See supra* Part I.

Since the advent of disgorgement, the SEC has only increased in power. It has notably received a number of other enforcement tools that enable it to fully enforce the antifraud provisions of the securities laws. For example, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 allowed for the imposition of civil monetary penalties—calculated according to the gross pecuniary gain of the wrongdoing[205]—in federal court for violations of federal securities laws.[206] The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 also gave expansive power to the SEC's Administrative Law Judges ("ALJs"), and thus "created the modern regime of administrative proceedings."[207] These ALJs were not only given cease-and-desist authority,[208] but also the ability to administratively order disgorgement with the same effect and requirements as federal courts.[209]

The Sarbanes-Oxley Act of 2002 expanded the SEC's powers even further, giving the Commission the statutorily authorized ability to compensate injured investors with the money received through civil penalties or disgorgement via a "Fair Fund."[210] And most recently, the Dodd-Frank Wall Street Reform Act of 2010 enabled the SEC to administratively impose civil penalties outside of federal court.[211] In administrative proceedings, civil monetary penalties are not imposed according to the defendant's gain, as in disgorgement, but instead are calculated according to "each act or omission" in violation of the Securities Acts,[212] with three tiers of penalty amounts increasing in severity.[213]

205. *E.g.*, 15 U.S.C. § 78u(d)(3)(A) (2012).

206. *See, e.g.*, *id.* § 78ff(c)(1)(B) ("Any issuer that violates subsection (a) or (g) of section 78dd–1 of this title shall be subject to a civil penalty of not more than $10,000 imposed in an action brought by the Commission.").

207. David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV., 1155, 1164 (2016).

208. Section 77h-1(a) provides:

> If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this subchapter, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.

15 U.S.C. § 77h-1(a).

209. *Id.* § 78u-2(e).

210. *Id.* § 7246.

211. *Id.* § 929(a).

212. *Id.* § 78u-2(b)(1).

213. 15 U.S.C. §§ 77h-1(g), 78u-2(b), 80a-9(d), 80b-3(i).

At the time of *Texas Gulf Sulphur*, disgorgement as an equitable remedy was necessary because it was the only way for the SEC to recover illicit profits from wrongdoers and to fully enforce federal securities laws.[214] But since then, the arrival of a "panoply of enforcement tools"[215] has significantly lessened—but not necessarily eliminated—the SEC's need for disgorgement in federal court.

B. Reasons To Keep Disgorgement as an Enforcement Tool

The persuasive case for limiting the SEC's excessive use of disgorgement in federal court does not mean that disgorgement should be abandoned entirely. Rather, there are three compelling reasons that disgorgement as an equitable remedy should remain a powerful tool in the SEC's enforcement array. First, the SEC cannot move all of its disgorgement actions to administrative proceedings because the future of ALJs remains in doubt. Second, disgorgement satisfies intuitive notions of justice by ensuring that ill-gotten gains are returned and greed is not rewarded. And third, disgorgement by the SEC serves a vital need—compensation for defrauded investors.

On its face, moving disgorgement to administrative proceedings is a feasible response to the threat *Kokesh* poses for disgorgement in federal court. After all, as former SEC enforcement director Andrew Ceresney has noted, the SEC may "obtain many—though not all—of the same remedies in administrative proceedings as [it] could get in district court."[216] It would also track well with the larger trend of the SEC's embrace of the administrative proceeding: "Before 2010, the agency initiated less than 400 administrative claims per year; after 2010, it initiated substantially more than 400; in 2014, it brought 610, a record."[217] And the SEC is resoundingly successful when it brings administrative actions; the SEC has a success rate of 90 percent in front of ALJs as opposed to 69 percent in federal court.[218]

However, ALJs—the very actors who would administratively order disgorgement—are on shaky footing as well. In *Lucia v. SEC*, the Supreme Court recently invalidated civil-service appointment of

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214. Kokesh v. SEC, 137 S. Ct. 1635, 1640 (2017).

215. *Id.* (noting that before *Texas Gulf Sulphur* there was an "absence of statutory authorization for monetary remedies").

216. Andrew Ceresney, Dir., Secs. & Exch. Comm'n Div. of Enf't, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297 [https://perma.cc/JES7-P95V].

