

SEC Enforcement after *Kokesh* and *Cohen*

The remedies the Securities and Exchange Commission (“SEC”) can seek in its enforcement actions are a critical question in the wake of the *Kokesh v. SEC*, 137 S.Ct. 1635 (2017) and *SEC v. Cohen*, Civil Action No. 17-cv-430 (S.D.N.Y. Order entered July 12, 2018). Specifically, the *Cohen* Court dismissed the SEC’s amended Foreign Corrupt Practices Act (“FCPA”) complaint against Michael Cohen and Vanja Baros, each of whom was employed by a subsidiary of hedge fund management firm Och-Ziff Capital Management LLC (“OZCM”), based on the statute of limitations and *Kokesh v. SEC*. *Cohen*, Civil Action No. 17-cv-430 (S.D.N.Y. Order entered July 12, 2018).

Background

The FCPA charges, first asserted in a complaint filed on January 26, 2017, center on a scheme to bribe African officials in various countries from 2007 through 2011. Messrs. Cohen and Baros are former employees of OZCM, or one of its subsidiaries, based in London.

The scheme allegations center around a series of transactions, each of which took place during a four year time period beginning in 2007. The first two transactions center on Libya and 2007. The business was sought for the firm in Libya when it was ruled by Colonel Muammar Gaddafi. Mr. Cohen enlisted Agent 1 who supposedly had connections to the ruling family. That person introduced Mr. Cohen to a son of Mr. Gaddafi who supposedly was the driving force behind the Libyan Investment Authority. A \$3.75 million “deal fee” was demanded which Mr. Cohen understood would be used to pay kickbacks in return for investments. The Libyan Investment Authority invested \$300 million in OZCH managed funds. The arrangement netted OZCH about \$100 million in fees.

The second Libya transaction focused on a real estate deal. To arrange for leases on real estate on which key developments would take place Agent 1 gave equity in the development company responsible for the project to a government official and Mr.

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Gaddafi's daughter. Mr. Cohen arranged for OZCM to provide a \$40 million convertible loan for the development and paid Agent 1 a \$400,000 deal fee used to bribe government officials.

Other transactions took place in, and involved, other countries. For example, a transaction involving mining rights in Chad and Niger began with an \$86 million loan extended by OZCH in May 2007 through a Turks & Caicos entity. The purpose was to acquire mining rights and licenses in the two countries and invest in an African focused oil exploration firm. It was also to pay bribes to facilitate the deal. The bribes were arranged by Agent 2 and included payments to high ranking government officials in Chad and Niger.

There were also transactions centered on the Democratic Republic of the Congo ("DRC"). In December 2007, for example, Defendants began discussions with Agent 3 about forming a joint venture to consolidate various DRC mining assets into a single, large mining company. On March 7, 2008 Agent 3 emailed Mr. Cohen regarding a plan to effect the consolidation. The first step involved OZCH acquiring a \$150 million stake in a DRC focused mining company the agent controlled. The stake was purchased. Agent 3 then paid \$11 million in bribes to certain officials. The DRC Mining Company, however, did not use the funds as planned. Rather the funds were used to acquire a platinum mining asset in Zimbabwe. Subsequently, the proceeds from the investment were used for a "loan" to affiliates of the ruling regime in Zimbabwe.

Transactions in the DRC also included: One in which Defendants arranged for OZCM to enter into a \$124 million convertible loan agreement through another entity with a DRC holding company. The point was to acquire a Congolese entity and fund future mining operations with the DRC. In another Agent 3 paid bribes to DRC officials to secure authorization for the scheme. DRC officials were bribed in part through a \$130 million lending arrangement to a British Virgin Islands entity controlled by Agent 3 allowing for the consolidation of the mining holdings and their eventual sale.

A 2010 transaction was implemented to provide funds for Agent 2 to bribe Guinean government officials in connection with another deal. To facilitate the transfer Defendants arranged for the purchase of 31.5 million shares of the London Mining Company for \$25 million by a Turks & Caicos entity. Those shares were then sold in part to one of the funds established by the joint venture the hedge fund management company had entered into through African Management Limited for \$77 million. The windfall profits permitted the payment of bribes to the Guinean government for the transaction.

Finally, in May 2011 a transaction was entered into that involved the acquisition of a 25% stake in an oil field off the coast of Congo-Brazzaville. A third party South African entity tied to the ANC would receive a stake for free. While the deal initially stalled because of regulatory concerns by Ochs-Ziff's legal department, Mr. Cohen restructured it and secured approval.

The opinion

Defendants moved to dismiss based on §2462 of Title 28 and the Supreme Court's decision in *Kokesh*. The section provides for a five year statute of limitations for "any proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise . . ." In *Kokesh v. SEC*, the Court held that this limitation period applies to requests for disgorgement by the SEC since they constitute a penalty within the meaning of the statute.

