

## THE EQUITY FAÇADE OF SEC DISGORGEMENT

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In its civil law enforcement cases under the federal securities laws, the Securities and Exchange Commission (SEC) routinely seeks disgorgement of ill-gotten gains, and courts routinely grant it.<sup>1</sup> The SEC commonly describes disgorgement as an equitable remedy,<sup>2</sup> and courts similarly begin their disgorgement analyses by assuming as axiomatic the equitable nature of disgorgement.<sup>3</sup>

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<sup>1</sup> The Securities and Exchange Commission (SEC) has secured more than \$1.8 billion in aggregate disgorgement orders in each of its four most recent fiscal years—far more than the agency has been awarded in statutory penalties over the same period. *See* SECS. & EXCH. COMM'N, Select SEC and Market Data, Fiscal 2012, 2 tbl. 1, *available at* [www.sec.gov/about/secstats2012.pdf](http://www.sec.gov/about/secstats2012.pdf) (\$2.1 billion in disgorgement and \$1 billion in penalties); SECS. & EXCH. COMM'N, Select SEC and Market Data, Fiscal 2011, 2 tbl. 1, *available at* [www.sec.gov/about/secstats2011.pdf](http://www.sec.gov/about/secstats2011.pdf) (\$1.9 billion in disgorgement and \$928 million in penalties); SECS. & EXCH. COMM'N, Select SEC and Market Data, Fiscal 2010, 2 tbl. 1, *available at* [www.sec.gov/about/secstats2010.pdf](http://www.sec.gov/about/secstats2010.pdf) (\$1.8 billion in disgorgement and \$1 billion in penalties); SECS. & EXCH. COMM'N, Select SEC and Market Data, Fiscal 2009, 2 tbl. 1, *available at* [www.sec.gov/about/secstats2009.pdf](http://www.sec.gov/about/secstats2009.pdf) (\$2.1 billion in disgorgement and \$345 million in penalties).

<sup>2</sup> As an example, in a recent case the SEC asserted this premise in the second sentence of the argument section of its brief. Brief of the Secs. & Exch. Comm'n, Appellee at 15, *SEC v. Whittemore*, 659 F.3d 1 (D.C. Cir. 2011) (No. 10-5321) (quoting *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989)). Similarly, in a report on disgorgement submitted by the agency to Congress, the second sentence of the SEC's background discussion of disgorgement stated: "Disgorgement is a well-established, equitable remedy applied by federal district courts and is designed to deprive defendants of 'ill-gotten gains.'" SECS. & EXCH. COMM'N, REPORT PURSUANT TO SECTION 308(C) OF THE SARBANES OXLEY ACT OF 2002, 2–3 (2003) [hereinafter *SEC Disgorgement Report*], *available at* [www.sec.gov/news/studies/sox308creport.pdf](http://www.sec.gov/news/studies/sox308creport.pdf).

<sup>3</sup> *See infra* notes 15 & 29 and accompanying text. A recent Lexis search of cases in which the SEC was a named party and the opinion contained the *exact* phrase "disgorgement is an equitable remedy" returned 81 hits. Moreover, this author's routine weekly electronic search and review of new court opinions issued in SEC enforcement cases has revealed dozens of opinions each year in which courts begin their disgorgement analysis with the assumed premise that disgorgement is equitable. For several

But what if that premise is wrong? What if disgorgement is an equitable remedy only *some* of the time? What if in many cases it is actually a remedy *at law*, or even a punitive remedy? And what if in some cases the very label of disgorgement is a misnomer?

This Article attempts to answer these critical but largely overlooked questions. It begins with a brief summary of the history and context of disgorgement among the various SEC enforcement remedies.<sup>4</sup> It then explains why disgorgement in SEC cases is often not a remedy in equity at all, but rather a classic remedy *at law* in the form of a personal liability to pay a sum of money—independent of whether the defendant still possesses the tainted profits, or ever possessed them at all.<sup>5</sup> Finally, the Article explores the potential legal and statutory ramifications of removing the façade of equity from the disgorgement remedy.<sup>6</sup>

### Disgorgement in Context

In carrying out its law enforcement role, the SEC is statutorily empowered to pursue a wide range of remedies against securities law violators. These remedies include injunctions,<sup>7</sup> administrative cease-and-desist orders,<sup>8</sup> monetary penalties,<sup>9</sup> and various forms of bars and suspensions.<sup>10</sup> The SEC can unilaterally order some of these remedies through administrative proceedings, while others are available only if the SEC files a lawsuit and obtains an order or judgment from a federal district court.<sup>11</sup>

Congress has never explicitly included disgorgement among the remedies the SEC can seek in federal court.<sup>12</sup> Despite this silence, the SEC has been seeking dis-

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recent examples, see *SEC v. O’Meally*, 2013 U.S. Dist. LEXIS 33487, at \*7 (S.D.N.Y. March 11, 2013) (“Disgorgement is a form of equitable relief.”); *SEC v. Murray*, 2013 U.S. Dist. LEXIS 32460, at \*4 (E.D.N.Y. March 6, 2013) (“Once the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies, including ordering that culpable defendants disgorge their profits.”); *SEC v. Art Intellect, Inc.*, 2013 U.S. Dist. LEXIS 32132, at \*69 (D. Utah March 6, 2013) (“Actions for disgorgement of improper profits are equitable in nature, because the purpose of disgorgement is to prevent unjust enrichment.”).

<sup>4</sup> See *infra* notes 7–28 and accompanying text.

<sup>5</sup> See *infra* notes 29–66 and accompanying text.

<sup>6</sup> See *infra* notes 67–83 and accompanying text.

<sup>7</sup> See, e.g., Securities Act of 1933 § 20(b), 15 U.S.C. § 77t(b) (2012); Securities Exchange Act of 1934 § 21(d)(1), 15 U.S.C. § 78u(d)(1).