217. Zaring, *supra* note 207, at 1174.

218. Eaglesham, *supra* note 30.

ALJs.[219] Because the ALJs were appointed by the civil-service staff and not by the Commission itself, and because the ALJs are officers of the United States and not merely employees of the SEC, the Court ruled that such appointments violate the Appointments Clause.[220]

Although the SEC recently moved to ratify its ALJs in accordance with the Appointments Clause ruling in *Lucia*,[221] a significant question looms regarding the circumstances enabling the removal of ALJs.[222] Justice Breyer, in his dissent, addressed this "embedded constitutional question" of "the statutory 'for cause' removal protections that Congress provided for administrative law judges."[223] Breyer, in doing so, draws upon another recent case, *Free Enterprise Fund v. Public Company Accounting Oversight Board*, which struck down multilevel protections for members of the Board.[224] Specifically, Breyer focused on an important ramification of the *Lucia* decision for the administrative state as a whole: "*If* the *Free Enterprise Fund* Court's holding applies equally to the administrative law judges—and I stress the 'if'—then to hold that the administrative law judges are 'Officers of

219. Lucia v. SEC, 138 S. Ct. 2044, 2049 (2018) (holding that SEC ALJs are "[o]fficers of the United States" and must therefore be appointed in accordance with the Appointments Clause of the Constitution).

220. *See id.* at 2052–55 (concluding on the basis of the test set out in *Freytag v. Comm'r*, 501 U.S. 868 (1991), that the ALJs are not employees but "officers" for the purposes of the Appointments Clause). The Appointments Clause states:

> [A]nd [the President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

U.S. CONST. art. II, § 2, cl. 2.

221. Order, Securities Act Release No. 10440, Exchange Act Release No. 82,178, Investment Advisors Act Release No. 4816, Investment Company Act Release No. 32,929, 2017 WL 5969234 (Nov. 30, 2017); *see also* Press Release, U.S. Sec. & Exch. Comm'n, SEC Ratifies Appointment of Admin. Law Judges (Nov. 30, 2017), https://www.sec.gov/news/press-release/2017-215 [https://perma.cc/SET4-SWSN].

222. This constitutional challenge of the ALJ regime has been discussed on *SCOTUSblog*:

> That gets us to the second and more significant question that this decision has produced: Can the extensive statutory protections against ALJ removal except for good cause, which must be determined by the independent Merit System Protection Board, survive, or will the court follow through on what it started in 2010 in *Free Enterprise Fund v. Public Company Accounting Oversight Board* and strike down these limits on removal?

Alan Morrison, *Symposium: Lucia v. SEC – more questions than answers*, SCOTUSBLOG (June 22, 2018 8:57 AM), http://www.scotusblog.com/2018/06/symposium-lucia-v-sec-more-questions-than-answers [https://perma.cc/EV5A-57NG].

223. *Lucia*, 138 S. Ct. 2044, 2057 (Breyer, J., dissenting).

224. Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 514 (2010).

the United States' is, *perhaps*, to hold that their removal protections are unconstitutional."[225] Accordingly, given the recent doctrinal upheaval as a result of *Lucia*, heavily leaning on an imperiled remedy (disgorgement) in an unstable forum (administrative proceedings) only compounds the risk that the SEC will lose valuable enforcement options.

Further, disgorgement should be saved because it is an intuitive tool for the SEC, and perhaps more importantly, it is fundamentally compatible with the larger purpose of the Securities Acts. The reasonableness of the principle that wrongdoers should not stand to profit from their ill-gotten gains is evidenced by the similarity of disgorgement to another well-established equitable remedy—restitution. Disgorgement and restitution share many of the same concepts in the securities enforcement context, operating as equitable remedies that take funds away from the wrongdoer.[226] The SEC defines restitution as "the repayment by a defendant of funds, or their equivalent, to an injured person."[227] Moreover, in SEC enforcement actions, "[r]estitution is intended to make investors whole."[228] In effect, limiting disgorgement so that it only compensates investors makes the relief function as restitution. The key difference between the two is one of rationale; the purpose of restitution is to make investors whole, while the purpose of disgorgement is to return the wrongdoer to his or her status quo from before the misconduct. For all the reasons that restitution has historically been embraced, disgorgement should also remain a viable equitable remedy.

