June 6, 2017

U.S. Supreme Court Holds That Five-Year Statute of Limitations Applies to Claims for Disgorgement Brought by the SEC

The Supreme Court ruled yesterday that claims for disgorgement brought by the SEC are governed by a five-year statute of limitations. The Court's unanimous opinion in *Kokesh* v. *SEC*, No. 16-529, slip op. at 5 (U.S. June 5, 2017) (Sotomayor, J.), held that disgorgement, as it is applied in SEC enforcement proceedings, operates as a "penalty" for purposes of the general federal statute of limitations applicable to "actions for the enforcement of . . . any . . . penalty." Under *Kokesh*, a claim by the SEC seeking disgorgement is thus subject to the same five-year period of limitations as claims by the SEC for civil fines, penalties other than disgorgement, and forfeitures. *Kokesh* rejected the SEC's position that claims for disgorgement are subject to no period of limitations at all, and could thus potentially be brought an unlimited number of years after the acts constituting the violation.

The Statute of Limitations in SEC Enforcement Proceedings

The statute of limitations applicable to SEC enforcement proceedings is 28 U.S.C. § 2462. Section 2462 provides that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise," must be commenced within five years from the date when the relevant claim accrued. Section 2462 has also been applied in enforcement proceedings brought by other federal regulatory agencies, including the Commodities and Futures Trading Commission,[1] the Office of Foreign Assets Control,[2] the Federal Communications Commission,[3] and the Federal Energy Regulatory Commission.[4]

Kokesh decided an issue that the Supreme Court had reserved in *Gabelli* v. *SEC*, 133 S. Ct. 1216, 1220 n.1 (2013). *Gabelli* concerned a dispute over what event triggers commencement of the five-year period of limitations created by § 2462. The SEC had contended that the five-year period commences on the date that the SEC (or other agency) discovered the wrongdoing. *Gabelli*, however, held that the five-year period commences on the date when the defendant's allegedly wrongful conduct occurred.

1 *See U.S. CFTC* v. *Coleman Tunney & Assocs., P.C.*, No. 13 cv 2919, 2013 WL 4565690, at *2 (N.D. Ill. Aug. 21, 2013).

2 *See Sacks* v. *OFAC*, 466 F.3d 764, 774 (9th Cir. 2006).

3 *See Action for Children's Television* v. *FCC*, 59 F.3d 1249, 1254 (D.C. Cir. 1995).

4 *See FERC* v. *Barclays Bank PLC*, 105 F. Supp. 3d 1121, 1131 (E.D. Cal. 2015).

The Proceedings Before the Lower Courts in *Kokesh*

In 2009, the SEC brought an enforcement action in federal district court against petitioner Charles Kokesh for misappropriating $34.9 million from investors beginning in1995 and ending in 2006. A jury found Kokesh liable for violating various securities laws. The district judge then imposed $2.4 million in civil penalties for conduct that occurred between 2004 and 2006. Section 2462 would not have permitted the district judge to impose civil penalties for conduct that had occurred before 2004. The district judge, however, also ordered disgorgement of $34.9 million, which was the total amount Kokesh had misappropriated from 1995 to 2006.

Kokesh appealed from the disgorgement order. He argued that the five-year statute of limitations applicable to claims for penalties also applied to claims for disgorgement. In his view, § 2462 therefore barred any claim for disgorgement of funds misappropriated before 2004. The Tenth Circuit rejected that argument. It concluded that the purpose of disgorgement was remedial, not punitive. It consequently held that disgorgement was not a "civil fine, penalty, or forfeiture" for purposes of § 2462, and that claims for disgorgement were not subject to the five-year period of limitations set forth in that statute. *SEC* v. *Kokesh*, 834 F.3d 1158 (10th Cir. 2016).

The Tenth Circuit's decision in *Kokesh* created a split with the Eleventh Circuit. After *Gabelli*, the Eleventh Circuit had held that claims for disgorgement seek to impose a "forfeiture" within the meaning of § 2462. *SEC* v. *Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016). We previously wrote about the Eleventh Circuit's decision in *Graham* here, and the Supreme Court's grant of certiorari in *Kokesh* here.

The Supreme Court's Opinion in *Kokesh*

The Supreme Court unanimously held that disgorgement is a "penalty" within the meaning of § 2462 because disgorgement is "imposed as a consequence of violating public law and . . . is intended to deter, not to compensate."[5] A "penalty," the Court held, is a "punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws."[6]

The Court offered three principal arguments to support its conclusion that disgorgement, as applied in SEC enforcement proceedings, is a "penalty." *First*, SEC enforcement proceedings are based on violations of public laws. When the SEC seeks disgorgement, it is therefore acting in the interest of the public at large, rather than in the interest of a particular injured party.[7] *Second*, the "primary purpose" of disgorgement is "to deter violations of the securities laws by depriving violators of their ill-gotten gains,"

5 *Kokesh* slip op. at 9.

6 *Id.* at 5 (quoting *Huntington* v. *Attrill*, 146 U.S. 657, 667 (1892)).

