

Congress Extends Statute of Limitations for SEC Disgorgement

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Through a short provision ensconced within thousands of pages of a Department of Defense spending bill, the Securities and Exchange Commission received dramatically expanded authority to seek disgorgement in its enforcement actions, thus reversing recent Supreme Court decisions regarding that remedy. After surviving multiple filibusters and a veto by President Trump, the National Defense Authorization Act was finally passed on January 1, 2021. In a short section entitled Investigations and Prosecution of Offenses for Violations of the Securities Laws (“Section 6501”), the bill grants express authority to the SEC to seek disgorgement and provides for a **ten-year statute of limitations** in seeking that disgorgement in specific actions where the violations require a showing of intentional misconduct.

On June 5, 2017, the Supreme Court unanimously held in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), that claims for disgorgement brought by the SEC were punitive and, thus, subject to a five-year statute of limitations. The SEC had routinely sought disgorgement as an equitable remedy in actions alleging securities law violations and claimed that it was not a penalty subject to the five-year statute of limitations under 28 U.S.C. § 2462. The Court disagreed with the SEC’s approach and prevented the SEC’s ability to pursue disgorgement for conduct more than five years before the filing of the SEC’s enforcement action.

Then, in June 2020, the Supreme Court decided *Liu v. SEC*, 140 S. Ct. 1936 (2020), a decision in which it upheld the SEC’s ability to pursue disgorgement but noted that, as an equitable remedy, it was subject to certain restrictions. The Court limited the SEC’s disgorgement ability to only the net income or net profit generated from the violative conduct, thus allowing defendants to offset legitimate expenses from a disgorgement calculation. The *Liu* Court further held that disgorgement must be for the benefit of investors, rather than for payment to the U.S. Treasury.

Section 6501 appears to be a direct result of the SEC’s efforts to undo or restrict the scope of *Kokesh*. In its annual report detailing enforcement activities in the fiscal year immediately following the *Kokesh* decision, the SEC estimated that it would “forgo up to approximately \$900 million in disgorgement.” The SEC upped this estimate to \$1.1 billion in its fiscal year 2019 annual report, in which the SEC acknowledged that it was likely “that *Kokesh* will continue to impact [its] ability to recover for harmed investors in long-running frauds.” In Congressional testimony regarding the impact of those decisions on SEC operations, SEC Chairman Jay Clayton expressed his intention to work with Congress to “ensure defrauded retail investors can get their investment dollars back. . . [through] authority [that] should be narrowly tailored to that end while being true to the principles embedded in statutes of limitations.”

With the passing of Section 6501, Congress has largely taken the teeth out of the *Kokesh* and *Liu* decisions and reversed the expectations of defense practitioners following those rulings. The SEC Enforcement Division now has the go-ahead to pursue disgorgement for violative conduct up to a decade old in some cases. The legislation applies to any action or proceeding that is pending on or

commenced after its enactment and, therefore, is likely retroactive, applying to conduct that has not been resolved previously with the SEC.

Where we once anticipated lower disgorgement figures, we anticipate this statutory development will lead to increased disgorgement calculations by the SEC in enforcement matters. Also, because the SEC typically seeks prejudgment interest in enforcement matters, calculated and compounded quarterly, tremendous interest charges could further expand the monetary expectations in litigated and settled actions with the SEC. It is unclear whether the restrictions imposed in the *Liu* decision—such as the need for disgorgement to be a remedy to benefit investors and the requirement that disgorgement be reduced by legitimate expenses—will remain intact. Much of that will be determined in litigation as the SEC flexes its disgorgement powers. Where we also once anticipated recent Supreme Court decisions would cause the SEC staff to expedite investigations to meet a five-year statute of limitations, now Section 6501 will allow the SEC staff to take more time with its often lengthy investigations. Finally, the SEC staff may be encouraged to tack on scienter-based fraud charges in order to avoid a statute of limitations defense using their newly expanded authority.