

January 7, 2020

The Viability of Disgorgement As An SEC Remedy: 2020 Will Have Profound Ramifications

INTRODUCTION

For decades, it has been accepted that the SEC remedy of disgorgement is available in any civil enforcement action brought by the U.S. Securities and Exchange Commission (“SEC” or “Commission”) for a violation of the federal securities laws.

However, in the 2017 case *Kokesh v. Securities and Exchange Commission*,¹ the United States Supreme Court held that SEC disgorgement is a “penalty” and imposed a five-year statute of limitations on SEC disgorgement actions.

Since then, defendants in court cases have challenged whether disgorgement is even authorized as an SEC remedy at all.²

The United States Senate became involved on March 14, 2019, with the introduction of a bill entitled the “Securities Fraud Enforcement and Investor Compensation Act of 2019”.³ If enacted, the Senate’s bill would grant statutory authority for disgorgement as an SEC remedy.

The United States House of Representatives entered the debate by introducing its own bill on September 17, 2019.⁴ Like the Senate bill, the House bill seeks to statutorily authorize disgorgement as an SEC remedy.

However, neither of the Senate nor House bill has been enacted and, as with all bills, there is a chance that neither bill will be passed and enacted into law. There is also the chance if a law is ultimately enacted, that law might contain different provisions, perhaps drastically different provisions, than what either bill presently contains.

In this environment, and apparently wishing to make its thoughts known on the issue, on November 1, 2019, the U.S. Supreme Court granted the petitioners’ motion for certiorari in *Liu v. SEC*.⁵ In the *Liu* case, the petitioners are challenging the authority of the SEC to seek disgorgement. Oral arguments in *Liu* are scheduled to be heard by the Supreme Court on March 3, 2020.⁶

THE *KOKESH* RULING THAT THE SEC REMEDY OF DISGORGEMENT IS A PENALTY

Much has already been written about the Supreme Court's *Kokesh* opinion since its issuance and need not be repeated here. Broadly speaking, in large part the Supreme Court derived its ruling that the SEC remedy of disgorgement is subject to a five year statute of limitations from 28 U.S.C. § 2462.⁷ That statute says that in any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture", the statute of limitations is five (5) years.⁸

According to the Supreme Court, when the SEC seeks disgorgement in a civil enforcement action, the disgorgement operates as a "penalty".⁹ Therefore, the Court said, because SEC disgorgement is a penalty, it falls under the five year statute of limitations provided for by 28 U.S.C. § 2462.¹⁰

Since the date of that ruling, the SEC has been required to bring its disgorgement actions within five years from the date on which its causes of action accrued.

THE IMPACT OF *KOKESH* ON THE SEC

Due to the *Kokesh* decision, the SEC has had to investigate and file its cases in court faster than it did before. Furthermore, the imposition of a five-year statute of limitations on SEC disgorgement cases has resulted in the SEC foregoing either entire cases or potential causes of action within those cases. In just the two and one half years since *Kokesh*, the SEC has already had to forego over one billion dollars in potential disgorgement.

The Chairman of the SEC confirmed this figure during his testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on December 10, 2019:

The Supreme Court's decision in *Kokesh v. SEC*, however, has impacted our ability to return funds fraudulently taken from Main Street investors.... Said simply, the *Kokesh* decision has had the anomalous effect of allowing the most "successful" perpetrators of fraud -- those whose frauds are well-concealed and stretch beyond the five-year limitations period -- to keep their ill-gotten gains. Since *Kokesh* was decided, an estimated \$1.1 billion in ill-gotten gains has been unavailable for possible distribution to harmed investors, much of which is tied to losses by investors. More recently, the SEC's ability to seek disgorgement in any district court action has been questioned.¹¹

Both the U.S. Senate and the U.S. House of Representatives have taken up bills addressing both the *Kokesh* ruling and the *Liu* case presently pending before the Supreme Court.

