

Congress Expands SEC's Disgorgement Power in Defense Spending Bill

Written by John W.R. Murray, Michael Hoven

January 8, 2021

On January 1, 2021, Congress significantly expanded the SEC's authority to seek disgorgement as a remedy for violations of the federal securities laws, responding to recent decisions by the U.S. Supreme Court that had limited the SEC's disgorgement power. Congress unexpectedly provided this enhanced authority by amending the Securities Exchange Act of 1934 ("Exchange Act") in an obscure portion of the over 1,400-page [National Defense Authorization Act](#), which it passed over President Trump's veto. The amendments give the SEC, for the first time, express statutory authority to seek disgorgement "of any unjust enrichment by the person who received such unjust enrichment as a result of [a] violation" in federal court actions.

The legislation also provides a new ten-year statute of limitations for disgorgement claims arising from violations that involve intentional fraud, doubling the time in which the SEC can obtain disgorgement for such misconduct. In addition, the amendments provide a ten-year statute of limitations for injunctions, bars, suspensions and cease-and-desist orders, and tolls the statute of limitations for the period of time during which a defendant is outside the United States.

Express Statutory Authority May Avoid *Liu*'s Limitations

The SEC has a long and successful history of obtaining disgorgement of ill-gotten gains, even though Congress never expressly authorized the remedy. Indeed, disgorgement historically has been the most significant form of monetary relief in the SEC's arsenal.

In *Liu v. SEC*,^[1] decided last year, the Supreme Court affirmed the SEC's ability to seek disgorgement based on the agency's authority under the Exchange Act to seek "equitable relief," but the Court also articulated several limitations on that power. First, the Court concluded that in order to constitute a permissible equitable remedy, a disgorgement award cannot exceed the wrongdoer's net profits, and therefore should not include legitimate business expenses. Noting that equitable relief must be "for the benefit of investors," the Court also determined that ill-gotten gains recovered by the SEC should be paid to harmed investors, calling into question the SEC's regular practice of depositing disgorgement awards in the United States Treasury. Finally, the Court observed that joint-and-several liability against co-defendants for disgorgement awards, which the SEC has routinely sought, is, at least in certain cases, inconsistent with principles of equity.

Now that Congress has expressly authorized disgorgement in an independent statutory provision, the SEC's disgorgement power is untethered from its authority to seek equitable relief. While the amendments do not expressly authorize the SEC to seek awards in excess of net profits, deposit disgorged funds in the Treasury, or seek joint-and-several liability, by separately codifying the disgorgement power in the Exchange Act, the amendments equip the SEC with a potential argument that disgorgement need not conform to the equitable principles that the Court applied in *Liu*. That said, the language authorizing disgorgement of "unjust enrichment" from "the person who received such unjust enrichment" suggests that, consistent with *Liu*, legitimate, or "just," expenses still must be netted out of the disgorgement calculation, and that joint-and-several liability generally remains beyond the SEC's authority.

New Ten-Year Statute of Limitations Partially Overrules *Kokesh*

The new ten-year limitations period for SEC disgorgement claims expressly applies to violations of Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act of 1933, Section 206(1) of the Investment Advisers Act of 1940, and to "any other provision of the securities laws for which scienter [i.e., intentional fraud] must be established." This provision overturns in part the Supreme Court's 2017 holding in *Kokesh v. SEC*^[2] that SEC disgorgement remedies are subject to the general federal five-year statute of limitations for actions seeking a civil fine or penalty.

The SEC has lamented *Kokesh*, which the agency estimates has caused it to forego more than \$1 billion in disgorgement. While the amended limitations period may be less generous than the pre-*Kokesh* regime—in which the SEC and some circuits maintained that no limitations period applied—for scienter-based violations, it doubles the limitations period, and raises the stakes accordingly in any enforcement action seeking disgorgement for such violations.

The longer statute of limitations may also incentivize the SEC to investigate older conduct and make it more reluctant to agree to non-scienter violations, to which the five-year limitations period still applies, in settlement negotiations. These potential effects may be particularly relevant in Foreign Corrupt Practices Act and accounting and financial reporting investigations, which typically move more slowly than other categories of enforcement matters.

New Authority Applies to Pending Actions

By their terms, the amendments “shall apply with respect to any action or proceeding that is pending” at the time of their enactment. The SEC may therefore argue that in any pending action where it is currently seeking disgorgement for a period of up to five years for a scienter-based violation, it can now pursue the last ten years of wrongfully obtained profits. However, the retroactive application of punitive measures—which *Kokesh* held SEC disgorgement awards to be for purposes of the federal statute of limitations—raises the questions of whether such application satisfies due process or runs afoul of the U.S. Constitution’s Ex Post Facto Clause.[3]

More SEC Enforcement in Federal Court?

Following *Kokesh* and *Liu*, many speculated that the SEC would avoid federal court and instead favor enforcement through administrative proceedings, where the SEC has enjoyed express authority under the Exchange Act to seek disgorgement since 1990. By providing express authority for disgorgement in federal proceedings, along with a ten-year statute of limitations in that forum, the new amendments strengthen the incentive for the SEC to opt for federal court, at least in cases where it seeks disgorgement in scienter-based cases for periods of more than five years.

[1] 140 S. Ct. 1936 (2020).

[2] 137 S. Ct. 1635 (2017).

[3] See *Landgraf v. Usi Film Prods.*, 511 U.S. 244, 281 (1994).

RELATED PRACTICES

- [White Collar Crime & Government Investigations](#)
- [Securities Litigation](#)
- [Litigation](#)

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.