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WHITE-COLLAR CRIME

# Congress's Signing Bonus for Gensler: New Powers for His SEC

**In this edition of their White-Collar Crime column, Robert J. Anello and Richard F. Albert explain that regardless of his enforcement priorities, Gary Gensler's SEC will benefit from the expansion of the SEC's powers that Congress included in the National Defense Authorization Act passed on the first day of the new year. In enacting this law, Congress effectively has overridden the SEC's recent stinging Supreme Court defeats.**

By **Robert J. Anello**

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Wall Street has greeted Gary Gensler's nomination as Chair of the SEC with some trepidation, perhaps with good reason. Congress, by contrast, may have presented him with a powerful signing bonus.

During Gensler's tenure at the CFTC, he transformed the agency into one of the federal government's enforcement powerhouses. On the other hand, however, Gensler's credentials—including two decades at Goldman Sachs, and a recent stint as a professor at MIT—suggest that he will be more than just a tough cop. He also brings deep experience in the financial markets and serious engagement with emerging issues such as cryptocurrency regulation.

Regardless of his enforcement priorities, Gensler's SEC, including his yet-to-be-named Director of the Division of Enforcement, will benefit from the expansion of the SEC's powers that Congress included in the National Defense Authorization Act (NDAA) passed on the first day of the new year. Those provisions expand the statute of limitations for equitable remedies in securities cases, and create a new statutory disgorgement remedy for the SEC. In enacting this law, Congress effectively has overridden the SEC's recent stinging Supreme Court defeats in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) and *Liu v. SEC*, 140 S. Ct. 1936 (2020), which trimmed the agency's ability to seek disgorgement from defendants, and has granted the agency new powers as the Biden Administration promises a new era in Washington.

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## 'Kokesh', 'Liu', and the SEC's Curtailed Remedies

The Securities Exchange Act of 1934, as originally enacted, gave the SEC only the power to seek to enjoin future violations. Although the agency, by virtue of its regulatory and administrative functions, possessed other means to pursue its mandate, when it came to seeking relief in court, the SEC sought more tools in its kit. The agency soon convinced courts that ancillary equitable remedies beyond injunctions, such as receivership, were appropriate. Beginning around 1970, the SEC began to use this equitable power to seek disgorgement.

"Disgorgement," in this context, refers to the court-ordered return of profits derived from an alleged violation of the securities laws. The remedy is a powerful one, available on the theory that it allows the SEC to make a violation unprofitable and that otherwise, violators might well decide they could tolerate the risk of penalties

or injunctive relief if their contemplated conduct were sufficiently lucrative. For this reason, even though with the 1990 passage of the Securities Enforcement Remedies and Penny Stock Reform Act the SEC gained the ability to seek conventional monetary penalties, for the past 50 years, disgorgement has been a key weapon in the agency's enforcement arsenal.

Four years ago, however, in *Kokesh*, the Supreme Court began to set limits on the SEC's use of this remedy. Considering a claim that disgorgement was tantamount to a penalty, the Supreme Court agreed, and ruled that disgorgement claims were subject to the five-year statute of limitations for monetary penalties. The effective impact, given the time some SEC enforcement cases can take to build, was to significantly limit the amount of disgorgement the SEC could seek in many cases. In a notable footnote in the court's unanimous opinion in *Kokesh*, Justice Sonia Sotomayor, by expressly declining to offer any "opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings," implicitly invited further challenges to the SEC's disgorgement practices.

That challenge was taken up last year in *Liu*. In *Liu*, although the court upheld the SEC's general authority to seek equitable disgorgement, it set three substantial constraints on the scope of that authority: (1) that any disgorgement award could not exceed the actual profits from the violation—meaning legitimate business expenses, among other things, would be deducted; (2) that the SEC could not seek joint and several liability among multiple violators; and (3) that a disgorgement award must be payable to victims rather than the U.S. Treasury.

Taken together, *Kokesh* and *Liu* dealt the SEC a stinging blow. Indeed, just one year after *Kokesh*, the SEC reported that the decision had cost the agency $900 million in forgone disgorgement. Then-Chair Jay Clayton pressed for reform, most notably by endorsing the proposed Investor Protection and Capital Markets Fairness Act, H.R. 4344, which provided for both broader disgorgement authority and a longer statute of limitations. That bill passed the House in 2019, but languished in the Senate.

**New Powers for the SEC**

It took unusual circumstances to get the legislation through Congress. The stage was set with this year's military appropriations and policy bill, which included several important and popular provisions, particularly a pay increase for service members. On Jan. 1, 2021, the bill passed by 81 to 13 in the Senate, after earlier passage by 322 to 87 in the House, over former President Trump's veto (issued apparently largely for reasons related to the regulation of social media companies).