THE U.S. SENATE'S BILL FORMALIZING THE SEC REMEDY OF DISGORGEMENT

The Senate's "Securities Fraud Enforcement and Investor Compensation Act of 2019" (S. 799), a bipartisan bill introduced by U.S. Senators Warner and Kennedy, would amend the federal securities laws by specifically authorizing the SEC to "seek disgorgement and restitution as a result of a violation of the securities laws, to establish the statute of limitations ... and for other purposes".¹²

If passed, S. 799 would validate the SEC remedy of disgorgement "in any action or proceeding brought by the Commission under any provision of the securities laws".¹³

Moreover, the bill would also grant the SEC the ability to also pursue restitution through legal proceedings,¹⁴ with the caveat that the amount of any disgorgement ordered by a court would be offset by the amount of the restitution also ordered in that case.¹⁵ The statute of limitations for SEC restitution claims would be ten years.¹⁶

However, the Senate's bill would not represent a complete victory for the SEC. Under S. 799, SEC disgorgement would continue to be subject to a similar five-year statute of limitations¹⁷ as set forth by the Supreme Court in *Kokesh*.

THE US HOUSE OF REPRESENTATIVES' BILL ON SEC DISGORGEMENT

Approximately six months later, in September 2019 the U.S. House of Representatives introduced its own "Investor Protection and Capital Markets Fairness Act".¹⁸ As with the Senate bill, H.R. 4344 is a bipartisan bill, co-sponsored by Representatives McAdams and Huizenga, which would provide statutory authority for the SEC to seek and obtain disgorgement in federal court proceedings.¹⁹

The bill also states that the SEC remedy of disgorgement is not to be construed as a penalty, civil fine, or forfeiture.²⁰ However, unlike the Senate bill, H.R. 4344 would not retain a five-year statute of limitations on SEC disgorgement actions, but rather would extend the limitations period to fourteen (14) years after the alleged violation.²¹

The legislative history of H.R. 4344 explains that overriding the *Kokesh* case is a primary motivation behind the House bill:

In 2017, the Supreme Court, in *Kokesh v. SEC*, held that the authority of the Securities and Exchange Commission, SEC, to recover for investors the wrongful gains of securities law violators, known as disgorgement, is effectively a penalty. As a result, the SEC's authority to obtain disgorgement is time limited by the Federal statute of limitations for penalties so that the SEC must bring its case within 5 years of the violation.

This ruling was a boon to white-collar criminals like Bernie Madoff and Allen Stanford, who are now able to defraud investors for a decade and keep their profits.

Even worse, the SEC is currently in litigation before the Supreme Court over whether it even has the authority to obtain disgorgement for investors.²²

The legislative history also reveals that the bill was partially intended to proactively address the *Liu* case that is presently pending before the Supreme Court:

... this legislation seeks to fix the *Kokesh* decision and would address the recent case the Supreme Court agreed to hear about whether the SEC has disgorgement authority at all.²³

On November 18, 2019 -- a little more than two weeks after the Supreme Court granted certiorari in the *Liu* case -- H.R. 4344 passed the House by a vote of 314 in favor, 95 against, with 21 Members not voting.²⁴ On November 19, 2019, the bill was received in the U.S. Senate and referred to the Senate's Committee on Banking, Housing, and Urban Affairs.

2020 WILL HAVE PROFOUND RAMIFICATIONS FOR FEDERAL SECURITIES LAW ENFORCEMENT

What the Supreme Court and Congress do in 2020 will have profound long-term ramifications for everyone involved with federal securities enforcement cases, regardless of what side of the table they sit on.

How and when the Supreme Court rules in the *Liu* case, as well as whether Congress enacts legislation addressing the SEC remedy of disgorgement, when it passes that legislation, and what the final SEC remedy provisions look like, will have far-reaching consequences for the SEC, SEC defendants, SEC whistleblowers, securities attorneys, and SEC whistleblower lawyers alike. (For what some of those

ramifications might be, see The Pickholz Law Offices' related blog post at <https://pickholzlaw.com/sec-disgorgement>.)

