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Public Harms, Public Rights, and SEC Enforcement Remedies

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Introduction

Beginning with an overwhelmingly bipartisan push in the early 1980s that resulted in legislation authorizing the Securities and Exchange Commission (SEC) to seek civil monetary penalties of up to three times a wrongdoer's gain from illegal insider trading,[1] Congress has acted on multiple occasions to increase the array of SEC enforcement remedies that courts can impose on defendants found to have violated the federal securities laws.[2] Congress has likewise steadily

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[1] See Insider Trading Sanctions Act of 1984 (ITSA), Pub. L. No. 98-376, 98 Stat. 1264 §2A (now codified as amended at Section 21A of the Securities Exchange Act of 1934 (Exchange Act)). Prior to the ITSA, the court-ordered enforcement remedies available to the SEC were largely limited to permanent or temporary injunctions and restraining orders as well as certain equitable remedies deemed ancillary to such injunctions. See generally DONNA M. NAGY, LISA M. FAIRFAX, & VERONICA ROOT MARTINEZ, SECURITIES LITIGATION, ENFORCEMENT, & COMPLIANCE: CASES AND MATERIALS at 550-54 (5th ed., West Academic) (detailing the SEC's principal enforcement remedies).

[2] See, e.g., ITSA, supra note 1; Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA), Pub. L. No. 100-704, 102 Stat. 4677 (1988) (amending the Exchange Act to clarify the three-times penalty available for unlawful "tipping" and to authorize such penalties for "controlling persons"); Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act), Pub. L. No. 101-429, 104 Stat. 931 (amending the Exchange Act as well as the Securities Act of 1933 (Securities Act), the Investment Advisers Act of 1940 (Advisers Act), and the Investment Company Act of 1940 (Inv. Company Act) to authorize the SEC to seek court-ordered monetary penalties for other types of securities law violations); *id.*, (amending the Exchange Act and the Securities Act to authorize the SEC to seek court-ordered officer and director bars when defendants are shown to be substantially unfit to serve); Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), Pub. L. No. 107-204, 116 Stat. 45 (amending the Exchange Act to authorize the SEC to seek court-ordered "equitable relief . . . for the benefit of investors" and amending the Exchange Act and Securities Act to authorize officer and director bars when the SEC has demonstrated an "unfitness to serve"); The William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 ("NDAA"), Pub. L. No. 116-

added to the enforcement remedies that the SEC can order against respondents in administrative proceedings that establish federal securities law violations.[3] At each juncture, the Committee Reports accompanying the legislation emphasized that Congress was enhancing the SEC's enforcement remedies to increase deterrence of securities-law violations, bolster investor protection, and further the public interest in fair, orderly, and efficient securities markets.[4] Congress also enacted legislation in 2002, and then widened its scope in 2010, empowering the SEC to place "monetary sanctions" obtained in its enforcement actions into a distribution fund for the "benefit of the victims of such violation"[5] or into an "investor protection fund" established in the U.S. Treasury, which the SEC can use either to pay awards to whistleblowers reporting certain securities law violations or to fund the activities of its Inspector General, an independent office within the SEC that conducts audits and investigations of the agency's operations.[6] Unlike most other areas of federal securities regulation, which have ebbed and flowed through the decades with legislative changes in both pro-regulatory and de-regulatory directions,[7] the SEC's panoply of enforcement remedies has only expanded, with no serious efforts toward legislative retrenchment.

283, § 6501, 134 Stat. 3388, 4625–26 (2021) (amending the Exchange Act to authorize the SEC to seek court-ordered disgorgement and providing an explicit ten-year statute of limitations for securities fraud or violations requiring a finding of scienter and a five-year limitations period for any other violations).

