

[Securities Regulation Daily Wrap Up, ENFORCEMENT—House passes disgorgement and diversity and inclusion bills, sends stop-gap funding bill to Senate, \(Nov. 19, 2019\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The House passed legislation that would clarify the SEC's ability to seek disgorgement within a 14-year limitations period while also passing legislation to mandate company disclosures on diversity and inclusion. The House also passed a temporary funding bill.

The House passed the Investor Protection and Capital Markets Fairness Act and the Improving Corporate Governance Through Diversity Act of 2019. The first bill clarifies that the SEC may seek disgorgement in enforcement cases, while the second bill would mandate public company disclosures about diversity and inclusion efforts in the boardroom and C-suite. The disgorgement bill passed by a [vote](#) of 314-95. The diversity and inclusion bill passed by a [vote](#) of 281-135.

Government funding update. Briefly, in other news, the House passed a continuing resolution (CR) that would keep the federal government open until lawmakers can address the several outstanding appropriations bills. The Further Continuing Appropriations Act, 2020, and Further Health Extenders Act of 2019 ([H.R. 3055](#)) passed the House after some early procedural wrangling and would prevent a government shutdown but only until December 20, 2019. The CR passed by a [vote](#) of 231-192.

House Appropriations Committee Chairwoman Nita Lowey (D-NY) tempered her [praise](#) for the CR: "Even with passage of this CR, American families, businesses, and communities need the certainty of full-year funding." Ranking Member Kay Granger (R-Texas) [tweeted](#) the text of her floor remarks opposing the CR, in which she lamented the reliance on CRs and the lack of agreement on spending levels for the several appropriations bills.

Meanwhile, Senate Majority Leader Mitch McConnell (R-Ky) [said](#) the following: "So this is not rocket science: The House needs to send us a short-term funding bill which the Senate can pass and which the president will sign. That is the way to keep government open while our important discussions continue to make progress towards closing out the appropriations process and getting full-year bills to the floor." House Majority Leader Steny Hoyer (D-Md) was also circumspect, [characterizing](#) the CR as the result of "failure." "It's a recognition that the Senate did not do its job. It's a recognition that the White House would not cooperate in getting to 302(b) allocations," said Hoyer.

Disgorgement. The Investor Protection and Capital Markets Fairness Act ([H.R. 4344](#)), sponsored by Rep. Ben McAdams (D-Utah), would clarify that the SEC may seek, and a federal court may award, disgorgement in SEC enforcement cases. Specifically, the SEC could seek disgorgement in the amount of any unjust enrichment obtained from the act or practice that triggered an SEC enforcement action. The bill also would clarify the SEC's ability to obtain injunctive relief, including officer and director bars. The bill would provide for a 14-year limitations period and would be effective for cases brought on or after the date of enactment. The House Financial Services Committee previously reported the bill by a vote of 49-5 in September 2019.

"U.S. capital markets are the envy of the world, promoting job growth and economic opportunity. But they only work to the extent that investors have faith that fraudsters cannot profit off wrongdoing," [said](#) Rep. McAdams.

Representative Ann Wagner (R-Mo) [said](#) the law had the backing of SEC Chairman Jay Clayton, who she said was concerned about frauds going undetected and about fraudsters keeping illicit gains they obtained outside the general federal 5-year limitations period. "I share concerns that the SEC could be slow to bring a case when certainty and swiftness should be the priority when pursuing enforcement actions. However, the reality is this: A

14-year statute of limitations is a reasonable first attempt to strike the appropriate balance in the disgorgement context," said Wagner.

A rule of construction would provide that disgorgement is not a civil fine, penalty, or forfeiture under Chapter 163 of Part VI of Title 28 of the U.S. Code. That set of provisions contains 28 U.S.C. §2462, which was the basis for the Supreme Court's holding in [Kokesh](#) that, for purposes of the applicable 5-year statute of limitations, disgorgement was a penalty.

The justices in *Kokesh*, however, left open the question of whether federal courts have the authority to award disgorgement. The Supreme Court will soon [hear a case](#) asking the following: "Whether the Securities and Exchange Commission may seek and obtain disgorgement from a court as 'equitable relief' for a securities law violation even though this Court has determined that such disgorgement is a penalty."

Similar legislation introduced in the [Senate \(S. 799\)](#), sponsored by Sen. Mark Warner (D-Va), would not only clarify the SEC's ability to seek disgorgement but would also permit the SEC to seek restitution. The amount of disgorgement awarded would be measured by the amount of unjust enrichment obtained by a violator, while restitution would be equal to the amount of an investor's loss. Disgorgement would be offset by the amount of any restitution paid. Restitution and other authorized equitable remedies (e.g., injunctions, bars, suspensions, or cease and desist orders) would be subject to a 10-year limitations period. The Senate version, however, would retain the 5-year limitations period for disgorgement contained in 28 U.S.C. §2462.

Diversity and inclusion. The Improving Corporate Governance Through Diversity Act of 2019 ([H.R. 5084](#)), sponsored by Gregory Meeks (D-NY), would mandate issuer disclosures about their boardroom and C-suite diversity and inclusion efforts. "Studies have shown that the lack of diversity in C-suites and corporate boards is not only an injustice, it is a detriment to business and a hindrance to innovation," [said](#) Rep. Meeks. "Bringing diversity to the highest levels of corporate governance will make companies more accountable to the public and to the economy, and improve their financial performance, as studies have shown."

Specifically, the bill would require an issuer that files reports under Exchange Act Section 13(a) to disclose in a proxy statement and in any information statement related to the election of directors filed with the Commission three things: (1) data on the racial, ethnic, and gender composition of the issuer's board, board nominees, and executive officers; (2) the veteran status of any board member, board nominee, or executive officer; and (3) whether, as of the date the issuer makes the required disclosures, the issuer's board or a board committee has adopted any policy, plan, or strategy to promote racial, ethnic, and gender diversity among the issuer's board members, board nominees, and executive officers. Data called for by items 1 and 2 would be based on voluntary self-identification.

An alternative disclosure regime would apply to an issuer that must file annual reports but has not filed proxy or information statements during a one-year period. In this circumstance, an issuer would make the required diversity disclosure in its first annual report filed after the one-year period ends.

The SEC's Director of the Office of Minority and Women Inclusion (OMWI) would have to publish within three years of enactment a set of best practices on how to comply with the proposed law (best practices would also be updated every three years). The SEC's OMWI director would have discretion to seek public comments on any proposed best practices. The Commission also would have to report to Congress annually regarding its analysis of the information required to be disclosed by issuers under the proposed law.

Moreover, the proposed law would mandate that the SEC create a Diversity Advisory Group to study how to increase gender, racial, and ethnic representation on company boards. The advisory group would submit an initial report to Congress while the Commission would report to Congress annually on the status of gender, racial, and ethnic representation on company boards. The advisory group's members must be drawn from government, academia, and the private sector. Reports issued by the advisory group would have to be made public, including on the SEC's website.

The House FSC reported a similar version of the bill ([H.R. 1018](#)) by a vote of 53-5 in July 2019. Senator Bob Menendez (D-NJ) has introduced similar legislation ([S. 360](#)), although the Senate version omits some of the latest House version's SEC Congressional reporting obligations.

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