<sup>8</sup> See, e.g., 15 U.S.C. §§ 77h-1(a), 78u-3(a).

<sup>9</sup> See, e.g., 15 U.S.C. §§ 77t(d), 78u(d)(3), 78u-1 to -2.

<sup>10</sup> See, e.g., 15 U.S.C. § 77h-1(f), 77t(e) (bars and suspensions from service as public company officer or director); 15 U.S.C. § 78u(d)(2), 78u-3(f) (same); 15 U.S.C. § 78o(b)(4), (b)(6) (bars and suspensions from service as or association with broker-dealers); Investment Advisers Act of 1940 § 203(e), (f), 15 U.S.C. § 80b-3(e) to (f) (2012) (bars and suspensions from service as or association with investment advisers).

<sup>11</sup> Compare 15 U.S.C. §§ 77h-1, 78u-2 to -3 (administrative remedies) with 15 U.S.C. §§ 77t, 78u, 78u-1 (federal court remedies).

<sup>12</sup> This is not merely a legislative oversight, as Congress has explicitly empowered the SEC to order

gorgement for decades, and courts have been granting it for nearly as long.<sup>13</sup> Courts initially held that disgorgement—or “restitution,” as some courts and commentators labeled it early on—was a remedy ancillary to the court’s statutory power to order equitable injunctive relief.<sup>14</sup> Over time, courts came to accept as a truism the notion that disgorgement is inherently an ancillary equitable remedy.<sup>15</sup>

Significantly, most of the seminal SEC disgorgement cases were decided before Congress first empowered the agency in 1990 to seek monetary penalties against securities law violators.<sup>16</sup> Until then, the temptation for the SEC to request and the courts to grant disgorgement based on questionable theories was understandable, lest securities law violators appear to avoid punishment by suffering a mere injunction against future wrongdoing without any accompanying monetary sanctions. Today, however, there are no compelling reasons to stretch disgorgement beyond its limits.<sup>17</sup> In recent decades, Congress has granted the SEC and the courts a vast array of options to impose harsh monetary and other sanctions against wrongdoers in virtually all kinds of securities cases, regardless of whether disgorgement is available as an additional remedy.<sup>18</sup> Indeed,

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disgorgement administratively without having to go to court at all. *See, e.g.*, 15 U.S.C. §§ 77h-1(e), 78u-2(e), -3(e). As noted by one commentator, the legislative history of these provisions “makes clear that Congress assumed that disgorgement was already available as a remedy in judicial proceedings.” Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 Bus. Law. 317, 321 (2008) (citing S. Rep. No. 101-337, at 8 (1990)). In practice, for reasons that exceed the scope of this article, the SEC rarely uses administrative proceedings to pursue contested disgorgement claims, preferring instead to file and litigate such claims in federal court. Nevertheless, the fact that Congress has explicitly granted the SEC, an independent *executive* branch agency, the power to order disgorgement administratively as part of its law enforcement functions, weighs heavily against any presumption that disgorgement is a remedy in equity. *See infra* notes 63–64 and accompanying text.

<sup>13</sup> The SEC first sought and obtained disgorgement in *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 92–94 (S.D.N.Y. 1970); *aff’d in part and rev’d in part*, 446 F.2d 1301, 1307–08 (2d Cir. 1971), and has done so innumerable times since. *See generally* John D. Ellsworth, *Disgorgement in Securities Fraud Actions Brought by the SEC*, 1977 Duke L.J. 641, 641–42 n.3 (1977); *SEC Disgorgement Report*, *supra* note 2, at 3 n.3 (citing cases).

<sup>14</sup> *See, e.g.*, *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989) (holding that because the Exchange Act does not restrict the equitable remedies of district courts, disgorgement is available “simply because the relevant provisions . . . vest jurisdiction in the federal courts”); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103–04 (2d Cir. 1972); *Texas Gulf Sulphur*, 446 F.2d at 1307–08.

<sup>15</sup> *See, e.g.*, *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991) (“The disgorgement remedy [the district court judge] approved in this case is, *by its very nature*, an equitable remedy . . . .” (emphasis added)); *First City Fin.*, 890 F.2d at 1230 (“Disgorgement is an equitable remedy . . . .”); *SEC v. Certain Unknown Purchasers of Common Stock of and Call Options for Common Stock of Santa Fe Int’l Corp.*, 817 F.2d 1018, 1020 (2d Cir. 1987) (“The disgorgement remedy approved by the district court in this case is, *by its nature*, an equitable remedy.” (emphasis added)).

<sup>16</sup> *See infra* note 18.

<sup>17</sup> *See generally* John K. Robinson, *A Reconsideration of the Disgorgement Remedy in Tipper-Tippee Insider Trading Cases*, 62 Geo. Wash. L. Rev. 432 (1994).

<sup>18</sup> *See, e.g.*, Securities Enforcement Remedies and Penny Stock Reform Act, Pub. L. No 101-429, secs. 101, 202, §§ 20(d), 21B, 104 Stat. 931, 932–33, 937–38 (1990) (codified in relevant part at 15 U.S.C. §§ 77t, 78u-2) (authorizing the SEC to seek, and courts to impose, among other things, monetary

with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the SEC can now *administratively* impose severe financial penalties, subject to only limited and deferential after-the-fact review by a federal court of appeals.<sup>19</sup>

More importantly for purposes of this Article, SEC disgorgement law developed mostly before the Supreme Court's 2002 decision in *Great-West Life & Annuity Insurance Co. v. Knudson*.<sup>20</sup> As discussed at length below, *Great-West* articulated the Court's most recent and authoritative teaching on whether and under what circumstances a restitutionary remedy constitutes equitable relief, as opposed to legal relief, in the context of a federal statute that explicitly allows the former but not the latter.<sup>21</sup> *Great-West* is especially significant because, within months after it was decided, Congress added a similar provision for equitable relief to the federal securities laws as part of the Sarbanes-Oxley Act of 2002.<sup>22</sup> Although that provision did not explicitly mention disgorgement, the widespread assumption that disgorgement was invariably a form of equitable relief has since emboldened the SEC and courts to cite it as statutory authority for ordering disgorgement.<sup>23</sup> Still, whether the power to order disgorgement derives from a district court's inherent equitable powers or from the explicit statutory authority of Sarbanes-Oxley—or both—it can lawfully be ordered only if it in fact constitutes *equitable* relief rather than legal relief.