The justification for disgorgement—that wrongdoers should be ordered to return ill-gotten gains to restore the status quo—also underlies other SEC enforcement measures. For example, a clawback provision in section 304(a) of the Sarbanes-Oxley Act of 2002 enables the SEC to recover a certain amount of executive officer compensation when the company restates its financials out of "material non-compliance" resulting from financial misconduct.[229] A proposed

225. *Lucia*, 138 S. Ct. 2044, 2060 (Breyer, J., dissenting).

226. *See* 2006 SEC SECTION 308(C) REPORT, *supra* note 107, at 2–3 ("Disgorgement is a well-established, equitable remedy applied by federal district courts and is designed to deprive defendants of 'ill-gotten gains.'").

227. *Id.* at 3 n.2.

228. *Id.*

229. *See* 15 U.S.C. § 7243(a) (2012) ("If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any

addition to the Dodd-Frank Wall Street Reform Act of 2010 contains a provision that would expand the use of clawbacks.[230] Ultimately, the general orienting principle of disgorgement is validated by the fact that the same principle also supports restitution and other SEC enforcement measures. Disgorgement is not an isolated enforcement doctrine, but rather an embodiment of the familiar notion that wrongdoers should not profit from their gains.

Disgorgement is also necessary because it fulfills an essential role—compensating defrauded investors when they otherwise would not be. In her study, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, scholar Urska Velikonja declares that "[t]he rise of public compensation, such as the SEC's distribution funds, fills a void in securities laws that leaves many victims with no private remedy."[231] Although some critique SEC enforcement actions as duplicative of private litigation like securities class actions,[232] Velikonja's study reveals the opposite: "Successful class actions accompany 46.3% of fair funds distributions overall and 28.1% of distributions in cases *not associated* with issuer reporting and disclosure violations."[233] Because the majority of cases are not accompanied by successful class actions, "the SEC's fair fund distribution is often the only source of compensation for defrauded investors."[234] Between 2002 and 2012, the SEC created 243 fair funds through the Sarbanes-Oxley Act of 2002, and those funds distributed $14.46 billion in civil monetary

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financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer.").

230. A law firm client release explains how this amended clawback provision would operate:

> Under Dodd-Frank, the policy would apply in the event the company had to prepare an accounting restatement due to the company's material noncompliance with any financial reporting requirement under the securities laws. The policy must provide that the company will recover from any current or former executive officer an amount of incentive-based compensation (including options awarded as compensation) equal to the excess, if any, of the amount that was paid to the executive officer, in the three years preceding the date on which the company was required to prepare the restatement, over the amount that would have been paid to the executive officer based on the accurate financial data.

Cydney Posner, *SEC Proposes Clawback Rules*, COOLEY (July 1, 2015), https://cooleypubco.com/2015/07/01/sec-proposes-clawback-rules [https://perma.cc/TMD2-CNMC].

231. Urska Velikonja, *Public Compensation for Private Harm: Evidence From the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 331 (2015).

232. *See, e.g.*, William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 139–40 (2011) (arguing that securities class actions and SEC enforcement actions achieve the same goal).

233. Velikonja, *supra* note 231, at 391.

234. *Id.*

penalties and disgorgement to defrauded investors.[235] Moreover, between 2004 and 2012, an estimated 75 percent of the amount the SEC received from enforcement actions was distributed through fair funds to defrauded investors.[236] These numbers represent a shockingly successful compensation scheme, especially considering that "traditional compensation schemes, in particular private litigation, fail to compensate victims for large classes of harms."[237]

V. SAVING DISGORGEMENT FROM ITSELF

While equitable disgorgement is under threat as currently implemented, it can still be saved if the SEC tailors its use in two primary ways. First, the SEC should limit disgorgement to amounts that restore the pre-wrongdoing status quo, instead of pursuing disgorgement beyond the amount the wrongdoer gained. Second, the SEC should distribute the funds obtained through disgorgement not to the U.S. Treasury or its own coffers, but rather to defrauded investors as much-needed compensation. By adopting both of these self-imposed reform measures, the SEC can ensure the continued vitality of disgorgement in light of *Kokesh* and other threats.

Limiting the use of disgorgement to the profit the defendant actually received is the first step in preserving disgorgement as a useful SEC enforcement measure.[238] The SEC should only request disgorgement from the district court in cases where the "ill-gotten gains remain extant and identifiable,"[239] providing "a specific pool of money that can be turned over to the SEC."[240] In these instances, there is a concrete measure of the defendant's wrongful gain, and disgorging that amount would restore the pre-wrongdoing status quo.

