American University Business Law Review

Volume 13 | Issue 1 Article 6

2024

# The Chicken or the Egg: The Proper Order of Analysis when Determining the Enforceability of a Delegation Clause and the Broader Arbitration Agreement in Consumer Contexts

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# "SHOW ME THE MONEY": THE SEC'S USE OF DISTRIBUTION AS A TOOL FOR INVESTOR PROTECTION

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## I. INTRODUCTION

In fiscal year 2022, the United States Securities and Exchange Commission ("SEC" or "Commission") filed 760 total enforcement actions.[1] While the total amount ordered in Commission actions increased to $6.439 billion (an increase from $3.852 billion in fiscal year 2021), the amount ordered for disgorgement fell to $2.245 billion (a decrease of six percent from fiscal year 2021).[2] Currently, the SEC is aggressively pursuing enforcement actions under the direction of Chairman Gary Gensler and Director of the Division of Enforcement, Gurbir Grewal.[3] This decrease in disgorgement funds seems like an outlier given the increased enforcement, but recent developments at the Supreme Court have impacted how disgorgement can be utilized as an enforcement tool by the SEC moving forward.[4]

Disgorgement has developed in many legal contexts, and essentially works to ensure that bad actors are not unjustly enriched by their bad actions.[5] The concept of distribution is relatively new and was developed from the recent changes to securities law.[6] Funds received through various enforcement actions are often pooled together into fair funds to maximize the distribution to harmed investors.[7] In certain situations, the current regulatory framework permits fair funds to be distributed to the Department of the Treasury.[8] The goal of distribution is to benefit harmed investors,

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1. Press Release, SEC, SEC Announces Enforcement Results for FY22 (Nov. 15, 2022) (on file with author) [hereinafter SEC Press Release].

2. *Id.*

3. *See id.*

4. Matthew Bultman, *SEC Enforcement Remedies Under Microscope Amid Aggressive Push*, BLOOMBERG L. (Sept. 29, 2022, 5:00 AM), https://news.bloomberglaw.com/securities-law/sec-enforcement-remedies-under-microscope-amid-aggressive-push ("The SEC has long enjoyed broad powers in enforcement remedies . . . [b]ut two US Supreme Court decisions, *Kokesh v. SEC* and *Liu v. SEC*, have provided defendants with ammunition in their challenges.").

5. *See Disgorgement*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining disgorgement as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion"); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. a (AM. L. INST. 2011).

6. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 308, 116 Stat. 745, 784–85 (codified as amended as 15 U.S.C. § 7246) (outlining how "fair funds for investors" would work).

7. *See* 15 U.S.C. § 7246(a).

8. *See* 17 C.F.R. §§ 201.1100–.1106 (2024); *see also* Kokesh v. SEC, 581 U.S. 455, 465 (2017) ("affirming distribution of disgorged funds to Treasury where 'no party before the court was entitled to the funds and . . . the persons who might have equitable claims were too dispersed for feasible identification and payment'" (quoting SEC v. Fischbach Corp., 133 F.3d 170, 171 (2d Cir. 1997))).

which is a prevailing interest throughout the securities laws.[9]

To illustrate the importance of both disgorgement and distribution, it is helpful to imagine a world where the SEC does not pursue disgorgement. In fiscal year 2022, over one-third (nearly thirty-five percent) of the Commission's money ordered came from disgorgement.[10] Under the fair funds provision of Sarbanes-Oxley, the Commission has the authority to combine the civil money penalties and disgorged funds, and work to distribute them to benefit harmed investors.[11] Without disgorgement, there is no provision that allows civil money penalties to be distributed for the benefit of harmed investors; the $4.194 billion in civil money penalties for fiscal year 2022 would sit, idly, in an account with the Treasury Department.[12] Without disgorgement, there could be no distribution, which provides the proximate reason to protect this enforcement remedy.

Ultimately, two distinct options have developed in cases where the SEC seeks disgorgement — an equitable remedy and a statutory grant.[13] The option that is used depends on the goal of the Commission in the case, as the equitable remedy exists to help harmed investors and the statutory grant creates an alternative deterrence tool.[14] These different goals create a way for the Commission to continue to fully utilize disgorgement in their enforcement actions.

Under recent developments in both statutory and case law, the Commission's ability to seek disgorgement has changed how funds are distributed to investors.[15] Because of the important financial recovery available using disgorgement, the SEC should continue to prioritize the equitable goal of helping harmed investors and seek the maximum disgorgement available under law to better facilitate the existing system of distribution.[16]

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9. *See* 15 U.S.C. § 78u(d)(5) ("[T]he Commission may seek, and any Federal court may grant, any equitable relief that may be *appropriate or necessary for the benefit of investors*." (emphasis added)).

10. *See* SEC Press Release, *supra* note 1.

11. *See* Sarbanes-Oxley Act § 308(a).

12. *See id.* ("[T]he amount of [the] civil penalty shall . . . be *added to and become part of the disgorgement fund* for the benefit of the victims . . . ." (emphasis added)); *see also* SEC Press Release, *supra* note 1.

13. *See* 15 U.S.C. §§ 78u(d)(5), (7).

14. *See generally* Liu v. SEC, 140 S. Ct. 1936 (2020); William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, 134 Stat. 4625 (2021).

15. *See generally Liu*, 140 S. Ct. 1936; Kokesh v. SEC, 581 U.S. 455 (2017); 15 U.S.C. § 78u(d)(7).

16. *See About the SEC*, SEC, https://www.sec.gov/about (last visited May 22, 2024) (describing the mission of the SEC); 15 U.S.C. § 78u(d)(5).

In Section II, this Comment will present a background on the relevant law of securities regulations by focusing on the SEC's enforcement remedies, through various statutes, cases, and regulations. Section II further discusses the disgorgement and fair funds provisions that are crucial to the Commission's distribution practices.[17] Then, Section III shows how this background impacts SEC operations and presents a framework for the relationship between disgorgement and distribution. Finally, Section IV offers recommendations that would allow the SEC to continue to utilize disgorgement to ensure maximum distribution for harmed investors.

## II. THE BIG PICTURE

The modern system of securities regulation emerged as a result of the systematic failure that led to the Great Depression in the early twentieth century.[18] Prior to the Depression-era changes, most securities regulation was done at the state level under a variety of "blue sky" laws.[19] Emerging from the economic morass of the Depression, Congress created an organization empowered to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[20]

### *A. Background on SEC Remedies*

The first piece of legislation enacted by Congress to steer the securities market out of the Depression is the Securities Act of 1933 (the "Securities Act").[21] The Securities Act sought to "provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof."[22] The

17. *See* Sarbanes-Oxley Act § 308; 17 C.F.R. § 201.1100–.1106 (2024).

18. *See* Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1897 (2013) ("The securities acts put in place safeguards to prevent history from repeating itself, including a system of mandatory public disclosure and sanctions for disclosure violations and fraud.").

19. *See* Elisabeth Keller, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 331–32 (1988) (explaining that "blue sky" laws were named because of the belief by lawmakers that without some form of regulation, bad financial actors would sell to the public "everything in the state but the blue sky." The article further states that state "[a]ntifraud laws did not take effect until evidence appeared that fraud had been or was about to be committed in the sale of securities").

20. *See About the SEC*, *supra* note 16.

21. *See* 15 U.S.C. §§ 77a–77aa (reflecting the Securities Act as amended over the nine decades since its initial enaction).