Courts have also given the SEC substantial procedural and evidentiary advantages in disgorgement cases based on the premise that it is an equitable remedy. For example, the SEC is required to proffer only a “reasonable approximation” of the alleged ill-gotten gains, at which point the evidentiary burden shifts to the defendant to disprove the SEC's

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penalties, officer-director bars, and penny-stock bars against any violator and authorizing the SEC to impose monetary penalties and other sanctions administratively against persons and entities in SEC-regulated industries); Sarbanes-Oxley Act, Pub. L. 107-204, §§ 305, 603, 807, 1105 and 1106, 116 Stat. 745, 778–79, 794–95, 804, 809–10 (2002) (codified in relevant part at 15 U.S.C. § 78u(d)(2), 78u(d)(6), 78u-3(f), 78ff(a), & 18 U.S.C. § 1348) (lowering the SEC's burden of proof to obtain officer-director bars; authorizing the SEC to impose such bars administratively and without court approval; authorizing the SEC to obtain penny-stock bars in federal court cases; adding new criminal penalties for securities fraud involving public companies; and increasing maximum penalty amounts for violations generally).

<sup>19</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, sec. 929P, § 308, 124 Stat. 1376 (2010). SEC administrative sanctions are set aside by courts only if “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” See 5 U.S.C. § 706(2)(A); *KPMG, LLP v. SEC*, 289 F.3d 109, 121 (D.C. Cir. 2002); *Graham v. SEC*, 222 F.3d 994, 999–1000 (D.C. Cir. 2000); *accord VanCook v. SEC*, 653 F.3d 130, 137 (2d Cir. 2011) (holding that the SEC's choice of administrative sanction disturbed only if “unwarranted in law or without justification in fact”).

<sup>20</sup> 534 U.S. 204 (2002).

<sup>21</sup> See *infra* notes 34–44 and accompanying text.

<sup>22</sup> Sarbanes-Oxley Act § 305(b), codified at 15 U.S.C. § 78u(d)(5). The amendment inserted a new subsection (5) into Section 21(d) of the Securities Exchange Act of 1934, providing that “[i]n any action or proceeding brought or instituted 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.” *Id.*

<sup>23</sup> *E.g.*, *SEC v. Whittemore*, 659 F.3d 1, 4 (D.C. Cir. 2011).

calculation.<sup>24</sup> Based on the presumption that disgorgement is an inherently equitable remedy, courts also generally hold that defendants facing SEC disgorgement claims enjoy neither the protection of any statute of limitations<sup>25</sup> nor the right to a jury trial.<sup>26</sup> Courts have also accepted the SEC's position that a disgorgement order is enforceable through contempt sanctions<sup>27</sup> and is not a debt that triggers the protections normally afforded to judgment debtors under the Federal Debt Collection Procedures Act.<sup>28</sup> All of these advantages, however, would presumably be swept aside in any given case if the disgorgement sought by the SEC were determined *not* to be an equitable remedy.

### The Equity Façacde and the Disgorgement Misnomer

As noted at the outset of this Article, the SEC and the courts have commonly described disgorgement as an equitable remedy, designed to deprive wrongdoers of unjust enrichment and to deter others from violating the securities laws.<sup>29</sup> It is also generally acknowledged that disgorgement cannot be used punitively, and thus must be limited to an amount causally connected to the alleged wrongdoing.<sup>30</sup> Beyond that, however, any resemblance to a truly equitable remedy largely disappears in most cases. For example, the SEC and the courts generally say that disgorgement can be ordered even against defendants who no longer possess or have access to the tainted profits, or never possessed them at all.<sup>31</sup> They further say that a defendant can be held jointly and severally liable for other people's gains as long as the participants were closely related or had collaborated in their scheme.<sup>32</sup> These attributes call into question whether the label of equity accurately describes disgorgement.

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<sup>24</sup> *E.g.*, *id.* at 7; SEC v. Happ, 392 F.3d 12, 31 (1st Cir. 2004); SEC v. First City Fin. Corp., 890 F.2d 1215, 1231–32 (D.C. Cir. 1989) (citing cases from other circuits).

<sup>25</sup> *See, e.g.*, Riordan v. SEC, 627 F.3d 1230, 1234 (D.C. Cir. 2010); SEC v. Rind, 991 F.2d 1486, 1492–93 (9th Cir. 1993); SEC v. Gabelli, 2010 U.S. Dist. LEXIS 27613, at \*12–13 (S.D.N.Y. 2010).

<sup>26</sup> *See, e.g.*, Rind, 991 F.2d at 1493; SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 94–96 (2d Cir. 1978).

<sup>27</sup> *See, e.g.*, SEC v. Huffman, 996 F.2d 800, 803 (5th Cir. 1993) (holding that a disgorgement order is enforceable by contempt because it is “more like a continuing injunction in the public interest than a debt” (citing *Pierce v. Vision Investments, Inc.*, 779 F.2d 302, 307–08 (5th Cir. 1986))); SEC v. Goldfarb, 2012 U.S. Dist. LEXIS 85628, at \*10–17 (N.D. Cal. 2012) (contempt available). *But see* SEC v. New Futures Trading Int'l Corp., 2012 U.S. Dist. LEXIS 55557, at \*5–6 (D.N.H. 2012) (striking provision in SEC's standard settlement template purporting to allow the agency to enforce the disgorgement provision through contempt sanctions).