[3] In the SEC's early years as an agency, the administrative remedies that Congress had authorized were largely limited to actions involving regulated entities, such as disciplinary proceedings that could be instituted against registered broker-dealers, investment advisers, or their associated persons. See, e.g., Exchange Act §§ 15(b)(4) and 15(b)(6) and Investment Advisers Act §§ 203(e) and 203(f) (authorizing sanctions that included censures, temporary suspensions, and permanent bars). But the SEC's authority to proceed administratively was expanded substantially in 1990 when Congress enacted the Remedies Act, *supra* note 2, which amended the four principal securities acts to provide for the imposition of a permanent cease-and-desist order against *anyone* found to have violated—or to have caused someone else to have violated—*any* provision of the federal securities laws. See Exchange Act § 21C(a); Securities Act § 8A(a); Advisers Act § 203(k)(1); Inv. Company Act § 9(f)(1). The Remedies Act also empowered the SEC to order an accounting of a wrongdoer's profit and the disgorgement of the ill-gotten gains. See Exchange Act § 21B(e); Securities Act § 8A(e); Advisers Act § 203(k)(5); Inv. Company Act § 9(e). In addition, it added civil monetary penalties to the sanctions available in broker-dealer and investment adviser disciplinary proceedings. See Exchange Act § 21B; Advisers Act § 203(i). But twenty years later, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), Pub. L. 111-203, 124 Stat. 1376, Congress extended the SEC's authority to order civil monetary penalties in administrative proceedings, so that it was essentially coextensive with its authority to seek penalties in federal court, provided it was "in the public interest." See Exchange Act § 21B; Securities Act § 8A(g); Advisers Act § 203(i); Inv. Company Act § 9(d).

[4] See, e.g., H.R. REP. NO. 98-355, at 8 (1983) (concluding that ITSA's monetary penalties "will be a powerful deterrent to insider trading abuses."); H.R. REP. NO. 100-910, at 7 (1988) (stating that the ITSFEA amendments "provide greater deterrence, detection and punishment of violations of insider trading"); S. REP. NO. 101-337, at 2 (1990) (observing that "in recent years, the markets under the SEC's jurisdiction have grown dramatically in size and complexity, and the SEC's ability to protect investors and to deter law violations increasingly has been challenged"); S. REP. NO. 107-205, at 39-40 (2002) (concluding that it is necessary "to increase the authority of the SEC to enable it more effectively to accomplish its mission of assuring the integrity of the markets and protecting investors").

[5] 15 U.S.C. § 7246(b).

[6] Exchange Act § 21F(g), 15 U.S.C. §78u-6. See generally Urska Velikonja, *How Fair Funds Changed Public Compensation and Strengthened SEC Enforcement*, 78 Bus. Law. 667 (2023).

[7] See, e.g., George S. Georgiev, *The Breakdown of the Public–Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J. of Law & Bus. 221, 223-24 (2021) (maintaining that the SEC's regulatory regime was "transformed in fundamental ways . . . by the Sarbanes-Oxley Act of 2002, the Dodd-Frank Act of 2010,

In recent years, however, SEC enforcement remedies have experienced a troubling wave of judicial retrenchment. On many occasions, federal courts—including the Supreme Court in *Kokesh v. SEC*[8] and *Liu v. SEC*[9]—have construed statutory provisions to impose on SEC remedies certain limitations or constraints that are nowhere specified in the statutory text and that contravene clear congressional policy choices. In other instances, federal courts—including the Court in *SEC v. Jarkesy*[10]—have struck down certain SEC remedies on constitutional grounds, notwithstanding decades of well-established precedents upholding analogous enforcement remedies administered by other federal agencies. Due to a recent circuit split over how to interpret the SEC's most recently authorized enforcement remedy—the express authority to seek court-ordered disgorgement,[11] the Supreme Court may soon agree to resolve the dispute.[12] If it does, the Court would be hearing what would be its fifth SEC enforcement remedies case in a little more than a decade.[13]

Construing the SEC's new express disgorgement remedy would provide an important opportunity for the Court, or at least some of its justices, to cease the distressing practice—exemplified in *Kokesh*, *Liu*, and *Jarkesy*—of applying prior Court decisions rendered in private litigation contexts to limit the scope of the SEC's enforcement remedies.[14] In particular, more

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and the 2012 JOBS Act," and observing that some reforms "served to heighten the disclosure and governance obligations in the name of 'investor protection'—the original mainstay of securities law," while others sought "to promote 'capital formation,' a more recent mainstay").

[8] 137 S. Ct. 1635 (2017) (concluding that court-ordered SEC disgorgement is a "penalty" and applying to that remedy a general five-year statute of limitations for federal agency enforcement actions).

[9] 140 S. Ct. 1936 (2020) (upholding court-ordered SEC disgorgement as a type of "equitable relief" authorized under § 21(d)(5) of the Exchange Act, but placing three "common-law limitations" on that remedy).

[10] 144 S. Ct. 2117 (2024) (holding that the Seventh Amendment's jury-trial right protects defendants from being ordered to pay civil monetary penalties in administrative proceedings for securities fraud).

