Supreme Court Applies Statute of Limitations to SEC Disgorgement Orders

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In a unanimous decision issued on June 5, 2017, the U.S. Supreme Court, in *Kokesh v. SEC*, 581 U.S. ___, held that disgorgement in securities enforcement cases is a "penalty" within the meaning of 28 U.S.C. § 2462, the general statute of limitations that governs penalty provisions throughout the U.S. Code, and therefore is subject to a five-year statute of limitations.

Implications

The Court's decision (discussed below) represents a clear limitation on the ability of the Securities and Exchange Commission (the SEC or Commission) to seek disgorgement in enforcement actions going forward, and it will likely have a significant impact. In 2016 alone, the SEC obtained disgorgement awards totaling approximately $2.8 billion, well in excess of the approximately $1.2 billion that the SEC secured in civil penalties.[1]

Potential implications of the *Kokesh* decision include the following:

- While many SEC enforcement actions are brought within the five-year statute of limitations prescribed by Section 2462, some are not. The *Kokesh* ruling will limit the Commission's ability to pursue full disgorgement as a remedy where the alleged conduct is long-running or well-concealed.
- In recent years, the SEC Division of Enforcement staff has become more aggressive in securing tolling agreements in cases that could potentially implicate statute of limitations concerns. Companies and individuals involved in SEC investigations should expect the staff to request tolling agreements in any investigation that is expected to continue for a significant amount of time.
- The SEC has utilized disgorgement as a primary remedial measure in Foreign Corrupt Practices Act enforcement settlements. Given the duration of conduct at issue in some of these actions, the SEC enforcement staff may rely more heavily on other remedies going forward. For instance, in order to offset the loss of disgorgement in some actions, the SEC may seek to impose higher civil monetary penalties or seek more aggressive disgorgement amounts for conduct occurring within the statute of limitations.
- The SEC Division of Enforcement purportedly streamlined internal procedures and made efforts to expedite investigations in recent years. While the fruits of these efforts have not always been apparent, in the wake of the *Kokesh* decision, there may be a renewed emphasis on streamlining enforcement investigations.
- The Court's ruling in *Kokesh* contained a footnote that may open the door to challenges as to whether courts can impose disgorgement at all in enforcement cases brought by the SEC or other government agencies, such as the Commodity Futures Trading Commission. The Court stated, "Nothing 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." Based on the nature of the questioning at oral argument, the Court may be skeptical of the SEC's authority to seek disgorgement absent explicit statutory authority. Congress has authorized the SEC to seek disgorgement in administrative proceedings but has not specifically authorized civil disgorgement in other venues. *See* 15 U.S.C. § 78u–2(e).

[1] *See* Select SEC and Market Data Fiscal 2016 (last visited June 6, 2017).

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- Finally, in order to remediate the consequences of long-running frauds, the SEC could resort to other equitable remedies that may survive the limitations imposed by *Kokesh*. For example, the SEC could seek the appointment of a receiver with the authority to marshal assets for the benefit of claimants, or restitution where the objective is more clearly remedial and not a sanction by the government — the characteristics that the Court viewed as penal in the disgorgement context. Any such efforts would have to overcome the skepticism expressed during oral argument and described in the footnote above as to whether any equitable remedies beyond those expressed in the statute are available to the SEC.

Background

Since the 1970s, the SEC has sought and obtained in civil enforcement actions disgorgement of ill-gotten gains from defendants as a result of their misconduct. Historically, the only remedy available to the SEC in an enforcement action was an injunction barring future violations. Without the statutory authority to seek civil monetary remedies, the Commission asked courts to order disgorgement as an exercise of their "inherent equity power to grant relief ancillary to an injunction." *SEC v. Texas Gulf Sulphur Co.,* 312 F. Supp. 77, 91 (S.D.N.Y. 1970).

In 1990, Congress specifically authorized the SEC to seek monetary civil penalties. Pub. L. No. 101-429, 104 Stat. 932 (codified at 15 U.S.C. § 77t(d)).[2] The Commission, however, has continued to seek disgorgement in enforcement proceedings. In 2013, the Supreme Court ruled that Section 2462 applies to civil monetary penalties sought by the SEC, but the Court did not consider whether it also applies to disgorgement. *See Gabelli v. SEC*, 568 U.S. 442 (2013).

In 2009, the Commission brought an enforcement action in federal district court against investment adviser Charles Kokesh, alleging that he violated a variety of securities laws by concealing the misappropriation of $34.9 million from four business development companies from 1995 to 2009. The Commission sought monetary civil penalties, disgorgement and an injunction barring Kokesh from future violations of the federal securities laws. A jury found that Kokesh's actions violated several securities laws, and the district court assessed a $2.4 million civil monetary penalty against Kokesh and ordered him to disgorge the full $34.9 million he was alleged to have misappropriated.

In considering the amount of the penalty, the district court determined that the statute of limitations under Section 2462 applied. The code provides that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." With respect to the amount of disgorgement, however, the district court concluded that the $34.9 million sought by the SEC was not a "penalty" within the meaning of Section 2462, and thus the five-year statute of limitations did not apply.

Kokesh appealed, and the U.S. Court of Appeals for the Tenth Circuit affirmed the district court ruling. In doing so, the appeals court sided with previous decisions issued by the U.S. Courts of Appeals for the District of Columbia Circuit and First Circuit. But the Tenth Circuit decision widened an existing circuit split, as the Eleventh Circuit had concluded in 2016 that "[b]ecause forfeiture includes disgorgement, § 2462 applies to disgorgement." S*EC v. Graham*, 823 F.3d 1357, 1364 (11th Cir. 2016). On January 13, 2017, the Supreme Court granted Kokesh's petition for a *writ of certiorari* on the question of whether Section 2462's statute of limitations applies to claims for disgorgement.

Decision

Writing for the unanimous Court, Justice Sonia Sotomayor resolved the circuit split, holding that SEC disgorgement operates as a penalty within the meaning of Section 2462, and therefore any claim for disgorgement must be commenced within five years of the date the claim accrued. The Court reasoned that SEC disgorgement is imposed by courts on defendants as a consequence of violating the securities laws; it is not imposed to compensate an aggrieved individual. Disgorged profits are paid to the district courts, which then have discretion to determine how the money will be distributed. While the courts may distribute the recovered funds to victims, no statute requires them to do so. The Court also determined that SEC disgorgement is imposed for punitive purposes, including deterrence.

The Court was not persuaded by the SEC's argument that disgorgement is not used as a punishment but is merely a remedial sanction that serves to restore the status quo by depriving violators of their unjust enrichment. In rejecting this argument, the Court reasoned that disgorgement sometimes exceeds the profits gained by a defendant, which can leave the defendant worse off than before the violation. Additionally, the Court found that while disgorgement may serve as compensation at times, sanctions can often serve more than one purpose and still be considered a penalty subject to Section 2462.

[2] With passage of the Insider Trading Sanctions Act of 1984, Congress had previously authorized the Commission to seek civil monetary penalties in the context of insider trading enforcement actions. *See* 15 U.S.C. §§ 78a *et seq.*

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