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Congress Buries Expansion of SEC Disgorgement Authority in Annual Defense Budget

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On December 11, 2020, Congress fulfilled its constitutional obligation "to provide for the common defense,"[1] passing for the 60th consecutive year the National Defense Authorization Act ("NDAA"), H.R. 6395. Buried on page 1,238 of this $740.5 billion military spending bill is an amendment to the Securities Exchange Act of 1934. That amendment gives the Securities and Exchange Commission, for the first time in its history, explicit statutory authority to seek disgorgement in federal district court. It also doubles the current statute of limitations for disgorgement claims in certain classes of cases. The amendment appears to be a direct response to recent Supreme Court decisions limiting the SEC's authority.

Although the Exchange Act does not by its terms authorize the SEC to seek "disgorgement" for Federal Court actions, the agency has long requested this remedy, and courts have long awarded it under their power to grant "equitable relief."[2] In *Liu v. SEC*, 140 S. Ct. 1936 (2020), however, the Supreme Court made clear that while disgorgement could qualify as "equitable relief" in certain circumstances, to do so, it must be bound by "longstanding equitable principles."[3] Generally, under *Liu*, disgorgement cannot be awarded against multiple wrongdoers under a joint-and-several liability theory, and any amount disgorged must be limited to the wrongdoer's net profits and be awarded only to victims, not to the U.S. Treasury. And just three years earlier, in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), the Court added other limitations on the SEC's ability to seek disgorgement, holding that disgorgement as applied by the SEC and courts is a "penalty" and therefore subject to the same five-year statute of limitations as the civil money penalties the SEC routinely seeks.[4]

The SEC has not responded positively to either decision, particularly *Kokesh*. Chairman Clayton stated that he is "troubled by the substantial amount of losses" he anticipated the SEC would suffer as a result of the five-year statute of limitations applied in *Kokesh*.[5] And for that reason, he has urged Congress to "work with" him to extend the statute of limitations period for disgorgement.[6]

Section 6501 of the NDAA appears to grant the SEC its wish, at least in part. The bill authorizes the SEC to seek "disgorgement . . . of any unjust enrichment by the person who received such unjust enrichment," establishing that the SEC has statutory power to seek disgorgement in federal court. And it provides that "a claim for disgorgement" may be brought within ten years of a scienter-based violation—twice as long as the statute of limitations after *Kokesh*. As one Congressman put it in reference to a similar provision in an earlier bill, this "legislation would reverse the Kokesh decision" by allowing the SEC to seek disgorgement for certain conduct further back in time.[7] The proposed amendment would apply to any action or proceeding that is pending on, or commenced after, the enactment of the NDAA.

If enacted, the NDAA will likely embolden the SEC on numerous levels. It will, for instance, likely encourage the agency to charge scienter-based violations to obtain disgorgement

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over a longer period. It also will likely incentivize the SEC to use this authority to eschew the equitable limitations placed on disgorgement in *Liu* and even to apply that expanded conception of disgorgement retroactively to pending cases. It is not clear, however, whether courts would go along. If Congress, for example, had wanted to free the SEC from all equitable limitations identified in *Liu*, it could have said so explicitly. Courts may be especially reluctant if, as the SEC may claim, the disgorgement provision of the NDAA can be applied retroactively. Because the "[r]etroactive imposition" of a penalty "would raise a serious constitutional question,"[8] the courts would not lightly find that disgorgement had slipped *Liu*'s equitable limitations, the one thing potentially keeping disgorgement from "transforming . . . into a penalty" after *Liu*.[9]

We will continue to monitor the NDAA, which is currently awaiting the President's signature or veto. Although the President has threatened to veto the bill over unrelated provisions, Congress likely has enough votes to override that veto.[10]

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[1] U.S. Const. pmbl.; *see also* U.S. Const. art. I, § 8, cls.12–14.

[2] 15 U.S.C. § 78u(d)(5); *see Liu v. SEC*, 140 S. Ct. 1936, 1940–41 (2020).

[3] *Liu*, 140 S. Ct. at 1946.

[4] The Supreme Court's cabining of the SEC's disgorgement authority to "longstanding equitable principles" in *Liu* raised at least some doubt whether SEC disgorgement continued to be a "penalty" for statute of limitations purposes under *Kokesh*.

[5] Jay Clayton, Chairman, SEC, Keynote Remarks at the Mid-Atlantic Regional Conference (June 4, 2019), https://www.sec.gov/news/speech/clayton-keynote-mid-atlantic-regional-conference-2019.

[6] *Id.*

[7] 165 Cong. Rec. H8931 (daily ed. Nov. 18, 2019) (statement of Rep. McAdams), https://www.congress.gov/116/crec/2019/11/18/CREC-2019-11-18-pt1-PgH8929.pdf.

[8] *Landgraf v. United States*, 511 U.S. 244, 281 (1994).

[9] *Liu*, 140 S. Ct. at 1944.

[10] Lindsay Wise, *Senate Approves Defense-Policy Bill Despite Veto Threat*, Wall St. J. (Dec. 11, 2020), https://www.wsj.com/articles/senate-advances-defense-policy-bill-despite-trump-veto-threat-11607703243.

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