<sup>28</sup> *See, e.g.*, Huffman, 996 F.2d at 802–03.

<sup>29</sup> *E.g.*, SEC v. First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998); SEC v. Hughes Capital Corp., 124 F.3d 449, 455 (3d Cir. 1997) (quoting *First City Fin.*, 890 F.2d at 1230).

<sup>30</sup> *E.g.*, *First City Fin.*, 890 F.2d at 1231 (citing cases from other circuits).

<sup>31</sup> *See, e.g.*, SEC v. Whittemore, 659 F.3d 1, 9–10 (D.C. Cir. 2011) (quoting *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000) and *Platforms Wireless*, 617 F.3d at 1098); SEC v. Benson, 657 F. Supp. 1122, 1134 (S.D.N.Y. 1987).

<sup>32</sup> *E.g.*, Whittemore, 659 F.3d at 10–12; SEC v. Calvo, 378 F.3d 1211, 1215–16 (11th Cir. 2004); *Hughes Capital*, 124 F.3d at 455.

In determining whether SEC disgorgement claims seek truly equitable relief, the starting point should be the Supreme Court's analysis in *Great-West*,<sup>33</sup> which interpreted the phrase "equitable relief" in Section 502(a)(3) of the Employee Retirement Income Security Act of 1974.<sup>34</sup> The plaintiffs were an insurer and a company-sponsored employee health plan seeking reimbursement of funds previously paid to a beneficiary after an auto accident.<sup>35</sup> They claimed that certain agreements entitled them to reimbursement from the proceeds of a settlement the beneficiary later recovered from a third-party tortfeasor.<sup>36</sup> In a 5-4 decision, the Supreme Court rejected several alternative attempts to classify the requested monetary relief as equitable rather than legal.<sup>37</sup> Most relevant for present purposes, the Court rejected the argument that the plaintiffs were seeking equitable restitution.<sup>38</sup>

The Court acknowledged that some forms of restitution are equitable in nature but emphasized that others are available only at law.<sup>39</sup> The Court quoted earlier precedent holding that "equitable relief," as used in the statute at issue, "must refer to 'those categories of relief that were *typically* available in equity.'"<sup>40</sup> The Court then distinguished between "restitution at law" and "restitution in equity," holding that only the latter fell within the court's equitable powers.<sup>41</sup>

The Court's description of "restitution at law" fittingly captures the essence of the disgorgement remedy typically sought by the SEC:

In cases in which the plaintiff "could *not* assert title or right to possession of particular property, but in which nevertheless he might be able to show just grounds for recovering money to pay for some benefit the defendant had received from him," the plaintiff had a right to restitution *at law* through an action derived from the common law-writ of assumpsit. In such cases, the plaintiff's claim was considered legal because he sought "to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money."<sup>42</sup>

The Court then distinguished the separate concept of restitution in equity:

In contrast, a plaintiff could seek restitution *in equity*, ordinarily in the form of a constructive trust or an equitable lien, *where money or property identified as belonging in good conscience to the plaintiff could clearly be traced*

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<sup>33</sup> 534 U.S. 204.

<sup>34</sup> 29 U.S.C. § 1132(a)(3).

<sup>35</sup> See *Great-West*, 534 U.S. at 207–08.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 210–20.

<sup>38</sup> *Id.* at 212–18.

<sup>39</sup> *Id.* at 212–14.

<sup>40</sup> *Id.* at 210 (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993)).

<sup>41</sup> *Id.* at 212–14.

<sup>42</sup> *Id.* at 213 (citations omitted) (quoting 1 Dan B. Dobbs, *Law of Remedies: Damages-Equity-Restitution* § 4.2(1), at 571 (2d ed. 1992); Restatement of Restitution § 160 cmt. a (1936)).

*to particular funds or property in the defendant's possession. A court of equity could then order a defendant to transfer title (in the case of the constructive trust) or to give a security interest (in the case of the equitable lien) to a plaintiff who was, in the eyes of equity, the true owner. But where "the property [sought to be recovered] or its proceeds have been dissipated so that no product remains, [the plaintiff's] claim is only that of a general creditor," and the plaintiff "cannot enforce a constructive trust of or an equitable lien upon other property of the [defendant]." Thus, for restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant's possession.*<sup>43</sup>

Because the plaintiffs in *Great-West* sought to impose the kind of personal monetary liability described by the Court as *legal* restitution, the Court held that the remedy was beyond the district court's equitable powers.<sup>44</sup>

Many SEC disgorgement orders do not fit within *Great-West*'s description of equitable relief because the defendant does not possess the allegedly illicit gains that flowed from the securities law violation, and thus the disgorgement seems most akin to a personal liability to pay a substitutionary sum of money approximating the illicit gains. Common examples include insider-trading cases in which tippers are ordered to disgorge not only their own profits but also those of their tpees.<sup>45</sup> Other cases involve defendants who have spent, squandered, or transferred their ill-gotten gains before being caught by the SEC, yet are still ordered to disgorge what they no longer possess.<sup>46</sup> In these cases, courts often rely in part on the concept of joint and several liability,<sup>47</sup> a dubious approach for reasons that exceed the scope of this Article.<sup>48</sup> In any event, the so-

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<sup>43</sup> *Id.* at 213–14 (alterations in original) (second & third emphases added) (citations omitted) (quoting Restatement of Restitution § 215 cmt. a (1936)). In footnoted dictum, the Court noted “a limited exception for an accounting for profits,” a remedy not at issue in that case. *Great-West*, 534 U.S. at 214 n.2. “If, for example, a plaintiff is entitled to a constructive trust on particular property held by the defendant, he may also recover profits produced by the defendant’s use of that property, even if he cannot identify a particular res containing the profits sought to be recovered.” *Id.* In the context of SEC enforcement, this remedy is most closely akin to the prejudgment interest that is routinely awarded on top of a lawfully ordered disgorgement award.

