

Recent Amendments to the Securities Exchange Act of 1934 Strengthen the SEC’s Disgorgement Powers

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On Jan. 1, 2021, the U.S. Congress passed amendments to the Securities Exchange Act of 1934 (Exchange Act) that significantly expand the U.S. Securities and Exchange Commission’s (SEC) authority to recover disgorgement of any “unjust enrichment” received by individuals and entities that violate the federal securities laws. Specifically, the amendments, which are codified at Section 6501 of the National Defense Authorization Act for Fiscal Year 2021 (NDAA),¹ accomplish the following:

- Amend Section 21(d) of the Exchange Act to expressly authorize the SEC to seek disgorgement in U.S. district courts of “any unjust enrichment” from persons who have violated the federal securities laws.
- Establish a 10-year statute of limitations for the SEC to seek disgorgement of funds related to the violation of scienter-based conduct under the Exchange Act, Securities Act of 1933, or Investment Advisers Act of 1940.
- Establish a 10-year statute of limitations for the SEC to obtain nonmonetary sanctions, including injunctions and industry bars for professionals.
- Toll the statute of limitations for any time in which persons who are subjects of enforcement actions are outside of the United States.
- Apply the new rules to any action that is pending on, or commenced after, the date the amendments were enacted.

The amendments were enacted in response to two recent Supreme Court decisions that curtailed the SEC’s ability to seek disgorgement. In *Kokesh v. SEC*, the U.S. Supreme Court held that disgorgements in SEC enforcement actions

constituted a penalty that is subject to a five-year statute of limitations. 137 S. Ct. 1635 (2017). In addition, in *Liu v. SEC*, decided in the summer of 2020, the Supreme Court upheld the SEC’s authority to seek disgorgement but imposed certain restrictions, including limiting disgorgement to a wrongdoer’s net profits, as opposed to permitting recovery of disgorgement under a joint and several theory of liability; allowing deductions of legitimate business expenses in the calculation of disgorgement; and requiring the disgorged funds to be returned to investors instead of being sent to the U.S. Treasury, as had often been done when harmed investors were not readily identifiable. 140 S. Ct. 1936, 1947 (2020). It remains an open question whether the limitations imposed by *Liu* will continue to apply in the wake of the amendments to the Exchange Act, an issue that is certain to become the subject of future litigation.

Takeaways

The amendments to the Exchange Act are likely to have a significant impact on SEC matters moving forward, as the length of time for which the SEC can now seek to recover disgorgement has been doubled for cases involving allegations of scienter. Moreover, in spite of the five-year statute of limitations imposed by *Kokesh*, the amount of disgorgement obtained by the SEC’s Enforcement Division has grown significantly over the past three years, as reflected in the chart below:

Total Disgorgement Ordered (in millions) ²			
FY 2020	FY 2019	FY 2018	FY 2017
\$3,589	\$3,248	\$2,506	\$2,957

¹ The NDAA was passed through a congressional override of President Trump’s veto.

² Source: SEC Enforcement Division Annual Report – FY 2020 at p. 17, available at <https://www.sec.gov/files/enforcement-annual-report-2020.pdf>.

When taking into consideration that the SEC will likely take a more aggressive approach to enforcement under the administration of President Joe Biden, one would expect the Enforcement Division's disgorgement recoveries to rise significantly over the next few years. The amendments to the Exchange Act will also significantly increase the Enforcement Division's leverage in negotiating settlements of enforcement actions.

The amendments will also likely encourage the SEC to pursue investigations of older conduct, particularly when they involve allegations of fraud. Relatedly, it has been common practice for the Enforcement Division to seek tolling agreements when it has concerns about its ability to file enforcement actions within the five-year statute of limitations. For cases that are now subject to the 10-year statute of limitations, the need for tolling agreements will be significantly curtailed.

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