22. Securities Act of 1933, 73 Pub. L. No. 22, 48 Stat. 74 (codified as amended as 15 U.S.C. § 77).

Securities Act established an extensive series of disclosures.[23] This focus on disclosure is interpreted as putting the protection of investors front and center in American securities regulation.[24] Indeed, certain executive branch materials reveal the same primary focus on investor protection.[25]

Following the passage of the Securities Act, Congress determined that self-regulation of exchanges and the broader securities industry was inadequate.[26] The Securities Exchange Act of 1934 (the "Exchange Act") was another Depression-era effort to ensure stability and public trust in the securities market.[27] One of the most important components of the Exchange Act was the establishment of the United States Securities and Exchange Commission, a civil law enforcement agency tasked with regulating the securities industry.[28] President Franklin Roosevelt urged Congress to pass legislation with "teeth in it" for the benefit and satisfaction of the American public.[29] Although there was a need for more regulation, lawmakers did not intend for the newly formed Commission to control the market for securities.[30]

The Senate Committee Report on the Exchange Act outlines the speculative practices that brought about the Depression and analyzes how the bill would limit (but not eradicate) the chances of further economic turmoil created by the securities industry.[31] The language of the bill

23. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (stating that the goal of the Securities Act of 1933 is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions").

24. *See* Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 688 (S.D.N.Y. 1968) (recognizing the fundamental purpose of Section 11 of the Securities Act (codified at 15 U.S.C. § 77k) of "requiring full and truthful disclosure *for the protection of investors*" (emphasis added)).

25. *See* FRANKLIN D. ROOSEVELT, THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT: VOLUME TWO 94 (1938) ("The plan is to protect the public by informing the investor, . . . and by providing that otherwise the issuer will subject himself to a criminal penalty.").

26. *See* S. REP. NO. 73-792, 4–5 (1934) (report from the Senate Committee on Banking and Currency); 15 U.S.C. § 78b.

27. *See* 15 U.S.C. §§ 78a–78qq (providing applicable United States Code reference reflects the Exchange Act as amended over the nine decades since its initial enaction); Keller, *supra* note 19, at 330 ("The Exchange Act provides for the regulation of the securities exchange markets and . . . also created the federal agency in charge of securities regulation.").

28. *See* 15 U.S.C. § 78d(a) (establishing the Commission and describing its makeup).

29. *See* S. REP. NO. 73-792, at 2 ("I do not see how any of us can afford to have [the bill] weakened in any shape, manner, or form.").

30. *See id.* at 13 ("[T]here is no intention whatsoever to permit the Commission to direct the flow of credit or to determine what securities shall be issued or sold.").

31. *See id.* at 3–5.

eventually signed into law by President Roosevelt resulted from a compromise between the two chambers of Congress; that compromise prioritized the investor protection goal of the new Securities and Exchange Commission.[32]

Under the Exchange Act, the SEC was empowered to promulgate rules under specific provisions and seek injunctions barring further violations of the fledgling securities laws.[33] Over time, the powers of the Commission have increased, as have the remedies available.[34] One of the largest changes came in the Securities Enforcement Remedies and Penny Stock Reform Act, which, as its name suggests, significantly broadened the SEC's enforcement capabilities.[35] Notably, the SEC was permitted to seek monetary penalties in civil actions under both the Securities Act and the Exchange Act.[36] The amount of civil money penalties eligible under these changes increase over time, and serve as a punishment and deterrent to wrongdoers.[37]

The emphasis on investor protection continued with the passage of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOX").[38] SOX arose out of various financial scandals, most significantly the collapse of the Enron Corporation.[39] By amending the Securities Act, Sarbanes-Oxley

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32. *See* H.R. REP. NO. 73-1838 (1934) (Conf. Rep.) (including over thirty mentions of "protection of investors" in both the body of the law and the accompanying statements of the conferees).

33. *See* 15 U.S.C § 78j (allowing promulgation of rules and regulations "necessary or appropriate in the public interest or for the *protection of investors*" (emphasis added)); 15 U.S.C. § 78u.

34. *See, e.g.*, Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931, 932 (permitting the Commission to seek civil monetary penalties); Sarbanes-Oxley Act of 2002 § 308, Pub. L. 107-204, 116 Stat. 745, 784 (introducing a "fair funds" provision crucial to the current distribution framework).

35. *See* Penny Stock Reform Act § 201 (providing amendments to Securities Act, Exchange Act, and two other Acts overseen by the SEC, the Investment Company Act of 1940 and the Investment Advisers Act of 1940).

36. *See id.* (representing, respectively, amendments to the Securities Act and the Exchange Act).

37. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-22-105596, CIVIL MONETARY PENALTIES: FEDERAL AGENCIES' COMPLIANCE WITH THE 2021 ANNUAL INFLATION ADJUSTMENT REQUIREMENTS 1 (2022) (examining various agencies' compliance with the Federal Civil Penalties Inflation Adjustment Act of 1990 and stating that "federal agencies use fines to "punish willful violators, deter future violations, and enforce regulatory policies government-wide").

38. Sarbanes-Oxley Act § 1 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

39. The legislative history of SOX contains hundreds of pages of hearing transcripts of bicameral investigations of Enron's collapse. *See generally Fall of*

created the Public Company Accounting Oversight Board, a significant change and powerful addition to the financial regulatory system.[40] Sarbanes-Oxley also enhanced the requirements for financial disclosure across the board and required higher levels of accountability for corporate entities.[41]

While Sarbanes-Oxley catalyzed a large-scale overhaul of the securities industry and other important aspects of corporate responsibility, one of the most important provisions for the role of the SEC was the creation of "fair funds" for the relief of victims of certain financial crimes.[42] Another crucial provision of SOX was the amendment to the Exchange Act which permitted the SEC to seek equitable remedies in court proceedings.[43]

### *B. Disgorgement and Fair Funds*

As commonly understood, disgorgement restricts the unjust enrichment of wrongdoers by requiring them to turn over profits.[44] The Supreme Court determined that an accounting of profits, which has little, if any, distinction from disgorgement, was a valid use of inherent equity powers.[45] Accounting for profits is a phrase that has been well-defined.[46] Equitable remedies were not statutorily granted to the Commission until the

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*Enron*: *How Could It Have Happened?: Hearing Before the S. Comm. on Governmental Affairs*, 107th Cong. (2002); *Financial Collapse of Enron, Part 1: Hearing Before the Subcomm. on Oversight and Investigations of the Comm. Energy and Com*, 107th Cong. (2002).

40. *See* Sarbanes-Oxley Act §§ 101–09; S. REP. NO. 107-205, at 2 (2002) ("The purpose of the bill is to address the systemic and structural weaknesses affecting our capital markets which were revealed by repeated failures."). The language quoted is from the Senate Committee on Banking, Housing, and Urban Affairs report on the Public Company Accounting Reform and Investor Protection Act of 2002, which was folded in the Sarbanes-Oxley conglomeration.

41. *See, e.g.*, Sarbanes-Oxley Act §§ 402–09, 701–05; *see also supra* notes 22–25 and accompanying text (providing a discussion on the importance of disclosure).

42. *See* Sarbanes-Oxley Act § 308(a) (granting the Commission discretion to include any civil monetary penalty with any disgorgement to create a single fund "for the benefit of the victims" of the securities violation).

43. *See* 15 U.S.C. § 78u(d)(5) ("In any [case brought] by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.").

44. *See Disgorgement*, BLACK'S LAW DICTIONARY (11th ed. 2019).