Comparable bills have passed every year for decades, and perhaps because this iteration seemed similarly destined for quick passage, Congress also included several provisions unrelated to national defense. Buried mostly unnoticed among them was "Section 6501—Investigations and Prosecution of Offenses for Violations of the Securities Laws." Section 6501, a short amendment to §21(d) of 1934 Act (codified at 15 U.S.C. 78u(d)), appears designed to more or less completely roll back the SEC's recent losses in the Supreme Court.

The key provisions of §6501 are simple. First, the law grants the SEC new explicit statutory authority to seek disgorgement. In doing so, the new statute makes no reference to any of the constraints set by *Liu*, which were founded in a close analysis of historical equity jurisprudence. On that basis, the SEC may contend that the new law leaves the agency free to seek joint and several liability for disgorgement beyond net profits, and to require payment of any award directly to the government.

Second, in response to *Kokesh*, the law sets the limitations period for statutory disgorgement claims related to scienter-based violations at 10 years, with 5 years for disgorgement related to other violations. This longer period both will permit the SEC to conduct longer investigations into older conduct, and could increase the amount of any eventual disgorgement by lengthening the period over which proceeds may be calculated.

Third, the law extends the statute of limitations for all equitable claims to 10 years. Notably, it also includes indefinite tolling of the statute of limitations for persons or

entities outside the United States. That provision has two effects: First, it is susceptible to interpretation as extending indefinitely SEC liability for foreign actors, and second, it may increase the potential disgorgement awards against such actors by permitting such awards to reflect the maximum statutory period in all cases.

Finally, the statute specifies that it applies to "any action or proceeding that is pending" on the date of the enactment, not just future suits. In other words, at least as the SEC is likely to interpret it, the statute pulls the rug out from under many defendants currently hoping to raise challenges on statute of limitations grounds.

**Busy Days Ahead for Litigants and the Courts?**

The SEC can be expected to interpret its new powers aggressively. Given the Supreme Court's past rulings, defendants may well seek to test those powers in the courts. The linchpin of prior high-court challenges has been the sparsity of legislative authority for a powerful and broadly exercised remedy, and that fundamental criticism no longer appears apt after the passage of §6501.

One fundamental question that seems likely to be at the front of the line for a court test is whether *Liu*'s restrictions, grounded in traditional common law equity jurisprudence, have any application to the SEC's new statutory disgorgement authority. Among other narrower questions to be fleshed out would appear to be to what extent Congress's explicit use of the common-law term "scienter"—unusual in a statute—incorporates the extensive body of court-developed law on that subject.

Another set of open questions concerns the extent to which transformation of disgorgement into a statutory remedy and extension of the statute of limitations will move disgorgement closer to a "punishment" that implicates Constitutional and common-law protections against double jeopardy, ex post facto laws, and retrospective application of new statutes.

With respect to double jeopardy, where Congress has specified a remedy is civil rather than criminal, the Constitutional protection attaches only when "sanctions are so punitive in form and effect as to render them criminal despite Congress's intent to the contrary." In *Hudson v. United States*, the Supreme Court described seven factors relevant to this determination, including "whether [the sanction] comes into play only on a finding of scienter," "whether its operation will promote the traditional aims of punishment-retribution and deterrence," and "whether the behavior to which it applies is already a crime." Although the Courts of Appeals thus far uniformly have rejected challenges to the SEC's pursuit of equitable disgorgement on these grounds, the only such decision following *Liu*, *United States v. Bank*, 965 F.3d 287 (4th Cir. 2020), noted (albeit did not expressly rely upon) *Liu*'s equity-based reasoning and limitations. The new statutory remedy, by invoking scienter and arguably removing the restraints of equity, may present a new opportunity for defendants to assert this challenge more persuasively.

Also likely will be disputes over the application of the new law to "any action or proceeding that is pending." It seems likely that the Staff of the Enforcement Division will seek to apply that language to investigations, not just filed actions. Courts will have to decide the extent to which the expanded statutes of limitations in §6501 reach conduct from before its enactment, and if so, whether their effect violates due process or the ex post facto clause's prohibition on retrospective application of penal statutes. For similar reasons to the double-jeopardy analysis, the result is not a foregone conclusion.

Whatever the resolution of these questions, in the near term, the new statute likely will mean a tougher road for defendants. The expanded limitations period may encourage the Enforcement Division to pursue older conduct, and for longer, and could increase defendants' potential exposure. In passing §6501, Congress has provided a valuable gift bag to welcome Gensler.

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