

[Securities Regulation Daily Wrap Up, ENFORCEMENT—Senate bill would explicitly authorize fed courts to order disgorgement in SEC cases, grant SEC restitution powers, \(Mar. 14, 2019\)](#)

Securities Regulation Daily Wrap Up

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A Senate bill with bipartisan sponsorship would clarify the SEC's and federal courts' authorities regarding disgorgement while maintaining a five-year limitations period, but the bill would also let the SEC seek restitution within a 10-year limitations period.

A bill co-sponsored by Sens. Mark Warner (D-Va) and John Kennedy (R-La) would clarify the SEC's authority to seek, and federal courts' authority to order, disgorgement in cases involving violations of the federal securities laws. The Supreme Court's *Kokesh* opinion had significantly curbed the SEC's ability to seek disgorgement for violations outside the applicable five-year limitations period. As a result, the Warner-Kennedy bill emphasizes issues regarding SEC and federal court authority left open by *Kokesh*, would grant the SEC authority to seek restitution within a 10-year limitations period, but would codify within the Exchange Act a five-year limitations period for disgorgement similar to the limitations period applied in *Kokesh*.

Disgorgement and restitution. The [Securities Fraud Enforcement and Investor Compensation Act of 2019](#) would amend portions of Exchange Act Section 21(d) to clarify the SEC's authority to obtain disgorgement. For one, the bill would explicitly authorize the SEC to seek, and for a federal court to order, disgorgement of any unjust enrichment received by a person who has violated federal securities laws. Moreover, disgorgement obtained in this manner would be offset by the amount of any restitution obtained from the violator and would be subject to a five-year limitations period. The authority of the SEC to seek, and for federal courts to order, disgorgement were not directly at issue in *Kokesh*, but the justices implicitly acknowledged the possibility that federal courts may lack such authority (See footnote 3 in the *Kokesh* opinion).

With respect to restitution, the bill would provide that the SEC may seek, and a federal court can order, restitution in a federal court case. The bill also clarifies that, in in-house administrative proceedings, the SEC can order restitution. The amount of restitution allowed in both types of proceedings would be equal to the amount of an investor's loss (Sens. Warner and Kennedy noted in their press release that, by contrast, disgorgement is limited to the violator's "profit margin"). The restitution provision would apply to persons who are (or must be) registered as broker-dealers, investment advisers, municipal securities dealers, municipal advisers, or transfer agents. The provision also would apply to persons who are associated with these types of persons as of the date of a violation. Restitution and other authorized equitable remedies would be subject to a 10-year limitations period.

Moreover, in calculating the accrual of limitations periods for disgorgement and restitution, the period of time an alleged violator spent outside of the U.S. would not be counted. The disgorgement and restitution provisions, if enacted, also would not impact private rights of action under the federal securities laws. The bill would be effective on or after the date of enactment.

Main Street investors and *Kokesh*. In [Kokesh](#), the Supreme Court unanimously held that disgorgement sought by the SEC was a penalty for purposes of the limitations period contained in 28 U.S.C. §2462, which applies to an "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." For many years, federal appeals courts had grappled with the question of whether disgorgement was a "penalty," a "forfeiture," or not within 28 U.S.C. §2462. The court in *Kokesh* [reasoned](#) that disgorgement was a penalty because it functioned as a remedy for violations of public laws, was designed to punish a violator in

order to deter bad conduct, and it was not solely compensatory because sometimes disgorged funds went to the Treasury instead of to harmed individuals.

Given the court's reasoning in *Kokesh*, the Warner-Kennedy bill could be viewed as seeking to avoid application of 28 U.S.C. §2462 by creating new authority for the SEC to seek restitution in addition to its authority to seek disgorgement. Presumably, restitution would be for the purpose of compensating securities fraud victims and, thus, would not fall within the ambit of "penalty" or other terms within 28 U.S.C. §2462 and that provision's shorter limitations period (the bill text uses the phrase "to an investor"). If there were any question about what restitution is, resort could be made to the Restatement (Third) of Restitution and Unjust Enrichment and to the principles discussed in *Kokesh*: (1) is there a public or individual purpose; (2) is there a punitive purpose; and (3) does the remedy compensate victims or are recovered funds paid to the government.

Senators Warner and Kennedy focused their explanation of the bill on the unfairness of the short window for disgorgement. "As Bernie Madoff demonstrated, financial fraudsters can sometimes go on for years, even decades, before they finally get caught. They shouldn't be able to rip off investors just because some arbitrary five-year window has expired," said Sen. Warner in a [press release](#).

According to Sen. Kennedy: "Investors who are scammed by con artists like Bernie Madoff and Allen Stanford lose their life savings. All too often, the victims of financial fraud aren't wealthy people. They're middle class Americans who lose every penny they set aside for their retirements. Because of a narrow window of time for recouping stolen investment dollars, fraudsters are actually incentivized to keep the shell game going for decades. This bill addresses that problem."

The senators also noted the impact of *Kokesh* on the SEC, something the SEC itself has voiced concerns about. "The Supreme Court's decision in *Kokesh v. SEC* has limited our ability to obtain disgorgement in certain long-running frauds. With respect to matters that have already been filed, we estimate the decision may cause us to forego up to approximately \$900 million in disgorgement, of which a substantial amount likely could have been returned to retail investors," said Stephanie Avakian and Steven Peikin, co-directors of the SEC's Enforcement Division, in the Division's 2018 [annual report](#). Co-Director Peikin had [previously](#) remarked that the SEC was keeping tabs on the impact of *Kokesh*. He also said that the agency would have to bring complex cases sooner in order to maximize its ability to seek disgorgement.

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