

Congress Passes Law Expanding the SEC's Ability to Seek Disgorgement

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On Friday January 1, with the Senate's floor vote to override the president's veto, Congress passed the 60th annual National Defense Authorization Act (NDAA). Encompassed within the \$740.5 billion military spending bill is an amendment (the Amendment) to the Securities Exchange Act of 1934 (Exchange Act), which (1) codifies the Securities and Exchange Commission's (SEC) authority to seek disgorgement in federal district court; (2) tolls the statute of limitations while defendants are outside of the United States; and (3) doubles the statute of limitations for scienter-based claims from five years to 10 years. For all other claims, the five-year statute of limitations remains. Congress passed the NDAA on December 11 and — for reasons unrelated to the Amendment — President Trump vetoed it on December 23. The House of Representatives voted to override the president's veto on December 28, and the Senate followed suit on January 1.

The Amendment is in direct response to two recent Supreme Court decisions. As described below and in [our previous client alert](#), the Supreme Court in *Kokesh* (2017)[1] and *Liu* (2020)[2] significantly curtailed the SEC's ability to seek disgorgement in civil enforcement actions. In the wake of *Kokesh*, former SEC Chairman Jay Clayton opposed these limitations on disgorgement, and was vocal about the need to reform the paradigm by which the SEC seeks ill-gotten gains from securities violators. The former chairman stated that he was "troubled by the substantial amount of losses" he anticipated the SEC would suffer as a result of the five-year statute of limitations applied in *Kokesh*. [3] In November 2020, when testifying before Congress following the *Liu* decision, the chairman stated that he estimated that "[s]ince *Kokesh* was decided, more than \$1 billion in ill-gotten gains has been unavailable for possible distribution to harmed investors." [4]

Empowered by the Amendment, we expect the SEC to aggressively seek disgorgement in more cases — particularly under the incoming Biden administration. Also, because the Amendment's statute of limitations expansion applies only to scienter-based claims, the SEC is further incentivized to pursue charges based on older alleged misconduct considering the 10-year statute of limitations. In light of the Amendment, the SEC may expand the scope of pending investigations to include aged conduct and occurrences that are potentially violative, which could considerably increase the stakes for defendants in ongoing enforcement actions. The increase in funds that the SEC may be able to collect from defendants could also encourage more whistleblowers to come forward because they are financially rewarded based on the amount of money that the SEC collects. In sum, 2021 could lead to a record amount of disgorgement recovered by the SEC.

Background: *Kokesh*, *Liu*, and Congress's Prior Attempts at Reform

For years, the SEC has pushed for more authority to seek disgorgement in civil enforcement actions. The

Exchange Act allows the SEC to seek “any equitable relief that may be appropriate or necessary for the benefit of investors.”^[5] Historically, the SEC has sought disgorgement as “equitable relief” in federal court, and federal courts have awarded disgorgement. The Supreme Court has slowly eroded the SEC’s authority to seek disgorgement in their *Kokesh* and *Liu* decisions.

In *Kokesh*, the SEC brought an enforcement action against a defendant who had perpetuated a 20-year fraud. The Court held that the SEC’s use of disgorgement was penal and not equitable and thus subject to the five-year statute of limitations period applicable to penalties. Additionally, a footnote in the opinion questioned whether or not the SEC could obtain disgorgement at all in federal court actions since the federal securities laws did not explicitly provide for such.

The House of Representatives and the Senate took action in response to the *Kokesh* decision. A bipartisan Senate bill titled, “Securities Fraud Enforcement and Investor Compensation Act of 2019,” was introduced in March 2019.^[6] The bill gave the SEC explicit authority to seek disgorgement, but the SEC would be subject to a five-year limitation. The bill never made it out of committee.

A few months later in November 2019, the House passed the “Investor Protection and Capital Markets Fairness Act,” which provides that “any Federal court may grant . . . disgorgement in the amount of unjust enrichment.”^[7] In support of this bill, Congressman Green (D-TX) stated that “[*Kokesh*] was a boon to white collar criminals . . . [e]ven worse, the SEC is currently in litigation before the Supreme Court over whether it even has the authority to obtain disgorgement for investors.”^[8] The bill passed in House and was referred to the Senate’s Committee on Banking, Housing, and Urban Affairs, but never made it out of the committee.^[9]

In June 2020, the Supreme Court in *Liu v. SEC* upheld the SEC’s authority to seek disgorgement as an equitable remedy, but created additional limitations. To qualify as an equitable remedy, the SEC is limited to seeking the defendant’s net profits, which must be awarded for the benefit of the victims. Although the decision in *Liu* secured the SEC’s authority to seek disgorgement, the opinion clarified the SEC’s limitations and suggested that the SEC will continue to have to litigate the parameters of the SEC’s disgorgement authority.

^[1] *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

^[2] *Liu v. SEC*, 140 S. Ct. 1936 (2020).

^[3] Jay Clayton, Chairman, SEC, Keynote Remarks at the Mid-Atlantic Regional Conference (June 4, 2019), <https://www.sec.gov/news/speech/clayton-keynote-mid-atlantic-regional-conference-2019>.

^[4] Jay Clayton, Chairman, SEC, Testimony on “Oversight of the Securities and Exchange Commission” (Nov. 17, 2020), <https://www.sec.gov/news/testimony/clayton-sec-oversight-2020-11-17>.

^[5] 15 U.S.C. § 78u(d)(5).

[6] See <https://www.congress.gov/bill/116th-congress/senate-bill/799>.

[7] See Investor Protection and Capital Markets Fairness Act, H.R. 4344, 116th Cong. (2019) (passed House Nov. 18, 2019).

[8] 165 Cong. Rec. 8929 (daily ed. Nov. 18, 2019).

[9] See Final Vote Results for Roll Call 627 (November 18, 2019), <https://clerk.house.gov/evs/2019/roll627.xml>.

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