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# Beyond Disgorgement: The Impact of *Kokesh* on the SEC's Pursuit of Equitable Remedies

On June 5, 2017, the Supreme Court issued its decision in *Kokesh* v. *SEC*, ruling that disgorgement claims are subject to a five-year statute of limitations. Although the holding itself was relatively narrow, the decision has already begun to reverberate in cases involving the SEC's ability to seek other types of remedies. Language in the decision potentially called into question the SEC's authority to seek disgorgement in the first place, and lower courts have grappled with the question of whether the reasoning of *Kokesh* operates to limit other forms of equitable relief commonly pursued by the SEC in its enforcement actions, such as injunctions and certain bars.

## The Supreme Court's Decision in *Kokesh*

Under 18 U.S.C. § 2462, a five-year statute of limitations applies to actions "for the enforcement of any civil fine, penalty, or forfeiture." The question before the Supreme Court in *Kokesh* was whether disgorgement (a remedy that involves SEC recovery of allegedly "ill-gotten" gains) qualifies as a "penalty" for purposes of determining the applicable limitations period.[1]

Writing for the Court, Justice Sotomayor found that disgorgement is a "penalty" and that the five-year limitations period therefore was applicable to actions seeking disgorgement.[2] The Court reasoned that "penalties" seek (1) to redress crimes against the public, as opposed to against individuals, and (2) to operate "for the purpose of punishment, and to deter others from offending in like manner—as opposed to compensating a victim for his loss."[3] In the Court's view, disgorgement orders meet this standard because they "go beyond compensation, are intended to punish, and label defendants wrongdoers as a consequence of violating public laws."[4]

Although the Court's holding was limited to the applicability of the five-year limitations period, the Court's opinion included a notable footnote raising a more fundamental question about the authority of the SEC to pursue disgorgement in the first place. Specifically, the Court reserved on the question—which was not squarely presented in *Kokesh*—of "whether courts possess authority to order disgorgement in SEC

1 *Kokesh* v. *S.E.C.*, 137 S. Ct. 1635, 1642 (2017).

2 *Id.* at 1643.

3 *Id.* at 1642 (internal citations and quotation marks omitted).

4 *Id.* at 1643 (internal citations and quotation marks omitted).



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enforcement proceedings or [] whether courts have properly applied disgorgement principles in this context."[5] As one justice pointed out at oral argument, the SEC has no express statutory authorization to seek disgorgement in a civil enforcement action.[6] Instead, the SEC has relied on the equitable powers of the court. If disgorgement serves a penal rather than equitable purpose, however, the courts' equitable powers may not confer the authority to order disgorgement in an SEC enforcement proceeding.

### *Kokesh*'s Impact on Other Forms of Relief Commonly Sought by the SEC

The decision in *Kokesh* has created uncertainty as to whether other forms of relief commonly pursued by the SEC, such as injunctions and certain bars, also should be characterized as penalties. As two recent cases demonstrate, lower courts have been grappling with that and other related questions in the wake of *Kokesh*.

The 8th Circuit Court of Appeals considered the question of whether injunctive relief constitutes a penalty. In *SEC* v. *Collyard*, the SEC filed an action alleging the sale of unregistered securities and sought a so-called "obey the law" injunction.[7] The 8th Circuit concluded that such an injunction is not subject to the five-year limitations period under 18 U.S.C. § 2462. The court held that, even though the injunction might have a deterrent effect, it was only "incidental . . . not its primary purpose," and "likely does little to deter people other than [the defendant]."[8] As the court concluded, "[w]e fail to see how an order to obey the law is a penalty."[9] The court did not address the question of whether other types of injunctions might be classified as penalties, but noted that while some courts had held that injunctions are always remedial, others took more flexible approaches to determine whether injunctions are punitive in nature.[10]

In *SEC* v. *Saad*, the D.C. Circuit Court considered the application of *Kokesh* to another type of relief often sought by the SEC, a permanent industry bar.[11] John Saad, a broker-dealer, unlawfully misappropriated

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5 *Id.* at 1642 n.3.

6 Transcript of Oral Argument at 7-8, *Kokesh* v. *SEC* (Apr. 18, 2017) (No. 16-529).

7 *SEC* v. *Collyard*, 861 F.3d 760, 764–65 (8th Cir. 2017).

8 *Id.* at 765.

9 *Id* (internal citations and quotation marks omitted).

