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What Restitution Could Mean For SEC Enforcement Cases

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A bipartisan bill has just been introduced in the Senate that would significantly expand the remedies available to the U.S. Securities and Exchange Commission's Enforcement Division. Introduced on March 14 by Sens. Mark Warner, D.-Va., and John Kennedy, R.-La., the Securities Fraud Enforcement and Investor Compensation Act would, for the first time in the SEC's 85-year history, allow it to pursue the broad remedy of restitution, at least in cases against members of the securities industry.

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As enacted in the 1930s, the securities laws allowed the SEC to seek injunctions against ongoing or future violations of the securities laws and rules, and to bar violators from the securities industry, but they did not specifically authorize the SEC to obtain a monetary recovery. Beginning around 1970, the SEC persuaded courts that their equitable jurisdiction to grant injunctive relief inherently allowed them to decree that wrongdoers must "disgorge" any ill-gotten gains they received from their violations.[1]

In 1990, Congress gave the SEC authority to seek monetary "penalties" to punish wrongdoing, but the SEC also continued to seek and obtain "disgorgement" of illegal gains.[2] Two years ago, the Supreme Court ruled that SEC disgorgement claims should be subject to the general five-year statute of limitations applicable to government claims for "enforcement of any civil fine, penalty, or forfeiture" under 28 U.S.C. § 2462.

However, Justice Sonia Sotomayor's opinion for a unanimous court startled many observers by possibly calling into question the SEC's long-accepted power to obtain disgorgement. Noting that the court's ruling was limited simply to the statute of limitations question, Sotomayor cautioned that the opinion should not be interpreted as ruling "on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."[3]

Responding to the new imposition of the five-year statue of limitations on SEC disgorgement claims, the SEC Enforcement Division's 2018 annual report noted, in view of the multi-year character of many securities violations, that the ruling "has limited our ability to obtain disgorgement in certain long-running frauds." The SEC estimated that the ruling "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."[4]

Warner and Kennedy have explicitly noted that their proposed legislation responds directly to this concern raised by the SEC Enforcement Division.[5] However, as discussed below, their bill takes an interesting approach to the problem in a number of respects, and overall it appears to give the SEC something different from what it has sought.

First, as to disgorgement of a wrongdoer's ill-gotten gains, the bill would grant explicit statutory authority for the SEC to pursue this traditional remedy, thus eliminating the worries raised by Sotomayor's suggestion that the SEC may not have such authority. However, responding to Sotomayor's comment that the SEC often seeks disgorgement not only of the wrongdoer's illegal gains but also of gains obtained by third parties as a result of the violator's activities,[6] the bill can be read to limit disgorgement to amounts that a person actually "received" or "obtained," thus possibly preventing the SEC from seeking disgorgement of amounts that a defendant "caused" in accounts of others. Thus, while preserving the disgorgement remedy for the SEC, the bill would potentially narrow the scope of the remedy.

Second, and without doubt the biggest development, the bill would add restitution as a new remedy in SEC enforcement actions, but only for claims against member of the securities industry — brokers, dealers, investment advisers, municipal securities dealers, municipal advisors, transfer agents and any of their associated persons. Claims for disgorgement may continue to be made against any person, and are not limited to securities industry members.

Claims for restitution are potentially far broader than claims for disgorgement. While, as Sotomayor noted, disgorgement focuses on depriving a wrongdoer of his or her own ill-gotten gains, restitution has an entirely different focus. Restitution seeks to compensate each victim for the amount of loss the victim has suffered from the wrongdoing.

In the words of the proposed legislation, restitution is "the amount of the loss that the investor sustained as a result of a violation" by the defendant.[7] Thus, a defendant profiting from a market manipulation might have to "disgorge" simply the amount he or she actually obtained, but the "restitution" remedy could require the defendant to compensate many victims across the market who were harmed by the misconduct.

In this respect, the bill would add to the SEC's core job of law enforcement by authorizing it to also seek victim compensation through restitution claims. In industry-focused cases, the SEC could sometimes find itself in the position of displacing counsel for private plaintiffs.

Interestingly, the bill would allow the SEC to seek restitution not only in federal court, but also in its in-house administrative proceedings. This expanded mission for the agency may pose a challenge, as it comes at a time when SEC budgets have been essentially flat for some time, resulting in a multi-year agency-wide hiring freeze.

Finally, consistent with Sotomayor's holding, the bill would continue to impose a five-year statute of limitations on disgorgement claims. The bill would thus not eliminate the SEC's particular concerns about being able to seek disgorgement in cases arising from "long-running frauds." Nor would it relieve the SEC from the five-year statute of limitations applicable to claims for civil monetary penalties.[8]

However, for restitution claims against members of the securities industry, the bill would expand the statute of limitations to 10 years. Additionally, the bill would, for the first time, provide a 10-year statute of limitations for other SEC equitable claims, including injunctions, bars, suspensions and cease-anddesist orders. Thus, in a single enforcement action, the SEC would face a five-year limitation on claims for disgorgement and civil penalties, but a 10-year limitation on claims for restitution and other forms of relief.

Warner and Kennedy are right to take legislative action to confirm the SEC's ability to pursue the disgorgement remedy that has been an enforcement mainstay for half a century. And the SEC is right to want Congress to consider whether or not, as a policy matter, a five-year statute of limitations is too tight for disgorgement in the some of the cases it investigates. But adding a new restitution remedy to the SEC's arsenal is a major leap that should only be taken after all stakeholders have carefully weighed its implications during the legislative process ahead.

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