45. *See* Root v. Ry. Co., 105 U.S. 189, 207 (1881) (observing that "it would be inequitable that [defendant] should make a profit out of his own wrong").

46. *See* Liu v. SEC, 140 S. Ct. 1936, 1951 (2020) (Thomas, J., dissenting) ("[A]ccounting for profits . . . compels a defendant to account for, and repay to a plaintiff, those profits that belong to the plaintiff in equity.").

enactment of SOX in 2002.[47] Nevertheless, the SEC has used courts' equity power to seek disgorgement since the 1970s.[48]

In *Securities & Exchange Commission v. Texas Gulf Sulphur*,[49] the SEC brought an insider trading action under the Exchange Act and the SEC's promulgated rules.[50] The District Court determined that protecting the public interest and preventing future violations warranted disgorgement of the fraudulent proceeds.[51] On appeal, the Circuit Court affirmed, determining that "the SEC may seek other [forms of relief] than injunctive relief . . . so long as such relief is remedial relief and is not a penalty assessment."[52] This determination comports with the consensus at the time that the Commission had broad discretion to enforce the securities laws.[53]

Disgorgement has become a central tool in the SEC's arsenal for collecting funds in enforcement actions.[54] One large-scale case study found that more than half of SEC enforcement actions have at least some disgorgement, and in the cases where it is present, disgorgement represents nearly eighty percent of the monetary penalties imposed.[55] While it has largely been used as an equitable remedy, there is debate over when and how the SEC uses disgorgement.[56]

Sarbanes-Oxley formally granted the Commission the right to seek equitable remedies, which has included disgorgement since *Texas Gulf Sulphur*.[57] SOX also created SEC fair funds, which allow for the consolidation of disgorged funds and civil penalties to help harmed investors.[58] Following the enactment of SOX, the SEC established rules

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47. *See* 15 U.S.C. § 78u(d)(5).

48. *See* SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 91 (S.D.N.Y. 1970) ("[C]ourts have utilized their inherent equity power to grant relief ancillary to an injunction.").

49. 312 F. Supp. 77 (S.D.N.Y. 1970).

50. *See id*. at 80.

51. *See id.* at 97.

52. *See* SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

53. *See* Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963) (citing a variety of cases from various Circuits).

54. *See* SEC Press Release, *supra* note 1 (providing enforcement results for FY2022).

55. *See* Urska Velikonja, *Public Enforcement after Kokesh*: *Evidence from SEC Actions*, 108 GEO. L.J. 389, 395 (2019) (examining over eight thousand SEC enforcement actions from 2010 to 2018).

56. *See* discussion *infra* Section III.

57. 15 U.S.C. § 78u(d)(5).

58. *See* 15 U.S.C. § 7246(a) ("If . . . the Commission obtains a civil penalty against any person for a violation of [securities] laws, or such person agrees, in settlement of any such action, to such civil penalty, the amount of such civil penalty shall, on the

which lay out the procedure for how fair funds are proposed, accepted, and administered.[59] The clear language of both the statute and regulation emphasizes that fair funds must be for the benefit of harmed investors.[60] The SEC will distribute fair funds to those investors according to a distribution plan that the SEC Division of Enforcement prepares and submits.[61] However, due to the logistics of distributing funds, the plan may stipulate that all funds should be paid to the United States Treasury.[62]

The Commission has an obligation to create fair funds in administrative proceedings.[63] Although no such obligation is imposed on federal courts, many SEC cases will also include a motion and order establishing a fair fund.[64] While court-ordered fair funds are often subject to the court's local rules regarding publication, for administrative proceedings, the Commission maintains a list of cases with information regarding the outcome of the proceeding, the proposed plan, and any other relevant material regarding the distribution process.[65] In both situations, a plan is required to guide the distribution.

Crafting a distribution plan is often difficult and requires a thorough analysis of the different claims and monies available; with this in mind, reviewing courts have historically given the Commission significant discretion to design and set the parameters of a distribution plan.[66] Courts'

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motion or at the direction of the Commission, be added to and become part of a disgorgement fund or other fund established for the benefit of the victims of such violation.").

59. *See* 17 C.F.R. §§ 201.100–1106.

60. *See* 15 U.S.C. § 7246(a); *id.* § 201.1100.

61. *See* 17 C.F.R. § 201.1101.

62. *See id.* § 201.1102(b) ("When . . . the cost of administering a plan of disgorgement relative to the value of the available disgorgement funds and the number of potential claimants would not justify distribution of the disgorgement funds to injured investors, the plan may provide that the [combined fund] shall be paid directly to the general fund of the United States Treasury.").

63. 17 C.F.R. § 201.1100.

64. *See, e.g.*, Order to Establish a Fair Fund, Appoint a Tax Administrator and Distribution Agent, and Approve Future Fees and Expenses, SEC v. Facebook, Inc., No. 3:19-cv-04241 (N.D. Ca. Aug. 17, 2020), https://www.sec.gov/divisions/enforce/claims/docs/facebook-fair-fund-order-081720.pdf.

65. *See Distributions in Commission Administrative Proceedings: Notices and Order Pertaining to Disgorgement and Fair Funds*, SEC, https://www.sec.gov/enforce/notices-and-orders-pertaining-to-disgorgement-and-fair-funds (last visited May 22, 2024) [hereinafter *Distributions in Proceedings*].

66. *See*, *e.g.*, SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997); SEC v. Wang, 944 F.2d 80, 83–84 (2d Cir. 1991); SEC v. Levine, 881 F.2d 1165, 1181–82 (2d Cir. 1989); SEC v. Forex Asset Mgmt. LLC, 242 F.3d 325, 330–31 (5th Cir. 2001).

examinations of these distribution plans focus on whether the plan is fair and reasonable.[67]

### *C. Recent Developments*

#### *i. Kokesh v. United States Securities and Exchange Commission*

One of the first major Supreme Court cases challenging the established method by which the SEC uses disgorgement came in the 2017 case of *Kokesh v. SEC*.[68] The Court had previously held that the five-year statute of limitations set out in 28 U.S.C. § 2462 applies when the Commission seeks statutory monetary penalties.[69] The question presented in *Kokesh* was whether the statute of limitations set out in § 2642 applies when the Commission seeks disgorgement, thereby making it a monetary penalty, rather than an equitable remedy.[70] Petitioner Kokesh owned two investment-advisor firms, and in 2009 the SEC brought suit in federal court alleging that he had misappropriated $34.9 million from investors.[71] The lower courts determined that the statute of limitations in § 2642 applied to the Commission's request for civil money penalties but upheld the full disgorgement and prejudgment interest awards.[72]

The Supreme Court sought to resolve a circuit court split over whether disgorgement claims in proceedings involving the SEC are subject to § 2462's five-year statute of limitations.[73] The Court held that SEC disgorgement constitutes a monetary penalty and defined a penalty as a "punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws."[74] If the Court had

67. *See* Off. Comm. of Unsecured Creditors of Worldcom, Inc. v. SEC, 467 F.3d 73, 81–82 (2d Cir. 2006) (noting that "once the district court satisfies itself that the distribution of proceeds in a proposed SEC disgorgement plan is fair and reasonable, its review is at an end"). Worldcom, like Enron, was one of the major companies that went bankrupt as a result of the bad practices that led to the Sarbanes-Oxley Act. As of this writing, it holds the ignominious distinction of being the third-largest US bankruptcy. The cited case represents some of the fallout from that bankruptcy, even four years later.