To effectuate this new direction, the SEC should prevent the dissipation of ill-gotten funds, using methods such as a "temporary restraining order, a preliminary asset freeze, the appointment of a

235. *Id.* at 333.

236. *Id.* at 334 n.12.

237. *Id.* at 338.

238. *See* Johnson et al., *supra* note 180 (noting that "the Commission could define disgorgement more narrowly as restitution to the victims of the illegal conduct, in keeping with the original holding of *Texas Gulf Sulphur* and therefore more in line with the traditional equitable powers of federal courts"); *see also* discussion *supra* Part IV.B. (regarding the difference between restitution and disgorgement).

239. Ryan, *supra* note 69, at 11.

240. *Id.*

receiver, [or] a voluntary agreement."[241] This would be a simple rule for the SEC to follow, but it would nonetheless significantly curtail the SEC's enforcement power.[242] As stated previously, the SEC does have a bevy of other enforcement tools—for example, civil monetary penalties and criminal sanctions—to mitigate this reduction in authority.[243] Although curtailing the expansive scope of its disgorgement power could frustrate the SEC's remediation of certain complex frauds, that is better than the alternative of losing disgorgement altogether.

In restraining disgorgement so that it only restores the status quo that existed prior to the wrongdoing, the SEC would thus avoid a central rationale of the *Kokesh* Court's penalty reasoning—that the SEC's use of disgorgement "sometimes exceeds the profits gained as a result of the violation."[244] Thus, disgorgement would be used solely as a remedial measure, and not a punitive one. As stated previously, there are numerous instances in which the SEC has recouped more from the wrongdoer than the profits he or she actually received; recall the insider trader forced to pay for the benefit gained by third parties in *Contorinis*,[245] the tipper ordered to give up profits obtained by the tippees in *Warde*,[246] and the wrongdoer-incurred expenses that were not deducted from disgorged ill-gotten gains as in *Kokesh*.[247] In these cases, the SEC pressed disgorgement as far as it could, but it is evident that the Supreme Court considers such tactics to be penalties, not remedial measures. To prevent disgorgement from fulfilling a

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241. *Id.*

242. *See id.* ("[T]hese cases [where ill-gotten gains are extant and identifiable], based on the author's two decades of anecdotal experience on both sides of SEC enforcement cases, represent a small fraction of SEC disgorgement cases.").

243. *See supra* Part IV.A.4.

244. Kokesh v. SEC, 137 S. Ct. 1635, 1644 (2017).

245. *See* SEC v. Contorinis, 743 F.3d 296, 302 (2d Cir. 2014) ("[A]n insider trader may be ordered to disgorge not only the unlawful gains that accrue to the wrongdoer directly, but also the benefit that accrues to third parties whose gains can be attributed to the wrongdoer's conduct."). *But see supra* note 197 and accompanying text (noting that *Kokesh* cites *Contorinis* disapprovingly to warn against overzealous disgorgement).

246. *See* SEC v. Warde, 151 F.3d 42, 49 (2d Cir. 1998) ("[E]ven if the [tippee's] profits were fairly characterized as third party profits, Warde would nevertheless be liable to disgorge their profits. A tippee's gains are attributable to the tipper, regardless whether benefit accrues to the tipper."). *But see supra* notes 198–99 and accompanying text (noting that *Kokesh* cites *Warde* disapprovingly).

247. *See Kokesh*, 137 S. Ct. at 1644 ("As demonstrated by this case, SEC disgorgement sometimes is ordered without consideration of a defendant's expenses that reduced the amount of illegal profit.").

significant part of the *Kokesh* penalty rationale, the SEC should limit its requests to the amount of profits actually gained as a result of the wrongdoer's violation. That is, disgorgement should be used only to restore the status quo.