10 *Compare SEC* v. *Bartek*, 484 Fed. Appx. 949, 956–57 (5th Cir. 2012) (holding that permanent injunction and public company officer director bars are penalties under § 2462), *with SEC* v. *Graham*, 823 F.3d 1357, 1361 (11th Cir. 2016) (holding that injunctions are never penalties because they are forward-looking), *SEC* v. *Quinlan*, 373 Fed.Appx. 581, 586–88 (6th Cir. 2010) (permanent injunction and public company officer director bar are not penalties under § 2462), and *United States* v. *Telluride Co.*, 146 F.3d 1241, 1245–48 (10th Cir. 1998) (holding that injunction requiring restoration of damaged wetlands is not a penalty under § 2462).

11 *Saad* v. *SEC*, 873 F.3d 297 (D.C. Cir. 2017).

his employer's funds, and then misled investigators in an effort to cover up his wrongdoing.[12] The SEC sustained a FINRA decision permanently barring Saad from registration with FINRA and from affiliation with any of its members.[13] Saad appealed, arguing that the permanent bar was impermissibly punitive rather than remedial and exceeded the SEC's authority.[14] The court remanded the case to the SEC to address, in the first instance, the relevance of *Kokesh* to Saad's objection.[15]

In a concurring opinion, Judge Kavanaugh concluded that an industry bar must be viewed as a penalty under the reasoning of *Kokesh*, noting that:

> The Supreme Court's reasoning in *Kokesh* was not limited to the specific statute at issue there. Like disgorgement paid to the Government, expulsion or suspension of a securities broker does not provide anything to the victims to make them whole or to remedy their losses. Therefore, in light of the Supreme Court's analysis in *Kokesh*, expulsion or suspension of a securities broker is a penalty, not a remedy.[16]

Judge Kavanaugh concluded that after *Kokesh*, "FINRA and the SEC will no longer be able to simply wave the 'remedial card' and thereby evade meaningful judicial review of harsh sanctions they impose," which will lead to "a fairer, more equitable, and less arbitrary system of FINRA and SEC sanctions."[17]

Another member of the *Saad* panel, however, filed a separate opinion expressing "grave doubts about the propriety of remanding th[e] case to the Commission again."[18] Judge Millett wrote that there is nothing in *Kokesh* "that bears on that decision by a private self-regulatory organization to disaffiliate with someone who repeatedly transgressed industry rules that are necessary to protect the investing public and the integrity of the securities industry."[19] On December 18, 2017, the SEC ordered the parties in *Saad* to submit further briefs in the remanded administrative proceedings on the *Kokesh* issue.[20]

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12 *Id.* at 298.

13 *Id.*

14 *Id.*

15 *Id.* at 304.

16 *Id.* at 306.

17 *Id.*

18 *Saad* v. *SEC*, 873 F.3d 297, 304 (D.C. Cir. 2017) (J. Millet, *dubitante*).

19 *Id.* at 312.

20 *In the Matter of the Application of John M.E. Saad for Review of Disciplinary Action Taken by FINRA*, Release No. 82348 (Dec. 18, 2017).

The Commission has had to consider the implications of *Kokesh* for other forms of relief. On Oct. 30, 2017, for example, the SEC imposed a permanent associational bar on the defendants in *Harris and Alfaya*, "even assuming that a permanent bar is punitive under *Kokesh*," because "'nothing in *Kokesh* unravels the D.C. Circuit's on-point circuit precedent' allowing the Commission to impose a permanent associational bar after considering the relevant factors."[21] In another case, however, the Commission ordered additional briefing on the issue of whether an expulsion or suspension may be characterized as remedial in light of *Kokesh* and the concurring opinion in *Saad*.[22]

As these cases demonstrate, lower courts (and the Commission itself) have been grappling and will continue to grapple with questions left unresolved by *Kokesh*, including whether other types of remedies commonly pursued by the SEC are properly characterized as penalties and, if so, whether the SEC has authority to obtain such remedies. Although it is difficult to assess the full impact of *Kokesh* until further clarity emerges on these issues, it is already clear that its effect may be broader and more profound than its narrow holding suggests.

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[21] *In the matter of Talman Harris and Victor Alfaya*, Release No. 1213 (Oct. 30, 2017) (citing to Judge Millet's *dubitante* opinion in *Saad*).

[22] *In the Matter of Kimberly Springsteen-Abbott for Review of Disciplinary Action Taken by FINRA*, Release No. 34-82378 (Dec. 21, 2017).

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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