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NATIONAL DEFENSE AUTHORIZATION ACT CODIFIES SEC'S RIGHT TO SEEK DISGORGEMENT; GRANTS AGENCY A 10-YEAR STATUTE OF LIMITATIONS IN CERTAIN CASES

When the United States Senate overrode the President's veto of the National Defense Authorization Act ("NDAA") for Fiscal Year 2021 on January 1, 2021 it, among other things:

- Provided, for the first time, express statutory authority for the U.S. Securities and Exchange Commission ("SEC") to pursue disgorgement for violations of the federal securities laws;
- Expanded the SEC's statute of limitations to seek disgorgement—from five years to 10 years—for scienter-based claims; and
- Codified an indefinite tolling of the limitations period while defendants remain outside of the United States.

The expanded authority granted to the SEC by the NDAA will underpin an already more aggressive season of enforcement expected to occur at the SEC under a Biden Administration. This Client Alert outlines the major changes ushered in by the NDAA and some practical implications that companies and individuals should consider in light of these changes.

Explicitly Authorizes the SEC to Seek Disgorgement

As discussed in a prior alert, the U.S. Supreme Court recently held in *Liu v. SEC* that the SEC may obtain disgorgement as "equitable relief" under 15 U.S.C. § 78u(d)(5), subject to a five-year statute of limitations, so long as the disgorgement award does not exceed the wrongdoer's illicit net profits (*i.e.* so long as funds spent on legitimate business expenses are not included in the disgorgement) and is returned to the wrongdoer's victims (not to the U.S. Treasury). 140 S. Ct. 1936 (2020). The NDAA expressly authorizes the SEC to seek disgorgement. Whether other restrictions imposed by the *Liu* decision, including that disgorgement be awarded for the benefit of harmed investors rather than directed to the Treasury Department, remains to be seen. Parties under SEC investigation or embroiled in litigation with the agency should carefully consider whether and how to advance defense strategies under *Liu* in light of the new law.

Extends the SEC's Statutes of Limitations for Scienter-Based Claims

For disgorgement based on non-scienter violations (*e.g.*, failure to register and violations that do not require proof of intent), a five-year statute of limitations continues to apply. Importantly, however, the NDAA extends to 10 years the SEC's lookback period for disgorgement and other equitable remedies stemming from scienter-based violations (*e.g.*, injunctions, bars, suspensions, and cease and desist

orders). Companies who operate under the SEC's watchful eye should carefully consider the implications of such a lengthy limitations period and, for instance, any need to modify internal controls and procedures relating to document management, employee hotline reporting, and other matters of compliance.

In addition, the statute's language indicates that the move to a ten-year limitations period for scienter-based conduct applies to currently pending cases, creating the potential for considerably different outcomes for defendants currently in court against the SEC. Of course, proof of scienter can take many forms and, from time to time, the SEC must resort to trying to prove intent through cross-examination of the accused wrongdoer herself. Hence, with its lookback period now doubled, the SEC may have reason to try to establish scienter evidence through increased—and thereby likely prolonged—investigative efforts (more subpoenas and testimony) and perhaps less appealing settlement offers.

Tolls Limitations Indefinitely While a Defendant is Outside the United States

Finally, the NDAA provides an unlimited tolling provision for time spent outside the United States, meaning any time a defendant spends outside the United States is not counted in the accrual of the limitations period. Thus, actions brought against individuals located outside the United States may be tolled indefinitely or until the defendant enters the United States.

CONCLUSION

The implications of this development will take time to fully understand, and no doubt many will be litigated. We will continue to monitor and keep clients updated on the SEC's enforcement efforts, and effective defense strategies, in light of this development in the law.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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