The SEC should also reorient its use of disgorgement so that it is solely a compensatory measure for defrauded investors. In fact, the SEC already employs its enforcement powers to receive compensation for affected victims of securities fraud through the Fair Funds provision of the Sarbanes-Oxley Act of 2002. Section 308 of that Act "gives the SEC a more prominent role in compensating defrauded investors."[248] This section states:

> If in any judicial or administrative action . . . the Commission obtains a civil penalty against any person for a violation of such laws, or such person agrees, in settlement of any such action, to such civil penalty, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of a disgorgement fund . . . for the benefit of the victims of such violation.[249]

The establishment of fair funds to compensate defrauded investors shows that the SEC already has a mechanism for funneling disgorgement proceeds directly to victims.[250] The SEC's self-imposed dedication of disgorgement proceeds to victim compensation alone would thus not require a new statutory framework, but a renewed commitment to an existing one. Moreover, these fair funds are effective. Between 2002 and 2012, the SEC created 243 fair funds that distributed $14.46 billion in civil monetary penalties and disgorgement amounts to defrauded investors.[251] Rather than treating section 308 fair funds victim compensation as optional, the SEC should treat it as a mandate that limits the Commission to seeking disgorgement only in instances where defrauded investors can be compensated.

The SEC's use of disgorgement solely as a compensatory measure would thereby ensure that the tool does not fulfill the second prong of the *Kokesh* penalty reasoning—a use to deter rather than to

248. Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW. 317, 318 (2008).

249. 15 U.S.C. § 7246 (2012) (quoted in Black, *supra* note 248, at 326).

250. *See* Black, *supra* note 248, at 326 ("[T]he statute confers upon the SEC the authority to include the civil penalty, along with the disgorgement amount, in a Fair Fund for distribution to the victims of the violation.").

251. Velikonja, *supra* note 231, at 333.

remediate.[252] Specifically, *Kokesh* held that pecuniary measures become penal when requested "for the purpose of punishment, and to deter others from offending in like manner."[253] As identified in *Kokesh*, many previous cases expressly treated disgorgement as a deterrent measure. For example, *Kokesh* cited *SEC v. Fischbach*[254] for the proposition that the "primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains."[255] In addition, the Court quoted *SEC v. Rind*[256]: "The deterrent effect of [an SEC] enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."[257] However, it is evident that deterrence is simply not a permissible justification for disgorgement after *Kokesh* because "[s]anctions imposed for the purpose of deterring infractions of public laws are inherently punitive."[258] By seeking disgorgement for the express purpose of compensating defrauded victims, the SEC could transform the tool from a penal sanction to an entirely remedial action. In that sense, SEC disgorgement would no longer be a deterrent under the *Kokesh* penalty test, helping to prevent the complete loss of disgorgement.

Although the SEC's self-restraint in crafting disgorgement policy could save the tool, this strategy certainly has drawbacks. Some posit that the SEC should not become "a collection agency for defrauded investors" because "effective enforcement policy is not necessarily compatible with a dominant emphasis on recovering and returning funds to investors."[259] A potential concern of such a preemptive narrowing of the SEC disgorgement power may be that it allows defendants to retain ill-gotten gains in cases where no defrauded investors can be identified. At the larger doctrinal level, the concern over whether the SEC should serve as a collection vehicle for defrauded investors is mitigated by the fact that its ability to compensate serves a vital purpose: "More often than not, the SEC

252. *See* Johnson et al., *supra* note 180 (suggesting that "[r]enaming the remedy to clarify that it is different from the 'SEC disgorgement' analyzed by the Court, and removing it from deterrence rhetoric, could help clarify that [disgorgement] is remedial, not a penalty.").

253. Kokesh v. SEC, 137 S. Ct. 1635, 1642 (2017).

254. SEC v. Fischbach Corp., 133 F.3d 170 (2d Cir. 1997).

255. *Kokesh*, 137 S. Ct. at 1643 (quoting *Fischbach Corp.*, 133 F.3d at 175).

256. SEC v. Rind, 991 F.2d 1486 (9th Cir. 1993).

257. *Kokesh*, 137 S. Ct. at 1643 (quoting *Rind*, 991 F.2d at 1491).