7 *Id.* at 7-8.

and deterrence is an "inherently punitive" objective.[8] *Third*, courts have ordered disgorgement even when the disgorged funds are retained by the Government, rather than remitted as restitution to wronged investors. That fact suggested that disgorgement is punitive, and not merely compensatory.[9]

For two reasons, the Court rejected the SEC's argument that disgorgement merely restores the status quo prior to the wrongdoing and is therefore "remedial."[10] *First*, the Court noted that in many cases, disgorgement leaves the defendant "worse off."[11] For example, courts have ordered "disgorgement" from a defendant based on wrongful profits received by third parties, and not by the defendant itself. Courts have also refused to reduce amounts subject to disgorgement by expenses incurred by the defendant in connection with the wrongful transactions. *Second*, disgorgement orders in SEC enforcement proceedings are intended in part to deter future violations. In the Court's view, that purpose suggested that disgorgement constitutes a penalty.[12]

Implications of *Kokesh* for SEC Enforcement Proceedings

- *Gabelli* and *Kokesh* have significantly reduced the SEC's ability to bring stale claims in enforcement proceedings. In *Gabelli*, the Court decided that the five-year period of limitations set forth in § 2462 commences upon the occurrence of the wrongdoing, and not upon the SEC's discovery of the wrongdoing. *Gabelli* thus declined to allow a potentially indefinite period of time to elapse before the five-year period commenced. *Kokesh*, by holding that the five-year period applies to claims for disgorgement, provides defendants with additional certainty respecting the period within which the SEC must bring claims seeking monetary penalties. *Kokesh* also prevents the SEC from trying to evade *Gabelli* by bringing claims for disgorgement in circumstances where the SEC might previously have sought a monetary penalty.

- SEC enforcement proceedings frequently involve wrongdoing that is alleged to occur over a significant period of time. In proceedings that the SEC commences within the five-year period specified in § 2462, *Kokesh* will prevent the SEC from seeking monetary penalties, including disgorgement, attributable to wrongdoing that occurred more than five years before commencement of the proceeding.

- In cases with a substantial potential for disgorgement attributable to older conduct, *Kokesh* may affect a defendant's decision to enter into a tolling agreement with the Government to extend the

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8 *Id.* at 8 (quoting *SEC* v. *Fishbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997)).

9 *Id.* at 8-9.

10 *Id.* at 9-10.

11 *Id.* at 10.

12 *Id.* at 10-11.

statute of limitations while an investigation is pending. Several recent settlements of SEC enforcement actions brought under the Foreign Corrupt Practices Act ("FCPA") and other statutes have involved conduct spanning many years. For example, in a recent FCPA settlement with General Cable, the SEC required the company to pay more than $55 million in disgorgement and interest in connection with conduct occurring over 13 years.[13] In the future, defendants are likely to consider how to craft such agreements to exclude the potential for disgorgement related to conduct that is more than five years old, and the SEC may consider asking for such a tolling agreement earlier in the investigation to preserve this powerful remedy.

- *Kokesh* does not address the SEC's consistent position that no period of limitations is applicable to an enforcement proceeding seeking only injunctive relief.[14] *Kokesh* therefore does not provide any assurance that the SEC will not commence an enforcement proceeding more than five years after the alleged wrongdoing; it limits only the available relief.

  In addition, the SEC has taken the position that "§ 2462 does not apply to FINRA disciplinary proceedings," and that "the disciplinary authority of self-regulatory organizations ('SROs') such as [FINRA] is not subject to any statute of limitations."[15]

- In a footnote, the *Kokesh* opinion cautioned that "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."[16] That footnote preserves arguments that the SEC lacks authority to seek disgorgement in civil actions, although the SEC has express authority to seek disgorgement in administrative proceedings.[17] The footnote also preserves challenges to the SEC's more far-reaching interpretations of disgorgement, such as the view that in insider trading cases, the SEC may obtain "disgorgement" from a tipper of unlawful profits that were actually received only by the tippee.[18] Similarly, in a case where an individual fund manager was found liable for trading based on inside information on behalf of the fund he managed, the Second Circuit held that a district court properly ordered "disgorgement" from the fund manager of the full amount of illegal profits received by the fund.[19]

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13 *In re General Cable Corp.*, Admin. Proc. File No. 3-17755 (Dec. 29, 2016).

14 *See, e.g.*, *Graham*, 823 F.3d at 1361-62.

15 *In re William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *22 (July 2, 2013), *aff'd on other grounds sub nom*. *Birkelbach* v. *SEC*, 751 F.3d 472 (7th Cir. 2014).

16 *Kokesh* slip op. at 5 n.3.

17 *See* Securities Exchange Act of 1934 § 21B(e), 15 U.S.C. § 78u-2(e).

18 *See SEC* v. *Warde*, 151 F.3d 42, 49 (2d Cir. 1998).

19 *SEC* v. *Contorinis*, 743 F.3d 296, 303-04 (2d Cir. 2014).

At the oral argument in *Kokesh*, the Chief Justice and Justices Kennedy, Alito, Sotomayor, and Gorsuch all asked questions arguably suggesting that because the SEC's authority to seek disgorgement in a civil action has no unambiguous statutory basis, the courts should be hesitant to authorize an expansive disgorgement remedy.[20] The SEC does have statutory authority to seek "equitable relief that may be appropriate or necessary for the benefit of investors"[21] in a civil action, but it is unclear whether disgorgement, as applied in civil actions brought by the SEC, falls within this authorization. Those concerns may re-emerge in litigation over other aspects of the scope of disgorgement as a remedy available to the SEC.

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[20] Transcript of Oral Argument at 7, 13, 15-16, 31-33, 52, *Kokesh* v. *SEC*, No. 16-529 (U.S. Apr. 18, 2017).

[21] Securities Exchange Act of 1934 § 21(d)(5), 15 U.S.C. § 78u(d)(5).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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