

CLIENT ALERT

Congress Buries Expanded SEC Disgorgement in End-of-Year Defense Budget

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On January 1, 2021, the United States Senate voted 81-13 to enact the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, H.R. 6395 (the “NDAA”), following the United States House of Representatives’s 322-87 December 28, 2020 vote, overriding the President’s December 23, 2020 veto. The bill had passed the House on July 21, 2020 and the Senate with changes on November 16, 2020. Following reconciliation, the Conference Report passed the House on December 8, 2020 and the Senate on December 11, 2020.

Section 6501 of the NDAA, which was added in the December 3, 2020 Conference Report, amended Section 21(d) of the Securities Exchange Act of 1934 to endow the Securities and Exchange Commission (the “Commission” or “SEC”) with new and expansive statutory powers to buttress its enforcement program and clarify some of the uncertainty created by recent Supreme Court decisions. Most notably, the NDAA:

- (1) Grants the Commission explicit statutory authority to seek disgorgement in any action or proceeding in federal court;
- (2) Expands the statute of limitations for violations involving fraud or scienter—in effect doubling the statute of limitations for fraud actions from five years to 10 years;
- (3) Prescribes a 10-year period for all equitable remedies, including cease-and-desist orders and injunctions; and
- (4) Indefinitely tolls the statute of limitations while individuals remain outside of the United States.

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The NDAA's express authority to seek disgorgement in federal court actions represents a long-fought victory for the Commission. In adopting this provision, Congress endorsed the Commission's position—taken in recent Supreme Court cases—that federal courts had the authority to order disgorgement in actions or proceedings the Commission brought.¹ In 2017, in *Kokesh v. SEC*,² the Supreme Court imposed a five-year statute of limitations on SEC claims for disgorgement and left open the question of whether federal courts even had the authority to order disgorgement. In June 2020, the Supreme Court confirmed that federal courts have the authority to order disgorgement as equitable relief in *Liu v. SEC*³ but placed significant limitations on its imposition. Specifically, the Court held that disgorgement could only be used in SEC actions to compensate victims, that legitimate business expenses could be deducted from disgorged funds, and that joint and several disgorgement was not permitted. Notably, the NDAA, while enshrining the authority of federal district courts to order disgorgement and expanding the statute limitation period for scienter-based charges to 10 years, did not address any of the *Liu* limitations on disgorgement. Because the text of Section 6501 of the NDAA only amended the Securities Exchange Act of 1934, these expanded powers would not extend to other agencies, such as the Commodity Futures Trading Commission.

The Commission estimated that, since the *Kokesh* decision, it has had to forego over \$1.1 billion in disgorgement.⁴ Implicitly recognizing this, the SEC's Division of Enforcement's 2020 Annual Report noted that “there have been and will continue to be changes in the balance between the penalties and disgorgement that the Division seeks and recommends to the Commission. Among other things, we may recommend higher penalties in some cases where the statutory scheme permits us to do so.”⁵ Accordingly, the doubling of the statute of limitations for violations involving fraud or scienter from five years to 10 years is a significant game changer in the Enforcement Division's balance calculations for monetary relief.

However, while Section 6501 of the NDAA applies to Section 10(b) of the Securities Exchange Act of 1934, Section 17(a)(1) of the Securities Act of 1933, and any other “securities laws for which scienter must be established,” the expanded statute of limitations does not apply to other non-scienter cases including internal control or other books and records cases under Section 13 of the Securities Exchange Act of 1934. Especially in the case of Foreign Corrupt Practices Act (“FCPA”) matters, which are often brought years after the violative conduct may have taken place, are charged as internal control and books and records violations, and are often significant drivers of the SEC's overall annual

¹ See 165 Cong. Rec. H8931 (daily ed. Nov. 18, 2019) (statement of Rep. McAdams referring to a similar provision in a different bill), [here](#) (“This legislation would reverse the *Kokesh* decision, specifically authorize disgorgement as a remedy that the SEC can seek, and give the SEC up to 14 years to seek disgorgement of ill gotten gains. So, in essence, this legislation seeks to fix the *Kokesh* decision and would address the recent case the Supreme Court agreed to hear about whether the SEC has disgorgement authority at all.”).

² 137 S. Ct. 1635 (2017).

³ 140 S. Ct. 1936 (2020).

⁴ Protecting Everyday Investors and Preserving Market Integrity: The SEC's Division of Enforcement, Sept. 17, 2020, Stephanie Avakian's Remarks at the Institute for Law and Economics, University of Pennsylvania Carey Law School Virtual Program, [available here](#).

⁵ SEC Division of Enforcement 2020 Annual Report, [available here](#).

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disgorgement figures,⁶ this limitation may prove meaningful to the Commission. The expanded statute of limitations for scienter-based violations may incentivize the Commission to include fraud or scienter-based charges going forward and aggressively seek tolling agreements during investigations in search of scienter-based misconduct. The NDAA specifically authorizes the Commission to invoke its new disgorgement powers in pending investigations. See Section 6501(b) of the NDAA (“The amendments made by subsection (a) shall apply with respect to any action or proceeding that is pending on, or commenced on or after, the date of enactment of this Act.”). Taken overall, the NDAA’s clarification and expansion of the SEC’s power to order disgorgement is remarkable, especially coming as it did without the benefit of any discussion or debate.

Willkie will continue to monitor developments in the enforcement of this statutory expansion of the Commission’s powers.

⁶ See Administrative Proceeding File No. 3-19260, In the Matter of Microsoft Corporation (August 28, 2020) [available here](#) (ordering disgorgement of \$13,780,733); Administrative Proceeding File No. 3-19948, In the Matter of Herbalife Nutrition Ltd. (August 28, 2020) [available here](#) (ordering disgorgement of \$58,669,993); Administrative Proceeding File No. 3-20132, In the Matter of The Goldman Sachs, Inc., (October 22, 2020) [available here](#) (ordering disgorgement of \$606,300,000).

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