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The Pickholz Law Offices has represented employees, officers, and others in **SEC whistleblower cases** involving financial institutions and public companies listed in the Fortune Top 10, Top 20, Top 50, Top 100, Top 500, and the Forbes Global 2000. We were the first law firm ever to win an SEC whistleblower award for a client on appeal to the full Commission in Washington, an achievement that Inside Counsel magazine named one of the five key events of the SEC whistleblower program.

In addition to representing SEC whistleblowers, since 1995 the Firm's founder, Jason R. Pickholz, has also represented many clients in **securities enforcement investigations** conducted by the SEC, FINRA, the U.S. Department of Justice and US Attorney's Offices, State authorities, and more. Examples of some of the many securities enforcement cases that Mr. Pickholz has been involved with are available on the Our Cases & Results page on The Pickholz Law Offices' website.

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¹ *Kokesh v. Securities and Exchange Commission*, 137 S. Ct. 1635 (2017). A copy of the Supreme Court's *Kokesh* decision can be found online at https://www.supremecourt.gov/opinions/16pdf/16-529_i426.pdf.

² *E.g., compare Jalbert v. SEC*, Civ. Action No. 17-12103-FDS (D. Mass, Aug. 22, 2018) with *Saad v. SEC*, 873 F.3d 297 (D.C. Cir. 2017).

³ Securities Fraud Enforcement and Investor Compensation Act of 2019, S. 799, 116th Congress, 1st Session. A copy of S. 799 can be found online at <https://www.congress.gov/116/bills/s799/BILLS-116s799is.pdf>.

⁴ Investor Protection and Capital Markets Fairness Act, H.R. 4344, 116th Congress, 1st Session. A copy of H.R. 4344 can be found online at <https://www.congress.gov/116/bills/hr4344/BILLS-116hr4344eh.pdf>.

⁵ *Liu and Wang v. SEC*, No. 18-1501 (US 2019), docket entry for November 1, 2018. A copy of the Supreme Court's docket sheet in *Liu* can be found online at <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/18-1501.html>.

⁶ *Liu and Wang v. SEC*, No. 18-1501 (US 2019), docket entry for November 26, 2019. A copy of the Supreme Court's docket sheet in *Liu* can be found online at <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/18-1501.html>.

⁷ *See Kokesh*, 137 S. Ct. at 1.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ SEC Chairman Jay Clayton, “Testimony on ‘Oversight of the Securities and Exchange Commission’ Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Dec. 10, 2019) (underline added). A copy of the SEC Chairman’s opening testimony can be found at <https://www.sec.gov/news/testimony/testimony-clayton-2019-12-10>.

¹² Securities Fraud Enforcement and Investor Compensation Act of 2019, S. 799, preamble.

¹³ *Id.*, S. 799 at 3:17 - 3:22.

¹⁴ *Id.*, S. 799 at 4:3 - 4:17.

¹⁵ *Id.*, S. 799 at 3:23 - 4:2.

¹⁶ *Id.*, S. 799 at 5:1 - 5:6.

¹⁷ *Id.*, S. 799 at 4:19 - 4:25.

¹⁸ Investor Protection and Capital Markets Fairness Act, H.R. 4344 (2019).

¹⁹ *Id.*, H.R. 4344 at 2:9 - 2:18.

²⁰ *Id.*, H.R. 4344 at 2:21 - 2:25.

²¹ *Id.*, H.R. 4344 at 3:1 - 3:5.

²² Congressional Record - House at H8930 (Nov. 18, 2019), remarks of U.S. Representative Green. A copy of the relevant Congressional Record can be found online at <https://www.congress.gov/116/crec/2019/11/18/CREC-2019-11-18-pt1-PgH8929.pdf>.

²³ *Id.* at H8931, remarks of U.S. Representative McAdams.

²⁴ Final Results For Roll Call 627 on H.R. 4344, Nov. 18, 2019. A copy of the final vote results can be found online at <http://clerk.house.gov/evs/2019/roll627.xml>.