68. *See* 137 S. Ct. 1635 (2017).

69. *See* Gabelli v. SEC, 568 U.S. 442, 454 (2013) (reversing and remanding back to the Second Circuit a case under the Investment Advisers Act, a key piece of twentieth-century legislation regulating the securities industry).

70. *Kokesh*, 581 U.S. at 459.

71. *See id.* at 459–660 (stating that the Commission also alleged that Kokesh caused the filing of false and misleading SEC disclosures).

72. *Id.* at 460.

73. *Id.* at 460–61.

74. *See id.* at 461 ("In its current form, § 2462 establishes a 5-year limitations period for 'an action, suit or proceeding for the enforcement of any civil fine, penalty,

determined that disgorgement was exclusively an equitable remedy, § 2462 would not have applied.[75] The Court then examined two prevailing principles arising from this definition of penalty: (1) a key factor of whether a sanction can be described as a penalty turns, in part, on whether the wrong is against the public or an individual; and, (2) a pecuniary sanction operates as a penalty only if it is seeking to punish and deter, rather than compensate a victim.[76]

Under these principles, the Court determined that the SEC, in seeking disgorgement, is acting in the public interest rather than exclusively for harmed individual investors.[77] Although disgorgement works to benefit and protect investors, the Court recognized that the tool is often used for punitive and deterrent purposes.[78] The Court in *Kokesh* further recognized the non-compensatory nature of SEC disgorgement orders at that time.[79] For the foregoing reasons, the Supreme Court determined that SEC disgorgement functioned as a penalty, and the statute of limitations presented in § 2462 would apply whenever the SEC seeks disgorgement.[80]

Importantly, a footnote in *Kokesh* explicitly states that "[n]othing 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."[81]

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or forfeiture.' This limitations period applies here if SEC disgorgement qualifies as either a fine, penalty, or forfeiture." (quoting 28 U.S.C. § 2462)); *id.* (quoting Huntington v. Attrill, 146 U.S. 657, 667 (1892)).

75. *See* 28 U.S.C. § 2462 (instituting a statute of limitations for a "*civil fine, penalty, or forfeiture*" (emphasis added)).

76. *Kokesh*, 581 U.S. at 461–62.

77. *See id.* at 462, 464; *see also* SEC v. Rind, 991 F.2d 1486, 1491 (2d Cir. 1993) ("[D]isgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets.").

78. *Kokesh*, 581 U.S. at 464; *see also* SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 92 (S.D.N.Y. 1970) (emphasizing the need to "deprive the defendants of their profits in order to . . . *protect the investing public by providing an effective deterrent to future violations*" (emphasis added to highlight the dual purpose behind disgorgement)).

79. *See Kokesh*, 581 U.S. at 464–65 (making special note of the fact that disgorgement funds are often placed with the Treasury, as opposed to being distributed to harmed investors). The current rules discussed above altered that practice, and made it more unlikely that fair funds, made up of both civil penalties and disgorgement, would be deposited with the Treasury. In so doing, the Commission made investor distribution a higher priority.

80. *Id.* at 465.

81. *See Kokesh,* 581 U.S. at 461 n.3.

*ii. Liu v. United States Securities and Exchange Commission*

The most recent change handed down from the United States Supreme Court came from the Court's eight-to-one majority penned by Justice Sotomayor in *Liu v. SEC*.[82] The case arose out of a scheme to defraud foreign nationals orchestrated by petitioner Liu and his wife.[83] Of the approximately $27 million Liu acquired, nearly $20 million went to marketing expenses and salaries, which was far more than the offering memorandum permitted; Liu diverted a "sizeable portion" of the acquired funds to personal accounts and a company under his wife's control.[84] The Commission alleged that Liu violated the terms of the offering agreement and the securities laws, and the United States District Court for the Central District of California granted summary judgment to the SEC which the Ninth Circuit affirmed.[85] The Supreme Court granted certiorari to determine whether the Exchange Act authorizes the Commission to seek disgorgement beyond a defendant's net profits from wrongdoing.[86]

The Court interpreted the language of § 78u(d)(5) and determined that Congress had prohibited the Commission from seeking an equitable remedy that exceeds a defendant's net profits.[87] This determination was in accordance with the history of equitable remedies and prevailing interpretations of disgorgement.[88] The Court further recognized that in practice, lower courts have awarded disgorgement in ways that test the boundaries of equity with the goal of providing some critiques of the system.[89]

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82. *See* Liu v. SEC, 140 S. Ct. 1936 (2020) (vacating and remanding to the Ninth Circuit); SEC v. Liu, 754 F. App'x 505 (9th Cir. 2018).

83. *See Liu*, 140 S. Ct. at 1941.

84. *See id.* at 1941–42.

85. *See id.* at 1942 (acknowledging that *Kokesh* "expressly refused to reach" the issue whether the District Court had the authority to order disgorgement).

86. *Id.*; *see also* 15 U.S.C. § 78u(d)(5) ("[T]he Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.").

87. *See Liu*, 140 S. Ct. at 1946 (determining that Congress had incorporated longstanding equitable principles into § 78u(d)(5)).

88. *See* Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 1 (2013), https://journals.law.harvard.edu/hblr//wp-content/uploads/sites/87/2013/11/Ryan__The-Equity-Façade-of-SEC-Disgorgement.pdf (discussing the history of disgorgement as an equitable remedy); SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991) ("The disgorgement remedy . . . is, by its very nature, an equitable remedy.").

89. *See Liu*, 140 S. Ct. at 1946 (enumerating specific issues with the practice of ordering funds be deposited in Treasury as opposed to victims, imposing joint and several liability, and declining to deduct legitimate business expenses from the disgorgement valuation).

Justice Thomas served as the lone dissenter in *Liu*, and his opinion remains true to his originalist leanings.[90] He states that because disgorgement was a creation of the twentieth century, it was not a form of equitable relief available at the time of the founding of the United States.[91] Therefore, Thomas argues, district courts cannot award disgorgement under § 78u(d)(5).[92] He further examines instances where the Court has interpreted "equitable relief" in other statutes to refer exclusively to relief available in the English courts of equity.[93] Thomas points out that the initial use of disgorgement in an SEC action came in the seminal *Texas Gulf Sulphur* case, where the Court characterized it as "restitution."[94] After analyzing the changing use of the term "disgorgement" over time, Justice Thomas concludes by remarking that disgorgement is a flashback to the days when courts would insert judicially created relief into statutes.[95]

*iii. National Defense Authorization Act of 2021*

A major change following the Court's decision in *Liu* came through the enactment of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 ("2021 NDAA").[96] The 2021 NDAA is largely similar to other defense authorization acts, authorizing the appropriation for the operation of the armed forces.[97] The 2021 NDAA's nearly 1,500 pages contain a wealth of other provisions ranging from foreign affairs to semiconductor initiatives.[98] Section 6501 of the 2021

90. *See id.* at 1950 (Thomas, J., dissenting).

91. *Id*. at 1951.

92. *Id*. at 1950–51.

93. *See id.* at 1951 ("There is nothing about § 78u(d)(5) that counsels departing from [the originalist] approach."). *See generally* Mertens v. Hewitt Assocs., 508 U.S. 248, 256 (1993) (interpreting the Employee Retirement Income Security Act of 1974); Grupo Mexicano de Desarrollo S.A. v. All. Bond Fund, Inc., 527 U.S. 308, 318–319 (interpreting the Judiciary Act of 1789); Taggart v. Lorenzen, 139 S. Ct. 1795, 1801 (interpreting provisions of the Bankruptcy Code).