[11] NDAA § 6501 (codified in 2021 as Exchange Act § 21(d)(7) and § 21(d)(3)(A)).

[12] Compare SEC v. Govil, 86 F.4d 89, 98-102 (2d Cir. 2023) (concluding that the "equitable limitations [imposed] on disgorgement" by the Supreme Court in *Liu* "survive" subsequent congressional action, and construing the new express disgorgement remedy to require proof by the SEC that a victim has "suffered pecuniary harm") with SEC v. Hallam, 42 F.4th 316, 338 (5th Cir. 2022) (holding that court-ordered disgorgement need not abide by the equitable limitations that the Court imposed in *Liu* because the provisions enacted in 2021 authorize disgorgement "in a legal—not equitable—sense") and SEC v. Navellier & Associates, 108 F.4th 19, 41 (1st Cir. 2024) (construing the new provisions as ones that provide for disgorgement as equitable relief, but declining to follow *Govil* and concluding that nothing in the *Liu* decision "require[s] investors to suffer pecuniary harm as a precondition to a disgorgement award").

[13] See supra notes 8-11 (citing *Kokesh, Liu,* and *Jarkesy*) along with Gabelli v. SEC, 568 U.S. 442 (2013) (holding that the statute of limitations applicable to court-ordered SEC penalties begins to run when the securities fraud is complete, regardless of when the SEC actually discovers the fraud).

[14] See, e.g., *Liu*, 140 S.Ct. at 1942 (imposing three "common-law limitations" on court-ordered disgorgement that were drawn from "works on equity jurisprudence" as well as prior Court precedents according a narrow construction to the equitable relief that was at issue in litigation involving private disputes between private parties). See also Donna M. Nagy, *The Statutory Authority for Court-Ordered Disgorgement in SEC Enforcement Actions*, 71 S.M.U. L. Rev. 895, 921-23 (2018) (discussing private litigation over "equitable relief" remedies in statutory provisions apart from the federal securities laws, and examining, in particular, the 5-4 decisions in Great-West Life & Annuity Ins. Co.

justices should more consistently recognize that when the SEC seeks and courts impose enforcement remedies, those actions are taken not to remediate private harms but rather to vindicate public rights and deter violations of the federal securities laws that harm the public interest.

To be sure, some opinions of the Court, or some dissenting opinions, have underscored the essential distinction between remedies sought in private disputes and remedies sought in government enforcement actions. In *Kokesh*, for example, in the unanimous decision authored by Justice Sonia Sotomayor, the Court observed quite correctly that "'[w]hen the SEC seeks disgorgement, it acts in the public interest, to remedy harm to the public at large, rather than standing in the shoes of particular injured parties.'"[15] And in *Gabelli v. SEC*,[16] in a unanimous decision authored by Chief Justice Roberts, the Court likewise recognized that "the SEC as an enforcer is a far cry from [a] defrauded victim."[17] Moreover, Justice Sotomayor's dissenting opinion in *Jarkesy*, which was joined by Justices Elena Kagan and Ketanji Brown Jackson, put forth a fervent defense of the public rights that are vindicated through SEC enforcement actions for civil monetary penalties for securities fraud.[18] Her powerful dissenting opinion also emphasized how enforcement actions brought by the SEC in its sovereign capacity differ substantially from securities litigation disputes between private parties seeking or defending against private claims for damages.[19]

But on other occasions the Court has viewed the remedies sought in a government enforcement action through a highly skewed prism that blurs the distinction between remedies sought in private disputes between private parties and relief sought in government enforcement proceedings. In contrast to his opinion in *Gabelli*, Chief Justice Roberts' 6-3 majority opinion in *Jarkesy* went so far as to conclude that "what matters is the substance of the suit, not where it is

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v. Knudson, 534 U.S. 204 (2002) and Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 342 (1999)).

[15] *Kokesh*, 137 S. Ct. at 1643 (quoting Respondent Government Brief at 22). See also *Kokesh*, 137 S. Ct. at 1643 (observing that the "violation for which the [disgorgement] remedy is sought is committed against the United States rather than an aggrieved individual—this is why, for example, a securities-enforcement action may proceed even if victims do not support or are not parties to the prosecution").

[16] 568 U.S. 442 (2013).

[17] *Id.* at 451.

[18] *Jarkesy*, 144 S.Ct. at 2154-76 (Sotomayor, J., dissenting). See *id*. at 2172 (emphasizing that in the federal securities laws, "regardless of any perceived resemblance to the common law, Congress enacted a new cause of action that created a statutory right belonging to the United States for the Government to enforce pursuant to its sovereign powers").