<sup>44</sup> *Id.* at 214.

<sup>45</sup> *See, e.g.*, *SEC v. Clark*, 915 F.2d 439, 453–54 (9th Cir. 1990); *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 89 (S.D.N.Y. 1970). For a strong articulation and analysis of the illogic of ordering disgorgement from non-trading tippers, see John K. Robinson, *supra* note 17, at 432.

<sup>46</sup> *See, e.g.*, *SEC v. Whittemore*, 659 F.3d 1, 9–12 (D.C. Cir. 2011).

<sup>47</sup> *E.g.*, *Whittemore*, 659 F.3d at 10–12; *SEC v. Calvo*, 378 F.3d 1211, 1215–16 (11th Cir. 2011); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997).

<sup>48</sup> In short, applying a tort-damage theory like joint and several liability to a purportedly equitable law enforcement remedy is the jurisprudential equivalent of forcing a square peg into a round hole. Unlike a private plaintiff, the SEC is not an injured victim suing to recover for compensable loss, injury, or damages that it has suffered. *Cf. Gabelli v. SEC*, 133 S. Ct. 1216, 1218 (2013) (noting that as a law enforcement agency, the SEC is “a different kind of plaintiff” seeking “a different kind of relief”).

called disgorgement does not purport to order specific performance, a constructive trust, or an equitable lien over specific funds or property derived from the alleged wrongdoing, all of which would, of course, be impossible. Instead, courts simply require the defendant to pay a substitutionary sum of money calculated as an approximation of ill-gotten gains the defendant does not possess. Not surprisingly, the SEC's collection rate in these cases is dismal.<sup>49</sup>

In ordering disgorgement, courts typically consider it irrelevant that the defendant no longer possesses the ill-gotten gains,<sup>50</sup> which seems incompatible with *Great-West*. One influential example is the D.C. Circuit's opinion in *SEC v. Banner Fund International*.<sup>51</sup> Rejecting the defendant's claim that he no longer had access to his illicit gains, and thus could not disgorge them, the court asserted that the defendant's approach would create a "monstrous doctrine" and lead to "absurd results," because it might incentivize securities law violators to spend or transfer their tainted profits before getting caught.<sup>52</sup> In hindsight, however, this aspect of *Banner Fund* cannot be squared with the Supreme Court's *Great-West* opinion two years later.

Like most disgorgement decisions, *Banner Fund* assumed that disgorgement is an inherently equitable remedy. But the court's literal language and rationale, when read in contrast with the Supreme Court's subsequent opinion in *Great-West*, leaves little doubt that *Banner Fund* was actually describing a *legal* remedy rather than an equitable one:

The SEC in turn contends that . . . the disgorgement order imposes an obligation upon [the defendant] personally, which he may satisfy using his own assets. Because *disgorgement is an equitable obligation to return a sum equal to the amount wrongfully obtained, rather than a requirement to*

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Although the SEC often sues to remedy misconduct that resulted in investor losses, the purpose of disgorgement is *not* to compensate those losses but rather to deprive the wrongdoer of his ill-gotten gains. *See, e.g., Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009) (quoting earlier cases). Thus, the disgorgement amount can be higher or lower than the damages sustained by those injured by the wrongdoing, and indeed the very question of whether anyone suffered a loss is "irrelevant" to the appropriateness and calculation of any disgorgement award. *Id.* Moreover, allowing the SEC the expediency of joint and several liability introduces risks of unfairness, favoritism, and the arbitrary exercise of prosecutorial discretion, because many securities fraud cases present more than one potential defendant, and the ability to hold any one of them jointly and severally liable for everyone else's gains presents the SEC with disquieting incentives when picking and choosing who among them it will charge.

<sup>49</sup> *See* SEC Disgorgement Report, *supra* note 2, at 20–21; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-02-771, SEC ENFORCEMENT: MORE ACTIONS NEEDED TO IMPROVE OVERSIGHT OF DISGORGEMENT COLLECTIONS 12–14 (2002), *available at* [www.gao.gov/new.items/d02771.pdf](http://www.gao.gov/new.items/d02771.pdf).

<sup>50</sup> *See* *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000) (noting that a contrary rule would lead to "absurd results"); *SEC v. Whittemore*, 691 F. Supp. 2d 198, 207 (D.D.C. 2010) (holding that whether a defendant retained the funds is "not germane" and how she spent them is "irrelevant"); *SEC v. Benson*, 657 F. Supp. 1122, 1134 (S.D.N.Y. 1987) (noting that the manner in which defendants "chose to spend" their gains is "irrelevant" to disgorgement).

<sup>51</sup> 211 F.3d 602.

<sup>52</sup> *Id.* at 617.



*replevy a specific asset*, we reject [the defendant’s] challenge and affirm the district court.

. . . As the SEC points out, the requirement of a causal relationship between a wrongful act and the property to be disgorged does not imply that a court may order a malefactor to disgorge only the actual property obtained by means of his wrongful act. Rather, the causal connection required is between the amount by which the defendant was unjustly enriched and the amount he can be required to disgorge. To hold, as [defendant] maintains, that a court may order a defendant to disgorge only the actual assets unjustly received would lead to absurd results. . . .