94. *Liu*, 140 S. Ct. at 1952 (first citing SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 93 (S.D.N.Y. 1970); and then SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir. 1971)).

95. *Id.* at 1952–53 (citing Corr. Servs. Corp. v. Malesko, 534 U.S. 61, 75 (2001) (Scalia, J., concurring)).

96. William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, 134 Stat. 4625 (2021).

97. *See id. See generally id.* § 101 (authorizing procurement for the armed services), § 201 (providing funds may be allocated to R&D, testing, and evaluation), § 301 (providing authorization of appropriation of funds to operation and maintenance).

98. The table of contents alone for the 2021 NDAA is approximately 33 pages long and little pertains to the securities laws, so for the sake of brevity, the selected example provisions merely provide a sense of the scope of the Act. The NDAA reflects the

NDAA is entitled "Investigations and Prosecution of Offenses for Violations of the Securities Laws," and provides a congressional response to the decisions handed down by the Court in *Kokesh* and *Liu*.[99] The relevant amendments to the Exchange Act speak to the central issues in *Liu* and *Kokesh*.[100] Section 78u(d)(7) expressly grants the Commission the authority to seek disgorgement under any provision of the securities laws and distinguishes it from other forms of equitable remedies.[101] With this framework and history in mind, the importance of distribution as a tool for investor protection is evident.

## III. WHAT REMAINS AFTER *LIU* AND THE NDAA?

The full effect of *Kokesh*, *Liu*, and the NDAA is still being surveyed and probed by the courts, but the securities industry has taken notice and is preparing for further changes.[102] Contemporaneously with the passage of the 2021 NDAA, a consensus emerged that the *Liu* decision allowed disgorgement as a permissible equitable remedy under § 78u(d)(5) when the disgorgement award does not exceed a wrongdoer's net profits.[103] Indeed, even the language of 2021 NDAA Section 6501 expressly permits disgorgement only of "unjust enrichment."[104] What, then, is left unanswered from the Commission's perspective?

The Commission's three-part mission involves protecting investors,

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adage that there are two things no one wants to see being made — sausage and legislation.

99. *See* 15 U.S.C. § 78u(d)(8) (clarifying and extending the statute of limitations for bringing actions under the various securities laws); *see also* § 78u(d)(7) ("In [cases] brought by the Commission under . . . the securities laws, the Commission may seek, and any Federal court may order, disgorgement.").

100. *See* 15 U.S.C. §§ 78u(d)(7)–(8).

101. 15 U.S.C. §§ 78u(d)(7), 78u(d)(8)(B). The changes also create a distinction between 28 U.S.C. § 2462 and 15 U.S.C. § 78u(d)(7) regarding statutes of limitations.

102. A quick online search reveals a plethora of blog posts and articles from law firms, legal scholars, and financial analysts. *See generally* Ike Adams et al., *SEC Disgorgement Authority May Be Limited Even After Recent Amendments to the Exchange Act*, ABA (Jan. 27, 2021), https://www.americanbar.org/groups/business_law/publications/blt/2021/02/sec-disgorgement-authority/ (arguing that the SEC's statutory remedy, granted by the 2021 NDAA, seems to be subject to many of the same limitations recognized by the Supreme Court in *Liu*).

103. *See* SEC v. Owings Grp., LLC, No. RDB-18-2046, 2021 U.S. Dist. LEXIS 90775, at *8 (D. Md. May 12, 2021) (analyzing the *Liu* decision and its impact on SEC action).

104. Securities Exchange Act of 1934, Pub. L. No. 116-283, § 6501(a), 134 Stat. 4625.

maintaining markets, and facilitating capital formation.[105] The foundation of securities regulation relies on disclosure to ensure investors have the information necessary to be protected in the markets.[106] The idea of protecting investors did not begin with the SEC, but emerged with the writings of a former Commissioner of the Federal Trade Commission, well before Congress promulgated the securities laws.[107] Nevertheless, as one scholar writes, "[i]nvestor protection is now a central feature of federal securities regulation in the United States."[108] That scholar goes on to say that investor protection focuses on four potential harms: fraud; unlevel informational playing fields; the extraction of private benefits; and the investors themselves.[109]

The SEC has used disgorgement as a multifaceted and powerful enforcement tool.[110] Although disgorgement is often framed as an equitable remedy, rather than a penalty, recent Supreme Court decisions have thrown its use into uncertainty.[111] Congress responded by specifically granting the Commission the right to seek disgorgement.[112] Although the

105. *See About the SEC*, *supra* note 16.

106. *See* Securities Act of 1933, 73 Pub. L. No. 22, 38 Stat. 74 (stating the purpose of the act as providing "full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof"); SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (stating that the goal of the Securities Act of 1933 is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions"); Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 688 (S.D.N.Y. 1968) (recognizing the fundamental purpose of Section 11 of the Securities Act as "requiring full and truthful disclosure *for the protection of investors*" (emphasis added)); ROOSEVELT, *supra* note 25, at 94 (explaining that the 1933 Act's purpose was to "protect the public by informing the investor").

107. *See generally* Huston Thompson, *Regulation of the Sale of Securities in Interstate Commerce: Solution of Problem of Protecting Investors Must be Effected by System of Publicity Giving Full Information as to Securities to Be Sold and Then Leaving Responsibility of Purchase to Him — Difficulties Confronting Federal Incorporation or Licensing Plan*, 9 ABA J. 157, 183–84 (1923).

108. Michael D. Guttentag, *Protection from What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 212 (2013) (detailing the centrality of investor protection in the language of enabling statutes, judicial decisions interpreting those statutes, and commentaries on federal securities regulations).

109. *See id.* at 222–32 (identifying four harms which continue to justify and influence securities legislation).

110. *See* SEC Press Release, *supra* note 1 (providing SEC enforcement results, with disgorgement playing a slightly smaller role because of the uncertainty cast on its use).

111. *See* Kokesh v. SEC, 581 U.S. 455, 461 (2017) (holding that SEC disgorgement constitutes a penalty); Liu v. SEC, 140 S. Ct. 1936, 1946 (2020) (limiting equitable relief to a defendant's profits).

112. *See* 15 U.S.C. § 78u(d)(7) ("In any action or proceeding brought by the Commission under any provision of the securities laws, the Commission may seek, and

2021 NDAA may provide the Commission with the option to seek disgorgement outside of equity, courts have used the principles set forth in *Liu* to limit disgorgement awards.[113] *Liu*, beyond requiring disgorgement to be awarded to victims, mandated that disgorgement be limited to net profits that take legitimate business expense deductions into account and restricted the imposition of joint and several liability in securities actions.[114]

Although disgorgement is often used interchangeably with restitution, the difference is more than semantic in the context of SEC enforcement actions.[115] Disgorgement seeks to avoid unjust enrichment for *wrongdoers*, while restitution seeks to make *investors* whole.[116] The Supreme Court has acknowledged that restitution is sometimes available in equity but sometimes available at law.[117] This distinction becomes important in analyzing the two different approaches following *Liu* and the 2021 NDAA.[118]

This framework creates two different options available to the SEC for disgorgement purposes — an equitable remedy and a statutory grant; these distinct options allow the Commission to frame their request for disgorgement in one of two ways.[119] While the usefulness of the statutory grant is yet to be seen, the possibilities exist for different framings of the issue by the Commission.[120] The first involves using disgorgement as an

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any Federal court may order, disgorgement.").