258. *Id.*

259. Black, *supra* note 248, at 345.

compensates harmed investors for losses where a private lawsuit is either unavailable or impractical."[260] For those who worry that some wrongdoers will go unscathed in cases where their victims go unidentified, the SEC—irrespective of disgorgement—still possesses the ability to "ask federal courts, when imposing statutory penalties against a defendant, to calculate that penalty as an amount equal to the 'gross amount of pecuniary gain to [the] defendant as a result of the violation.'"[261]

However, the existence of civil monetary penalties calculated according to the amount of ill-gotten gains raises another question: Why does the SEC not just use statutorily enacted civil monetary penalties to recover these illicit profits? The answer is simple: It is easier for the SEC to collect disgorgement proceeds than civil penalty proceeds because penalties are subject to the Federal Debt Collection Procedures Act ("FDCPA"),[262] which erects significant procedural hurdles for the SEC to overcome when seeking to collect defendant profits.[263] In contrast, both administrative and court-ordered disgorgement, as the direct result of district court orders, are subject to only the Federal Rules of Civil Procedure.[264] This makes disgorgement proceeds easier to obtain because the SEC can seek collection through a number of options, most significantly through civil contempt proceedings, which are prohibited under the FDCPA.[265] In spite of these counterarguments, restraining the use of disgorgement to the

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260. Velikonja, *supra* note 231, at 336.

261. Ryan, *supra* note 69, at 13 (quoting 15 U.S.C. § 78u(d)(3)(B) (2012)).

262. Federal Debt Collection Procedures Act of 1990, 28 U.S.C. §§ 3001–3308 (2012).

263. The SEC recognizes that the FDCPA limits its ability to collect penalties:

> To collect penalties, the Commission is limited to the remedies provided by the Federal Debt Collection Procedures Act ("FDCPA") to pursue judgments for penalties. These include: execution on real property and personalty; writs of garnishment; installment payment orders; and, in certain circumstances, fraudulent transfer actions, which can be initiated against debtors who transfer their assets, thereby keeping them out of the creditor's reach.

2006 SEC SECTION 308(C) REPORT, *supra* note 107, at 26 (citations omitted).

264. *See id.* at 25–26 (noting that "[t]he FDCPA cannot be used to seek recovery of disgorgement debt" and listing ways that a court could enforce disgorgement under the Federal Rules of Civil Procedure).

265. The SEC has a few options to pursue judgments for disgorgement:

> First, the Commission can request the federal court to hold a defendant in civil contempt for failure to pay the judgment under Fed. R. Civ. P. 70. The Commission can also request the federal courts to issue "writs of execution" allowing it to "execute on" real or personal property. An execution is the physical seizure or forced sale of a defendant's real or personal property. Finally, the Commission can utilize its administrative wage garnishment process.

Id. (citations omitted).

compensation of defrauded investors remains both a sensible and easily applied course of action for the SEC.

CONCLUSION

Disgorgement, since its inception in *Texas Gulf Sulphur*, has undergone perhaps the most extensive doctrinal transformation of any remedy sought by the SEC. As a form of ancillary equitable relief, disgorgement was originally intended to supplement the principal statutory remedy of an injunction. Instead, "[d]isgorgement has become the routine remedy for a securities enforcement action."[266] The lack of a statutory basis for disgorgement became a flashpoint after the *Kokesh* decision ruled it a penalty for statute of limitations purposes. The Court's reasoning could easily be applied to disgorgement at large, putting the mechanism at existential risk. Disgorgement, as currently implemented, has been extended to the edge of its power by the SEC, and has often superseded its equitable mandate by recouping amounts that exceed the ill-gotten gains of wrongdoers.

Accordingly, the potent tool of disgorgement remains at risk of being removed entirely from the enforcement arsenal. With its fault lines exposed after *Kokesh*, disgorgement should be reined in for a number of reasons—recent Supreme Court decisions trend toward repudiating such unbridled governmental power, the SEC has inequitably enforced disgorgement as a penalty, and the original rationale for disgorgement is not nearly as persuasive as it once was. Threatened by the loss of its most favored tool, the SEC should narrow its use of disgorgement to recovery of nothing more than the amount illicitly gained by the wrongdoer, and the SEC should use the disgorged funds to compensate fraud victims. Both of these measures would allow for disgorgement to return to its remedial—not deterrent—origins, thus ensuring that the SEC's use of the enforcement tool avoids the penalty reasoning of *Kokesh*. However persuasive the argument against disgorgement may be, the tool is nonetheless necessary in federal court because the future of the remedy is uncertain in administrative proceedings, because it embodies the intuitive notion of preventing wrongdoers from profiting from their wrongs, and because it fulfills the need for victim compensation. Ultimately, ensuring disgorgement's future as an equitable remedy in federal court means saving disgorgement from itself.

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266. SEC v. Berlacher, No. 07-3800, 2010 WL 3566790, at *14 (E.D. Pa. Sept. 13, 2010).