. . . [A]n order to disgorge establishes a personal liability, which the defendant must satisfy regardless whether he retains the selfsame proceeds of his wrongdoing.<sup>53</sup>

*Banner Fund* flatly rejected the notion that disgorgement requires current possession of, or access to, the “actual property” representing the ill-gotten gains; the court instead explicitly equated disgorgement with the mere payment of a sum of money “equal to the amount wrongfully obtained.”<sup>54</sup> Two years later in *Great-West*, however, the Supreme Court made clear that the kind of remedy described in *Banner Fund* (and similar cases) is actually a legal one rather than an equitable one.<sup>55</sup> Specifically, *Banner Fund*’s literal description of disgorgement as imposing a “personal liability” to pay “a sum equal to the amount wrongfully obtained,” rather than an obligation to return “the actual assets wrongfully received,” eerily presaged the nearly verbatim language *Great-West* later used to describe restitution at law.<sup>56</sup> Moreover, contrary to what *Banner Fund* incorrectly assumed, whether a defendant “retains the selfsame proceeds from his wrongdoing” is not only relevant to the distinction between equitable and legal remedies that seek the repayment of money, it is largely dispositive under *Great-West*.<sup>57</sup>

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<sup>53</sup> *Id.* (emphasis added).

<sup>54</sup> *Id.*

<sup>55</sup> *Great-West*, 534 U.S. at 213.

<sup>56</sup> *Banner Fund*, 211 F.3d at 617.

<sup>57</sup> Supporters of prevailing SEC disgorgement law might cite by analogy to the Second Circuit’s opinion in *FTC v. Bronson Partners, LLC*, 654 F.3d 359 (2d Cir. 2011). However, *Bronson* was interpreting the Federal Trade Commission Act and is otherwise distinguishable. The relevant statute in *Bronson*, unlike the Exchange Act and the statute at issue in *Great-West*, was silent regarding the kinds of relief a court could award beyond injunctions. *Id.* at 365 (quoting statute). *Bronson* relied heavily on *Porter v. Warner Holding Co.*, 328 U.S. 395 (1946), to suggest that this statutory silence gave courts almost limitless power to award monetary relief ancillary to a statutory injunction. 654 F.3d at 365–66. The relevant section of the Exchange Act, however, is noticeably different from the statutes in *Porter* and *Bronson*, and for practical purposes is identical to the statute in *Great-West*. Whereas *Porter* involved a statute that granted courts power to issue any “other order” in addition to injunctions, and *Bronson* involved a statute that was silent on the matter, both the Exchange Act and the statute in *Great-West* empower courts to issue injunctions plus other “equitable relief.” As *Great-West* made clear, the qualifier “equitable” would be meaningless if not read to limit the available remedies to those *in equity*. 534 U.S. at

Indeed, in cases like *Banner Fund*, the very label of disgorgement is a misnomer. The federal securities laws do not define the terms “disgorge” or “disgorgement,” but in common parlance they mean to eject or discharge the contents of something.<sup>58</sup> These terms presuppose that the contents remain extant in order to be disgorged. In the securities law context, true disgorgement should similarly mean that the defendant in fact possesses or at least has access to the asset being disgorged. Otherwise, calling the remedy “disgorgement” is akin to a doctor advising an emaciated patient to disgorge last year’s Thanksgiving dinner. When the order makes no pretense of requiring the actual disgorgement of anything the defendant possesses or has access to, it is neither disgorgement nor an exercise of equitable power. It is a mere personal liability to pay a money judgment—the quintessence of a remedy at law.

Additionally, disgorgement fails *Great-West*’s test for equitable relief in several other ways. First, disgorgement is a relatively modern concept, particularly in the context of law enforcement. It does not appear to have even been known to historical courts of chancery, much less typically granted by them, the key determinant of equitable relief under *Great-West*.<sup>59</sup> Indeed, disgorgement was not known, contemplated, or typically awarded even when Congress enacted the federal securities laws. One commentator found “only 11 cases in federal and state case law that were published between 1800 and 1960 that use the term ‘disgorgement’ in any context.”<sup>60</sup> The Government Accounting Office has likewise reported that “[t]he use of the disgorgement sanction in securities law violation cases is a relatively recent phenomenon,” and that “[d]isgorgement was first ordered in a securities law violation case in 1970.”<sup>61</sup> The closest historical antecedent to modern disgorgement is probably restitution, which as

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209–10. Moreover, the fact that Congress added this phrase to the Exchange Act in 2002, just months after *Great-West* interpreted the identical phrase in another federal statute, strongly suggests that the phrase should have the same import as it did in *Great-West*. Additionally, the appellant in *Bronson* did not argue the specific point raised in this article, as both the parties and the court appear to have simply assumed that disgorgement (unlike restitution) is equitable; the dispute ultimately centered on how disgorgement should be calculated and whether “equitable tracing” rules should apply. 654 F.3d at 372–75. Finally, *Bronson*’s literal description of disgorgement—like that in *Banner Fund*—actually echoes the themes articulated in *Great-West* to describe what an equitable remedy is *not*. *Id.* at 373–74 (noting that the disgorgement plaintiff “does not claim any entitlement to particular property” or “priority over the other creditors of the defendant,” but “asks only to have a judgment for the amount of [the] ill-gotten gains, which . . . will simply permit [the plaintiff] to share with other creditors on an equal basis”).

<sup>58</sup> See, e.g., MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 332 (10th ed. 1993).

<sup>59</sup> See *Great-West*, 534 U.S. at 211.

<sup>60</sup> See George P. Roach, *A Default Rule of Omnipotence: Implied Jurisdiction and Exaggerated Remedies in Equity for Federal Agencies*, 12 FORDHAM J. CORP. & FIN. L. 1, 47 n.175 (2007).

<sup>61</sup> U.S. GOV’T ACCOUNTABILITY OFFICE, GAO/GGD-94-188, SECURITIES ENFORCEMENT: IMPROVEMENTS NEEDED IN SEC CONTROLS OVER DISGORGEMENT CASES 2, n.3 (August 1994) (citing *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77 (S.D.N.Y. 1970)), available at [www.gao.gov/assets/230/220095.pdf](http://www.gao.gov/assets/230/220095.pdf).

previously noted was the label some early disgorgement cases used,<sup>62</sup> and which was the very remedy the Supreme Court analyzed in *Great-West*.