113. *See* Matthew G. Lindenbaum et al., *'Liu v. SEC': One Year Later*, N.Y. L.J. WHITE-COLLAR CRIME (June 25, 2021), https://www.nelsonmullins.com/storage/u4WWkYyi2eZmwNJ5tMCHWv6HkrW63ZqoOX7YXInq.pdf (arguing that "the limiting principles on the SEC's disgorgement power outlined in *Liu* remain alive and well despite the NDAA").

114. *See Liu*, 140 S. Ct. at 1946–50 (2020).

115. *See* Urska Velikonja, *Public Enforcement After* Kokesh: *Evidence from SEC Actions*, 108 GEO. L.J. 389, 400 (2019) (discussing the difference between disgorgement and restitution).

116. *See Disgorgement*, BLACK'S LAW DICTIONARY (11th ed. 2019); Velikonja, *supra* note 115, at 400 (defining restitution).

117. *See* Great-West Life & Annuity Ins. v. Knudson, 534 U.S. 204, 212–14 (2002) (examining historical approaches while interpreting ERISA statutory language).

118. *See Liu*, 140 S. Ct. at 1938; *see also* William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, 134 Stat. 4625 (2021).

119. *See* 15 U.S.C. §§ 78u(d)(5) (outlining equitable remedy), 78u(d)(7) (outlining statutory grant).

120. *See* Lindenbaum et al., *supra* note 113 (noting that the *Liu* Court "strongly hinted, without deciding, that situations where disgorged funds are simply deposited into the Treasury would not qualify as an award 'for the victims' except in unique circumstances, such as where it is infeasible to distribute the collected funds to investors"). This interpretation of the Court's "hint[ing], without deciding" opens the door to other possibilities for litigation strategy on the part of the SEC, *id.*

equitable remedy to help protect investors by returning a portion of the money that was lost as a result of the defendant's bad actions.[121] This option promotes the investor protection component of the SEC's mission.[122] The statutory grant, provided by the 2021 NDAA, allows the disgorgement to function more as a penalty, creating a disincentive for other participants in the securities industry.[123] Although this difference may seem simply semantic, it creates an avenue for the SEC to continue using one of the most powerful tools at its disposal.[124] Crucially, under both the equitable remedy and statutory grant, any disgorgement award is not permitted to exceed a defendant's profits from wrongdoing.[125]

### *A. The Relationship Between Disgorgement and Distribution*

Disgorgement is a remedy used in a variety of enforcement and other civil contexts.[126] Those other contexts require a different analysis; the statutory and case law framework discussed herein only pertains to securities enforcement actions brought by the SEC.[127] In American jurisprudence, equity never "lends its aid to enforce a forfeiture or penalty."[128] Penalties, according to the Supreme Court, have three distinct features.[129] These features are what led the *Kokesh* Court to determine that

121. *See* 15 U.S.C. § 78u(d)(5); *see also Liu*, 140 S. Ct. at 1948 ("The equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit.").

122. *About the SEC*, *supra* note 16 (setting forth goals such as "protect[ing] investors; maintain[ing] fair, orderly, and efficient markets; and facilitat[ing] capital formation").

123. *See* 15 U.S.C. § 78u(d)(7). *But see* Kokesh v. SEC, 581 U.S. 455, 461 (2017) (holding that SEC disgorgement would *always* constitutes a penalty because of how it was structured at the time).

124. *See* SEC Press Release, *supra* note 1 (showing that although disgorgement played a smaller role because of the uncertainty, it was still a major component of SEC action).

125. *See Disgorgement*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining disgorgement as "the act of giving up something (such as profits illegally obtained) on demand or by legal compulsion); *Liu*, 140 S. Ct. at 1946; SEC v. Owings Grp., LLC, No. RDB-18-2046, 2021 U.S. Dist. LEXIS 90775, at *8 (D. Md. May 12, 2021).

126. *See, e.g.,* James Edelman, *Restitutionary Damages and Disgorgement Damages for Breach of Contract*, 8 RESTITUTION L. REV. 129, 130, 133, 136–51 (2000) (examining the availability of disgorgement as a remedy for breach of contract actions); 15 U.S.C. § 1117(a) (providing statutory grant for disgorgement in Patent and Trademark disputes).

127. *See* 15 U.S.C. § 78u(d)(5), (7).

128. *See* Marshall v. Vicksburg, 82 U.S. 146, 149 (1872) (reflecting, despite its 150-year age, a key component of the English courts of equity and the continuing thinking regarding equity under the common law).

129. *See* Gabelli v. SEC, 568 U.S. 442, 451–52 (2013) (stating penalties "go beyond

SEC disgorgement was a penalty, as it stood at the time.[130] These three features also play into the limiting factors expressed in *Liu*.[131]

The distinction between penalties and equities supports the Supreme Court's determination in *Liu* that the SEC can utilize disgorgement as an equitable remedy under 15 U.S.C. § 78u(d)(5) but only to the extent that the potential award does not exceed the defendant's net profits from wrongdoing.[132] Importantly, *Liu* stated that courts must "deduct legitimate business expense before awarding disgorgement under § 78u(d)(5)."[133] Additionally, the *Liu* Court, interpreting § 78u(d)(5), stated that the "equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit."[134] The Court thereby rebuked the then-common practice of depositing collections in a fund at the Treasury.[135]

Examining the language of both §§ 78u(d)(5) and 78u(d)(7), it is clear that the SEC has the discretion to seek disgorgement in the actions it brings in federal court.[136] Section 78u(d)(5) includes a provision that the equitable relief must benefit investors, but § 78u(d)(7) contains no such language.[137] Some of the earliest case law regarding the Commission seeking equitable relief, in keeping with common law theories of equity, required that the relief not be a penalty.[138] Although disgorgement has been granted under a court's equity power, it has also been affirmed as a valid deterrent the SEC

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compensation, are intended to punish, and label defendants wrongdoers").

130. *See* Kokesh v. SEC, 581 U.S. 455, 463–64 (2017) (taking special issue with the fact that SEC disgorgement at the time was not compensatory).

131. *See* Liu v. SEC, 140 S. Ct. 1936, 1946–50 (2020); *see also supra* notes 112–13 and accompanying text.

132. *See Liu*, 140 S. Ct. at 1946 (examining and applying historical conceptions of equity).

133. *Id.* at 1950 (placing a further limit on the amount eligible for recovery under disgorgement, beyond the established "ill-gotten gains" requirement).

134. *Id.* at 1948 (stating additionally that there is "no analogous common-law remedy permitting a wrongdoer's profits to be withheld from a victim indefinitely without being disbursed to known victims").

135. *Id.* at 1947 (noting one of the difficulties in distribution, at least from the point of view of the Commission, is collecting the funds ordered); *see also* SEC, DIV. OF ENF'T, 2020 ANN. REP. 18, https://www.sec.gov/files/enforcement-annual-report-2020.pdf.

136. *See* 15 U.S.C. §§ 78u(d)(5) ("the Commission may seek . . . any equitable relief"), 78u(d)(7) ("the Commission may seek . . . disgorgement").

137. *Compare* § 78u(d)(5), *with* § 78u(d)(7).