[19] *Id.* at 2163 (Sotomayor, J., dissenting) (observing that, in bringing an enforcement action for securities fraud, "the SEC seeks to 'remedy harm to the public at large' for violation of the Government's rights") (quoting *Kokesh*, 581 U.S. at 463).

brought, who brings it, or how it is labeled."[20] Viewing the SEC's civil monetary penalty remedy from that distorted vantage point undergirded the majority's conclusion that the SEC's securities fraud enforcement action against the defendants was "a common law suit in all but name."[21]

Justice Sotomayor's ardent dissent in *Jarkesy* is likewise difficult to square with her 8-1 majority opinion for the Court in *Liu*, which eschewed the distinction between public rights and private rights when analyzing the court-ordered disgorgement remedy that had been challenged by the petitioners. Indeed, it was the Court's failure to recognize the public rights that are vindicated, and the public harms that are deterred, that led to what I will argue was *Liu*'s erroneous conclusion, which had been foreshadowed in *Kokesh*—namely, that disgorgement is a valid equitable enforcement remedy only insofar as its aim is to compensate the victims of a wrongdoer's violation of the federal securities laws.[22] Indeed, neither *Liu* nor *Kokesh* even acknowledged, much less applied, the Court's longstanding principle that the scope of a federal court's equitable powers can vary depending on the nature of the dispute,[23] and that in federal enforcement actions for federal statutory violations, "when the public interest is involved," a federal court's "equitable powers assume an even broader and more flexible character than when only a private controversy is at stake."[24]

This Essay proceeds in two parts. Part I's first section focuses on the disgorgement amendments that Congress added to the federal securities laws in 2021 as well as the Court's 2020 decision in *Liu* and its 2017 decision in *Kokesh*, both of which construed statutory provisions in ways that narrowed the scope of what at the time was the ancillary or implied remedy of court-ordered SEC disgorgement. Although the new legislation does not define the term "disgorgement," there is abundant evidence from prior legislation as well as the accompanying congressional committee reports that Congress has long viewed the remedy of disgorgement as "a method of

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[20] *Jarkesy*, 144 S.Ct. at 2136.

[21] *Id.*

[22] *Liu*, 140 S.Ct. 1940 (concluding that "[t]he equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit"). See also infra text accompanying notes __ (observing that the *Liu* Court did not mention even once the word "deterrence" or any of its variations, whereas the *Kokesh* Court made a total of fifteen references to deterrence, deter, deterring, or deterring); infra text accompanying notes __ (observing that *Liu*'s sole reference to the disgorgement remedy being directed at the violation of "public laws" was in its recounting of *Kokesh*'s reasons for finding disgorgement to be a penalty, and then distinguishing *Kokesh* because it did not address whether disgorgement can "qualify as 'equitable relief' under § [21](d)(5)" of the Exchange Act).

[23] Virginian R. Co. v. Railway Employees, 300 U.S. 515, 552 (1937) ("'Courts of equity may, and frequently do, go much farther'' to give ''relief in furtherance of the public interest than they are accustomed to go when only private interests are involved''").

[24] Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946). See also Kansas v. Nebraska, 135 S.Ct. 104, 1053 (2015) (emphasizing that "'[w]hen federal law is at issue and 'the public interest is involved,' a federal court's 'equitable powers assume an even broader and more flexible character than when only a private controversy is at stake'") (quoting *Porter*, 328 U.S. at 398).

forcing a defendant to give up the amount by which he was unjustly enriched," as distinct from "restitution or damages," which are remedies "designed to compensate the victims of a violation."[25] Part I's second section focuses on the Court's decision last summer in *Jarkesy*, which on Seventh Amendment constitutional grounds extinguished the SEC's ability to impose civil monetary penalties in in-house administrative proceedings for securities fraud. Part II then identifies and analyzes the common thread in *Kokesh*, *Liu*, and *Jarkesy.* It also examines recent lower court decisions construing SEC enforcement remedies and advocates for judicial analysis that is squarely focused on the public harms and public rights at stake in SEC enforcement actions.

[25] See H.R. REP. NO. 101-616, at 35 (observing in 1990 that in addition to seeking court-ordered civil monetary penalties for securities law violations, "[t]he Commission, of course, will continue to be able to seek disgorgement in its civil injunctive actions").