Moreover, the federal securities laws explicitly include disgorgement among the many remedies the SEC is empowered to order administratively without ever seeking the imprimatur of a federal court sitting in either law or equity.<sup>63</sup> By explicitly authorizing disgorgement as an administrative remedy, capable of being ordered by an independent executive branch agency carrying out its law enforcement functions, Congress must have recognized that disgorgement is not invariably a remedy in equity. It seems highly doubtful that Congress would—or constitutionally could, consistent with separation of powers—bestow one of the core judicial powers of an Article III court of equity upon a law enforcement agency of the executive branch.<sup>64</sup>

To be sure, some disgorgement might fairly be characterized as equitable under *Great-West*. For example, the SEC sometimes moves with alacrity to preserve suspected ill-gotten funds through a temporary restraining order, a preliminary asset freeze, the appointment of a receiver, a voluntary agreement, or otherwise. Sometimes the ill-gotten gains remain extant and identifiable even in the absence of affirmative steps by the SEC to preserve them. If and when the SEC obtains a disgorgement order in these types of cases, there is a specific pool of money that can be turned over to the SEC. Not coincidentally (and not insignificantly), in these cases the SEC has a relatively high success rate in collecting the resulting disgorgement judgments.<sup>65</sup> But these cases, based on the author's two decades of anecdotal experience on both sides of SEC enforcement cases, represent a small fraction of SEC disgorgement cases.<sup>66</sup>

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<sup>62</sup> See generally *SEC v. First Pac. Bancorp*, 142 F.2d 1186, 1192–93 (9th Cir. 1998) (declining to “engage in a rather scholastic argument about whether restitution and disgorgement are really just about the same thing” and citing cases going both ways on the point). *But see* SEC Disgorgement Report, *supra* note 2, at 2–3 (acknowledging that courts at times use the terms disgorgement and restitution interchangeably, but arguing that they are distinct concepts).

<sup>63</sup> See, e.g., 15 U.S.C. § 78u-2(e), -3(e). Like other administratively ordered sanctions, an administrative disgorgement order is subject only to limited and deferential review by a court of appeals, and thus will be set aside only if “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” See *supra* note 19 and cases cited therein. For reasons beyond the scope of this article, the SEC rarely brings contested disgorgement claims in administrative proceedings, preferring instead to pursue them in federal court.

<sup>64</sup> Even Article I courts—which are at least courts of some kind rather than law enforcement agencies of the executive branch—have been held to lack general equitable powers. See, e.g., *Bowen v. Massachusetts*, 487 U.S. 879, 905 (1988) (federal Court of Claims lacks equitable powers of a district court); *Comm'r v. McCoy*, 484 U.S. 3, 7 (1987) (Tax Court lacks general equitable powers); *cf.* *Comm'r v. Gooch Milling & Elevator Co.*, 320 U.S. 418, 420–21 (1943) (Board of Tax Appeals, an executive branch administrative predecessor of the Tax Court, lacks equity jurisdiction).

<sup>65</sup> See SEC Disgorgement Report, *supra* note 2, at 1, 9, 22.

<sup>66</sup> The author recently argued the relevance of *Great-West* to SEC disgorgement on behalf of a client in a petition for an *en banc* rehearing in the D.C. Circuit and a subsequent petition for certiorari in the Supreme Court, but both petitions were denied without comment. See *SEC v. Whittemore*, No. 05-cv-00869 (D.C. Cir. Dec. 22, 2011) (unpublished order denying rehearing *en banc*); *cert. denied*, 133 S. Ct.

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## Potential Ramifications

If the above analysis is correct—if disgorgement is often *not* an equitable remedy in SEC enforcement cases but rather a legal remedy akin to a simple money judgment—there would be several practical ramifications for SEC enforcement.

First, whenever disgorgement is legal rather than equitable, the SEC has no lawful power to seek it in federal court proceedings, and the courts have no lawful power to award it. Being purely a creature of statute, the SEC can lawfully seek in court only those remedies Congress has authorized it to seek, and disgorgement *at law* is not among those remedies.<sup>67</sup> Likewise, being courts of limited jurisdiction, federal courts can lawfully impose only those remedies at law that Congress has authorized in the relevant statutes.<sup>68</sup> As discussed above, ever since disgorgement was first accepted as a lawful remedy in SEC enforcement, the only plausible sources of authority cited to support it are either the courts' inherent power to grant equitable remedies ancillary to their explicit statutory power to grant injunctive relief<sup>69</sup> or the recent statutory provision for “equitable relief” added by Sarbanes-Oxley.<sup>70</sup> If and when disgorgement is not in fact an equitable remedy, neither source of lawful authority is available.

Second, notwithstanding the colorful warnings of *Banner Fund* and other cases, the resulting partial demise of disgorgement would not raise an alarm in the realm of SEC enforcement. As previously discussed, the SEC has a vast arsenal of other equitable and punitive remedies to address securities law violations even in cases where disgorgement is unavailable or inappropriate.<sup>71</sup> Violators are also subject to potential criminal prosecution<sup>72</sup> as well as money damage awards in private lawsuits.<sup>73</sup> In short, securities

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28 (2012). Only two district court opinions appear to have squarely considered the relevance of *Great-West* to SEC disgorgement, and both ruled in the SEC's favor. SEC v. DiBella, 409 F. Supp. 2d 122, 132–33 (D. Conn. 2006); SEC v. Buntrock, 2004 U.S. Dist. LEXIS 9495, at \*6–9 (N.D. Ill. May 25, 2004). However, both cases examined the issue in the context of a motion to strike, and neither appeared to have involved a scenario where the illicit gains had been transferred to other parties as part of the relevant scheme and thus were no longer available to disgorge. Moreover, as one commentator has noted, *Buntrock* essentially “assume[d] away the issue” and thus “failed to undertake the analysis established in *Great-West*” and even “flout[ed] the Supreme Court's message in *Great-West*.” See Roach, *supra* note 60, at 48.