138. *See* SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971) ("SEC may seek other than injunctive relief in order to effectuate the purposes of the [Exchange] Act, so long as such relief is remedial relief and is not a penalty assessment.").

can use to protect investors.[139] Thus, it is again apparent that disgorgement has the capacity to protect investors at both the individual and collective levels.[140]

In the majority of the cases, it is acceptable, even preferred, for disgorgement to serve as both a way to benefit harmed investors and a deterrent — two beneficial outcomes for the price of one.[141] Furthermore, while undistributed disgorgement is a valid, albeit legally dubious, deterrent at the collective level, the dual function of distribution to offer restitution and punish wrongdoing protects both individual investors and the collective investing public.[142] Certain situations create specific questions about the relationship between disgorgement and distribution; we turn the analysis there.

Whether distribution is required whenever disgorgement is ordered depends on the goal of the award. In cases where the SEC chooses to seek disgorgement, and a court chooses to grant it as an equitable remedy under § 78u(d)(5), the disgorgement must go to the benefit of harmed investors.[143] Therefore, distribution is required, and the SEC would likely utilize the powers granted under Sarbanes-Oxley to combine any disgorged funds with civil money penalties to increase the amount available to those same investors.[144] However, in situations where the disgorgement serves as a deterrent, it would likely be under § 78u(d)(7), and no distribution would be required, as the public interest would be served by penalizing the wrongdoer.[145]

Disgorgement is a crucial and powerful tool that the SEC has relied on in

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139. *See* SEC v. Rind, 991 F.2d 1486, 1491 (9th Cir. 1993) ("[D]isgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets"); SEC v. Teo, 746 F.3d 90, 102 (3d Cir. 2013) ("[T]he SEC pursues [disgorgement] 'independent of the claims of individual investors'" in order to "'promot[e] economic and social policies.'" (quoting George W. Dent Jr., *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865, 930 (1983))).

140. *Compare* 15 U.S.C. § 78u(d)(5) (may seek equitable relief "for the benefit of investors"), *with Rind*, 991 F.2d at 1491 (disgorgement actions protect investors in furtherance of the "public policy mission").

141. *See* 15 U.S.C. § 78u(d)(5); *Rind,* 991 F.2d at 1491.

142. *See* Liu v. SEC, 140 S. Ct. 1936, 1948 (2021); *see also Teo*, 746 F.2d at 102; *Rind*, 991 F.2d at 1491.

143. *See* 15 U.S.C. § 78u(d)(5).

144. *See* 15 U.S.C. § 7246(a) (statutory establishment of fair funds under SOX); 17 C.F.R. § 201.1101 (SEC rule promulgated under SOX for administration of fair funds).

145. *See* 15 U.S.C. § 78u(d)(7); *see also* Kokesh v. SEC, 581 U.S 455, 462 (2017) (discussing two distinct principles of public or private wrongs and punishment and deterrence).

past enforcement actions.[146] Although the Commission has been slightly more hesitant in seeking the remedy pending further guidance following *Liu*, it is not a tool that the Commission would like to lose.[147] In certain cases, for a variety of reasons, distribution may not be considered or may be infeasible.[148] Traditionally, the Commission would deposit those collected, but undistributed, funds in the Treasury.[149] Even the current SEC Rules permit this practice in certain situations.[150]

On the other side of the coin, whether disgorgement is available when no distribution is feasible or considered also depends on the framing of the disgorgement. In situations where the Commission has reason to believe that distribution is infeasible, the disgorgement would need to be justified by § 78u(d)(7) and presented as a punishment.[151] Disgorgement framed as an equitable remedy must be distributed to harmed investors, so if no distribution is considered, the equitable remedy option is not available under current case law.[152]

### *B. What Happens to Remaining Funds After a Distribution?*

The distribution process can only begin in earnest following a successful judgment and collection.[153] Prior to such judgment and collection, the Commission must investigate and litigate the action, which can often take years.[154] Although concrete data is difficult to come by, one source states

146. *See* SEC Press Release, *supra* note 1; Velikonja, *supra* note 115, at 395.

147. *See* John D. Ellsworth, *Disgorgement in Securities Fraud Action Brought by the SEC*, 1977 DUKE L.J. 641, 641–42 (1977) (noting the "prominent and still expanding role" of equitable disgorgement in SEC actions).

148. *See* 17 C.F.R. § 201.1102 (permitting fair fund monies to be paid to a court registry or the United States Treasury).

149. *See* Liu v. SEC, 140 S. Ct. 1936, 1947 (2020) (taking issue with this practice in connection with principles of equity and helping harmed investors).

150. *See* 17 C.F.R. § 201.1102(b) ("When, in the opinion of the Commission or the hearing officer, the cost of administering a plan of disgorgement relative to the value of the available disgorgement funds and the number of potential claimants would not justify distribution of the disgorgement funds to injured investors, the plan may provide that the disgorgement funds and any civil penalty shall be paid directly to the general fund of the United States Treasury.").

151. *See* 15 U.S.C. § 78u(d)(7).

152. *See* 15 U.S.C. § 78u(d)(5); *Liu*, 140 S. Ct. at 1948 ("The equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit.").

153. *See Distributions in Proceedings*, *supra* note 65. Several of the active fair funds began more than 3 years ago, which reflects the tough realities of moving the distribution process along.

154. *See* SEC, How Investigations Work, https://www.sec.gov/enforcement/how-investigations-work (last visited May 22, 2024) (detailing the extensive steps taken in

that the investigations alone typically take two to four years to complete.[155] As is the case in many areas of the law, it is often too difficult to recover the full award from defendants.[156] Additionally, finding all of the harmed investors can present significant logistical hurdles.[157] A final consideration comes from accounting and proportionality.[158] The proposed distributions for investors must be rounded to the nearest cent based on their proportional investment and can often lead to small excess funds for each investor — when these funds are combined in a larger case, it can add up to significant values.[159]

In a distribution where all actual investors have had their funds distributed, and there is money remaining in the fund because of accounting realities, the SEC should be able to deposit these remaining funds with the Treasury, as permitted by valid regulations.[160] The goal of disgorgement as an equitable remedy is to help harmed investors, and the costs associated with distributing any remaining funds would outweigh the marginal benefit to investors.[161] Legislation has allowed for sums deposited with the Treasury to be put towards the payment of

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Commission investigations, which often require long periods of time).

155. *See Frequently Asked Questions, SEC Whistleblower Advocates*, https://secwhistleblowerадvocate.com/sec-whistleblower-frequently-asked-questions/#:~:text=How%20long%20does%20it%20take,to%20four%20years%20to%20complete (last visited May 22, 2024) (explaining how long SEC investigations take and the investigative process).

156. *See* SEC, Addendum to Div. of Enf't Press Release SEC Announces Enforcement Results for FY22 (Nov. 15, 2022), https://www.sec.gov/files/fy22-enforcement-statistics.pdf.

157. *See generally* Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331 (2015) (presenting a large-scale study on fair fund distributions, including some of the challenges faced by the SEC).

158. *See id.* at 342 n.68 ("The Office of Distributions . . . conducts a feasibility study to determine whether a distribution would be cost effective based on thirty different factors.").

159. *See* Will Kenton, *Rounding Error*, INVESTOPEDIA (June 26, 2021), https://www.investopedia.com/terms/r/rounding-error.asp (last visited May 22, 2024) ("[T]he difference between the result of a mathematical algorithm that uses exact arithmetic and that same algorithm using a slightly less precise, rounded version of the same number or numbers. The significance of a rounding error depends on the circumstances.").

160. *See* 17 C.F.R. § 201.1102(b) (outlining circumstances where payment to the United States Treasury is permitted when fair funds cannot be distributed to investors because of logistical or economic hurdles).

