

January 3, 2021

# Congress Expressly Authorizes SEC Disgorgement and Extends Limitations Periods

---

## Congress Provides the SEC with Legislative Relief from the Supreme Court's Decisions in *Kokesh v. SEC* and *Liu v. SEC*.

---

### SUMMARY

The William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, enacted on January 1, 2021, amended the federal securities laws to expand significantly the SEC's ability to obtain disgorgement and other remedies. The SEC is now expressly authorized in federal court actions to seek disgorgement of a wrongdoer's ill-gotten gains and can now do so whenever its claim is brought within five years—or ten years for scienter-based claims—from the last date of the violation giving rise to the claim. Claims for equitable remedies such as injunctions, bars, and suspensions may be brought as long as ten years after the last date of the violation giving rise to the claim.

These changes mark a significant legislative response to the Supreme Court's decisions in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), and *Liu v. SEC*, 140 S. Ct. 1936 (2020), which scaled back the SEC's disgorgement authority.

---

### BACKGROUND

Disgorgement of ill-gotten gains has long been one of the primary forms of relief that the SEC seeks in its enforcement actions. The past several years, however, saw a significant judicial push-back on the SEC's disgorgement authority.

## SULLIVAN & CROMWELL LLP

In *Kokesh*, the Supreme Court held that disgorgement operates as a “penalty” and is therefore subject to the five-year limitations period in 28 U.S.C. § 2462.<sup>1</sup> The Court provided three reasons in support of this conclusion. *First*, SEC disgorgement is a remedy for wrongs “committed against the United States rather than an aggrieved individual.”<sup>2</sup> *Second*, “SEC disgorgement is imposed for punitive purposes,” namely, deterrence.<sup>3</sup> *Third*, “SEC disgorgement is not compensatory,” because while some disgorged funds are paid to victims, other funds are dispersed to the United States Treasury.<sup>4</sup> Notably, the Court expressly reserved judgment on the question of “whether courts possess authority to order disgorgement in SEC enforcement proceedings.”<sup>5</sup>

The impact of *Kokesh* on SEC disgorgement was substantial. For long-running violations of the federal securities laws, the SEC has been unable to disgorge proceeds obtained more than five years prior to the filing of its actions. In *Kokesh*, for example, the SEC obtained disgorgement of only \$5 million of the nearly \$35 million that the defendant, *Kokesh*, had misappropriated from investors over a 12-year span.<sup>6</sup> In 2019, the SEC estimated that, to that point, *Kokesh* had caused it to forgo seeking in the aggregate approximately \$1.1 billion in disgorgement in its filed cases.<sup>7</sup>

In *Liu*, the Supreme Court answered the question left open by *Kokesh*, holding that claims for disgorgement fell within the SEC’s authority to seek “equitable relief” in federal court actions, pursuant to 15 U.S.C. § 78u(d)(5).<sup>8</sup> The Court held that disgorgement orders that do not exceed the wrongdoer’s net profits and are awarded for victims are permissible.<sup>9</sup> Noting, however, that courts had at times awarded the SEC disgorgement in ways that “test[ed] the bounds of equity practice,” the Court indicated that a disgorgement order may transgress the SEC’s right to obtain equitable relief if it (a) exceeds the wrongdoer’s net profits, e.g., by failing to deduct legitimate expenses incurred; (b) includes proceeds held by another, e.g., through a finding of joint and several liability; or (c) is not intended to be returned to victim investors.<sup>10</sup>

---

<sup>1</sup> *Kokesh v. SEC*, 137 S. Ct. 1635, 1639 (2017).

<sup>2</sup> *Id.* at 1643.

<sup>3</sup> *Id.* at 1643-44.

<sup>4</sup> *Id.* at 1644.

<sup>5</sup> *Id.* at 1642 n.3.

<sup>6</sup> *SEC v. Kokesh*, 884 F.3d 979, 985 (10th Cir. 2018).

<sup>7</sup> SEC Division of Enforcement, 2019 Annual Report, at 21 (2019), <https://www.sec.gov/files/enforcement-annual-report-2019.pdf>.

<sup>8</sup> *Liu v. SEC*, 140 S. Ct. 1936, 1940 (2020).

<sup>9</sup> *See id.*

<sup>10</sup> *Id.* at 1946-50.

## AMENDMENTS TO SECTION 21(D)

The SEC has long sought legislative relief from these decisions.<sup>11</sup> Congress has now answered by amending Section 21(d) of the Securities Exchange Act of 1934 in two important ways.

*First*, new statutory language now provides explicitly that the SEC may seek, and federal courts may order, “disgorgement . . . of any unjust enrichment . . . as a result of [a] violation” of the securities laws.<sup>12</sup> Disgorgement therefore has an independent statutory basis, not one derived solely from a court’s authority to order equitable relief.

*Second*, new provisions expand limitations periods for claims for disgorgement and SEC equitable remedies. New Section 21(d)(8) provides that the SEC may bring a claim for disgorgement “not later than 5 years after the latest date of the violation,” or “not later than 10 years after the latest date of the violation . . . if the violation involves conduct that violates” any scienter-based provision of the securities laws.<sup>13</sup> The statute also provides that the SEC “may seek a claim for any equitable remedy, including for an injunction or for a bar, suspension, or cease and desist order, not later than 10 years after the latest date on which a violation that gives rise to the claim occurs,” regardless of whether the violation requires proof of scienter.<sup>14</sup>

These changes apply to any SEC action or proceeding that was pending on, or commenced on or after, January 1, 2021.<sup>15</sup>

---

## IMPLICATIONS

The amendments to Section 21(d) are likely to fundamentally alter the SEC’s ability to obtain remedies.

*First*, by providing a specific statutory grant of authority for disgorgement that is not rooted solely in the court’s authority to impose equitable relief, the limitations on the scope of permissible disgorgement discussed in *Liu* may no longer apply. It remains to be seen whether the SEC will now seek and whether courts will order disgorgement that exceeds a wrongdoer’s net profits, on a joint-and-several basis, or where the return of disgorged funds to victim investors is not contemplated. If so, these issues are likely to be the subject of further judicial review.

---

<sup>11</sup> See, e.g., Jay Clayton, SEC Chairman, Testimony on “Oversight of the Securities and Exchange Commission” before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Nov. 17, 2020), <https://www.sec.gov/news/testimony/clayton-sec-oversight-2020-11-17>.

<sup>12</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, H.R. 6395, 116th Cong. § 6501(a)(1) (2021) (enacted).

<sup>13</sup> *Id.* § 6501(a)(3).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* § 6501(b).

## SULLIVAN & CROMWELL LLP

*Second*, the statute meaningfully expands the SEC's ability to reach back in time and disgorge funds from wrongdoers. For scienter-based charges, disgorgement is now available for ten years. In addition, although there may be some ambiguity in the statutory language, one reading of the statute would permit the SEC to recapture *all* funds obtained in a scheme so long as the SEC has filed its claims within five years (or in the case of scienter-based charges, ten years) of the "latest date of the violation."

*Third*, the SEC now has a specific grant to obtain non-monetary equitable relief such as injunctions, bars, and suspensions whenever its claims are filed within ten years of the last act giving rise to the violation.

\* \* \*

## SULLIVAN & CROMWELL LLP

### ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

### CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to [SCPublications@sullcrom.com](mailto:SCPublications@sullcrom.com).