<sup>67</sup> See, e.g., Am. Bus. Ass'n v. Slater, 231 F.3d 1, 8 (D.C. Cir. 2000) (Sentelle, J., concurring) (“Congress's failure to grant an agency a given power is not an ambiguity as to whether that power has, in fact, been granted. On the contrary, and as this Court persistently has recognized, a statutory silence on the granting of a power is a *denial* of that power to the agency.”).

<sup>68</sup> See, e.g., Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 377 (1994) (holding that federal courts, being courts of “limited jurisdiction,” “possess only that power authorized by Constitution and statute, [] which is not to be expanded by judicial decree” (internal citation omitted)).

<sup>69</sup> See *supra* notes 13–15 and accompanying text.

<sup>70</sup> See *supra* notes 22–23 and accompanying text.

<sup>71</sup> See *supra* notes 18 & 19 and accompanying text.

<sup>72</sup> See 15 U.S.C. §§ 77x, 78ff.

law violators do not get off scot-free simply because the SEC cannot seek disgorgement in a particular case.

Moreover, even under a strict adherence to the principles of *Great-West*, the SEC would have several options to deprive securities law violators of the profits caused by their violations. As previously noted, the agency often moves swiftly to preserve tainted profits—through court orders, voluntary agreements, or otherwise—before those profits can be transferred or dissipated, and in other cases the funds remain available even without any affirmative steps being taken to preserve them.<sup>74</sup> In such cases, the court could presumably order truly equitable disgorgement consistent with *Great-West*.<sup>75</sup> As also previously noted, whenever the SEC finds a securities law violation it can order disgorgement from the violator administratively, without having to go to court at all (although subject to deferential judicial review).<sup>76</sup> The SEC can also ask federal courts, when imposing statutory penalties against a defendant, to calculate that penalty as an amount equal to “the gross amount of pecuniary gain to [the] defendant as a result of the violation.”<sup>77</sup> Of course, if these remedies are insufficient, the SEC can always seek help from Congress, which has accommodated similar requests in recent decades.<sup>78</sup>

To be sure, if courts began acknowledging that some SEC disgorgement demands seek legal rather than equitable relief—yet concluded they could still award it (or the SEC prevailed upon Congress to authorize disgorgement *at law* by statute)—the distinction between legal and equitable disgorgement would affect a host of collateral issues and rights affecting SEC disgorgement defendants. For example, based largely on the premise that SEC disgorgement claims seek inherently equitable relief, courts have generally denied defendants the repose of any statute of limitations<sup>79</sup> and the right to a jury trial.<sup>80</sup> For similar reasons, courts have allowed the SEC to enforce disgorgement judgments through contempt sanctions (including incarceration) rather than limiting the agency to the writ of execution normally used to enforce money judgments.<sup>81</sup> One fed-

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<sup>73</sup> See *Janus Capital Grp., Inc. v. First Derivative Traders*, 31 S. Ct. 2296, 2301 (2011) (acknowledging private right of action under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder).

<sup>74</sup> See *supra* note 65 and accompanying text.

<sup>75</sup> Cf. *Sereboff v. Mid Atl. Med. Servs., Inc.*, 547 U.S. 356, 362–63 (2006) (distinguishing *Great-West* where plaintiff sought recovery of “specifically identifiable” funds that were “within the possession and control” of the defendant because the parties had previously stipulated the funds would be set aside and preserved pending final determination of the merits of the lawsuit).

<sup>76</sup> See *supra* notes 12 (citing relevant statutes) and 19 (describing standard of review for SEC administrative sanctions and citing cases).

<sup>77</sup> See, e.g., 15 U.S.C. § 78u(d)(3)(B).

<sup>78</sup> See *supra* notes 18 & 19 and accompanying text.

<sup>79</sup> See *supra* note 25.

<sup>80</sup> See *supra* note 26.

<sup>81</sup> See *supra* note 27. Compare Fed. R. Civ. P. 69(a)(1) (enforcement of money judgment is through writ of execution) with Fed. R. Civ. P. 70(e) (contempt available for failure to obey judgment for a specific act).

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eral circuit has even held that an SEC disgorgement order is not a “debt” owed to the government that triggers the protections ordinarily afforded under the Federal Debt Collection Act.<sup>82</sup> Removing the façade of equity would severely undermine the prevailing approach to all of these issues.<sup>83</sup>

### Conclusion

The prevailing notion that SEC disgorgement is an inherently equitable remedy ought to be thoughtfully revisited. Courts award the SEC billions of dollars in disgorgement each year, yet in many cases the premise of equity seems squarely at odds with the Supreme Court’s analysis of restitution in *Great-West*. Given the amounts at stake in these cases, as well as the significant procedural disadvantages a defendant confronts when a court acts in equity rather than at law, the long-standing premise of equity warrants a higher degree of skepticism and scrutiny than it has received thus far.

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<sup>82</sup> See, e.g., *Huffman*, 996 F.2d 800, 802–03 (5th Cir. 1993).

<sup>83</sup> The SEC’s ability to obtain an equitable preliminary asset freeze at the start of an enforcement case would also be doubtful whenever the SEC could not identify the specific assets representing the fruits of the securities law violation because the Supreme Court has held that such preliminary equitable remedies are not available to secure assets prior to trial where a plaintiff seeks only legal relief in the form of a money judgment. See *Grupo Mexicano v. Alliance Bond Fund*, 527 U.S. 308, 321 (1999); *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 734 (11th Cir. 2005) (distinguishing *Grupo Mexicano* on the ground that disgorgement is an equitable remedy).