161. *See* Velikonja, *supra* note 157, at 346 (describing a study which revealed the SEC exercised its distribution authority sparingly because of high costs associated with creating and administering distribution plans).

whistleblowers reporting securities fraud and to fund the activities of the Inspector General.[162] These purposes are still important, even though the priority is benefitting harmed investors; the Commission can still deposit remaining funds with the Treasury.[163]

## IV. "HELP ME HELP YOU": RECOMMENDATIONS FOR MOVING FORWARD

Securities regulation and enforcement is an important area of civil law enforcement, and the Commission's work in protecting investors should be maintained to the highest extent possible.[164] The amount of civil money penalties available to the Commission is set by statute and subject to small adjustments corresponding to inflation.[165] Disgorgement, then, is a valuable tool that the SEC can utilize to get more money for one of two interconnected goals — benefitting investors and punishing wrongdoing.[166] Under common law equity, the most recent Supreme Court guidance, and recent Congressional action, these goals must be expressly distinct.[167] With that in mind, there are three recommendations for the Commission moving forward.

### *A. The SEC Should Prioritize Beneficial Distribution to Harmed Investors over Punishing Wrongdoing*

Prioritizing beneficial distribution to harmed investors is a choice that best complies with the statutory scheme and would be an efficient method of advancing the SEC priority of protecting investors.[168] With the dawn of

162. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1844 (2010) (creating a fund at Treasury entitled the SEC Investor Protection Fund and outlining how the Fund is funded and for what purpose it was created).

163. 17 C.F.R. § 201.1102(b) (describing the circumstances under which fair funds may be deposited with the Treasury).

164. *See* Guttentag, *supra* note 108, at 212–13 (discussing the primacy of investor protection in the securities laws).

165. *See* SEC, Inflation Adjustments to the Civil Monetary Penalties Administered by the SEC, https://www.sec.gov/files/civil-penalties-inflation-adjustments_1.pdf (Jan. 15, 2022) (laying out a helpful guide to the statutory penalties under different aspects of the securities laws); *see also* Bipartisan Budget Act of 2015, Pub. L. No. 114-74, § 701 (2015) (amending the Federal Civil Penalties Inflation Adjustment Act of 1990 for updated procedures).

166. *Compare* 15 U.S.C. § 78u(d)(5), *with* 15 U.S.C. § 78u(d)(7).

167. *See* Kokesh v. SEC, 581 U.S. 455, 465 (2017); Liu v. SEC, 140 S. Ct. 1936, 1940 (2020); William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, 134 Stat. 4625 (2021).

168. *See* Guttentag, *supra* note 108, at 223–24.

a new era of retail investing, more individuals stand to be harmed by bad actions in the securities realm.[169] The ability to help less sophisticated investors recover some of their losses would also encourage trust in the markets and regulatory framework.[170] Civil penalties are tools specifically designed to punish wrongdoing, so they should carry the brunt of the load.[171]

### *B. The SEC Should Advocate for Stronger Civil Penalties to Serve the Public Interest by Deterring Wrongdoing in the Securities Industry*

In situations where civil money penalties are enforced against huge corporations or institutions who have violated the securities laws, the fines are often a drop in the bucket and do little to deter future wrongdoing.[172] The SEC should impress upon Congress the need for stricter penalties for violating the securities laws, so the burden shifts away from disgorgement. With the development of fair funds under Sarbanes-Oxley, these higher civil monetary penalties could be joined with equitable disgorgement of ill-gotten gains to maximize the amount available for distribution.[173]

### *C. The SEC Should Continue to Aggressively Pursue Disgorgement of Ill-Gotten Profits*

*Liu* is clear that in cases where disgorgement functions as an equitable remedy, the disgorgement award must not go beyond a wrongdoer's profits.[174] This means courts must "deduct legitimate business expenses"

169. Retail investing, as opposed to institutional investing, is done by individuals on a smaller scale. Institutional investing refers to massive funds and banks. *See generally* Akash Shah et al., *Retail Investors Are Here to Stay*, BANK OF N.Y. MELLON (Aug. 2022), https://www.bnymellon.com/us/en/insights/all-insights/retail-investors-are-here-to-stay.html.

170. *See What We Do,* SEC, https://www.sec.gov/about/what-we-do#section1 (last visited May 22, 2024) (stating the Commission's focus on "Main Street" investors and that they "protect investors by vigorously enforcing the federal securities laws" to hold wrongdoers accountable and deter future misconduct).

171. *See* SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 92 (S.D.N.Y. 1970) ("[P]rotect the investing public by providing an effective deterrent to future violations.").

172. *See* Velikonja, *supra* note 157, at 344 ("[D]amages in securities cases are small compared to aggregate investor losses.").

173. *See* Sarbanes-Oxley Act of 2020, Pub. L. No. 107-204, § 308(a), 116 Stat. 745 (providing the statutory basis for fair funds); 17 C.F.R. § 201.1100 (describing the SEC's rules for fair funds under SOX).

174. *See* Liu v. SEC, 140 S. Ct. 1936, 1940 (2020) (holding that a "disgorgement award that does not exceed a wrongdoer's net profits and is awarded to victims is equitable relief").

before awarding disgorgement under § 78u(d)(5).[175] Legitimate business expenses are determined on a case-by-case basis, so the Commission may pursue the disgorgement remedy and litigate what must be deducted under equity.[176]

## V. CONCLUSION

The principal goal of American securities regulation is to protect investors.[177] Investors are best protected when they stand to recover some of their losses after being harmed by bad actors.[178] Disgorgement has been an effective double-edged sword for the Commission, functioning as a way to maximize harmed-investor recovery and deter and punish those bad actors.[179] After the developments presented in *Kokesh*, *Liu*, and the 2021 NDAA, the Securities and Exchange Commission's ability to seek disgorgement and their process of distribution are uncertain.[180]

Under current statutory and case law, the Commission may continue to pursue disgorgement remedies and protect investors.[181] Although the disgorgement remedy is available both as an equitable remedy or a punitive deterrent, the best way to carry out this goal is to utilize equity to prioritize beneficial distribution to harmed investors.[182] By framing the disgorgement award sought as an equitable remedy, the Commission avoids the limiting principles expressed in *Liu*, which would allow for greater recovery.[183] Greater recovery allows for larger fair funds and more efficient distribution plans, thereby returning more money to harmed investors. By returning more money to harmed investors through distribution, the SEC accomplishes its mission of protecting investors.

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175. *See id.* at 1950.

176. *See id.*; 15 U.S.C. § 78u(d)(5).

177. *See* Guttentag, *supra* note 108, at 212 (emphasizing the importance of investor protection in securities regulation).

178. *See id.* at 210. Distribution to harmed investors combats two of the main areas for harm presented in that article: fraud and the extraction of private benefits.

179. *Compare* 15 U.S.C. § 78u(d)(5) (equitable recovery for investors), *with* 15 U.S.C. § 78u(d)(7) (specially recognized form of penalty).

180. *See* Kokesh v. SEC, 481 U.S. 455 (2017); *Liu*, 140 S. Ct. at 1955–56; William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, 134 Stat. 3388 (2021).

181. *See Liu*, 140 S. Ct. at 1948; 15 U.S.C. §§ 78u(d)(5), 78u(d)(7).

182. This would be done by utilizing 15 U.S.C. § 78u(d)(5) and the equitable relief granted by courts.

183. See *Liu*, 140 S. Ct. at 1936–37.