Here the parties agreed that the transactions took place between May 30, 2007 and April 15, 2011, years before the complaint was filed. The SEC claimed, however, that §2462 applies only to remedies, a question that should be considered later in the case, that the claims against Mr. Cohen were tolled and that it should be permitted to conduct discovery. The Court rejected each claim.

First, a motion to dismiss is the proper vehicle for considering the statute of limitations questions in this case. While the statute of limitations is typically an affirmative defense "a court may dismiss a complaint for failure to state a claim if the allegations in the complaint . . . show that relief is barred by the applicable statute of limitations . . . This general rule applies with particular force to §2462, which prohibits the court from 'entertain[ing] actions that accrued more than five years earlier . . .'" While the statute focuses on remedies as Plaintiff contends, this does not change the analysis.

The fact that an injunction is sought here and that the Commission reserved the right to take discovery does not preclude considering the statute of limitations on a motion to dismiss. If the injunction operates as a penalty it would be barred by the statute. Furthermore, "it would make no sense if the SEC could evade the statute of limitations by alleging untimely misconduct and then demand discovery in the hopes of uncovering misconduct within the limitations period." Such discovery would be nothing but a "fishing expedition" which will not be permitted.

The tolling agreements executed by Mr. Cohen also do not preclude the application of the statute of limitations at this stage of the proceedings. While Mr. Cohen did execute tolling agreements which extended the statute by 21 months, that does not save the action here. The tolling agreements related to the investigation captioned *In the Matter of Libyan Investment Authority*. Those transactions took place in 2007 and 2008. Mr. Cohen did not agree to toll matters that arose from the investigation captioned *In the Matter of Och-Ziff Capital Management, LLC*. Since the other transactions on which the amended complaint here is based arose from this investigation, the tolling agreements do not apply to them by their plain terms, despite the SEC's claims to the contrary.

Second, in view of the dictates of §2462 and the Supreme Court's holding in *Kokesh*, the Court concluded that the SEC's claims for disgorgement and an injunction, under the facts here, are untimely and must be dismissed. The statute of limitations runs from the time the Defendants engaged in the alleged misconduct. In this regard the statute specifically states that the claim accrues when the fraudulent conduct occurs. Plaintiff's assertion that it does not begin to run until the person received compensation from the misconduct is not supported by the statute or any authority. Indeed, "if the SEC were correct that a claim for disgorgement accrues only when the defendant receives iii-gotten

gains . . . that would mean Defendants' receipt of ill-gotten gains was an element of the SEC's 'disgorgement claims,' which the SEC would need to have plausibly alleged in its complaint. Because the Commission has not actually alleged that Defendants received any ill-gotten gains, the court would therefore need to dismiss the SEC's 'disgorgement claims' for failure to state a claim." While the SEC claimed that it is "reasonable to infer" that there were ill-gotten gains, a complaint cannot be amended by presenting new material in an opposition to a motion.

Plaintiff's request for injunctive relief is also time barred. Under the facts here that injunction "would operate at least partially as a penalty . . ." On its faces § 2462 does not specifically apply to an injunction. While some courts have held that the section does not apply to injunctions others have reached a different conclusion. More importantly, the conclusion that "injunctions are categorically exempt from §2462 is inconsistent with *Kokesh*. Under that decision the question of whether the injunction is a penalty is a function of if it is sought to redress alleged wrongs to the public and not just individuals and if it would at least in part function as a penalty.

In this case the *Kokesh* analysis compels the conclusion that the injunction sought would at least in part function as a penalty. There is no doubt that the violations alleged were committed against the United States, rather than an aggrieved individual. Likewise, the "parties agree, this injunction would impose no duties on Defendants beyond their existing duty to obey the law . . . What this injunction would do, however, is mark Defendants as lawbreakers and 'stigmatize [them] in the eyes of the public.'" [internal citations omitted]. Under these circumstances, there is no doubt it would function at least in part as a penalty which is sufficient for the application of the statute of limitations. While the Eighth Circuit in reaching a contrary result discussed the "primary purpose" of the injunction "[t]o the extent *Collyard* [*SEC v. Collyard*, 861 F. 3d 760 (8th Cir. 2017)] suggests that a remedy is not a §2462 penalty if the remedy's penal effect is only incidental to its remedial effect, the court respectfully finds this suggestion at odds with *Kokesh*." The amended complaint is dismissed and leave to amend denied.

Comment

Kokesh and *Cohen* present at least two significant issues for SEC Enforcement. First, the straight forward application of the five year statute of limitations creates a potential issue. Many SEC investigations focus on years old conduct, particularly in the FCPA area as in this action. The time limitation imposed by the five year statute of limitations will present a significant challenge in those cases. Those difficulties include not just the question of whether an injunction is viewed as a penalty but if it can be issued even if it is considered as equitable. If the facts in the case are outside the statute of limitations the court may well take the position that an injunction cannot issue under Rule 65, Fed. R. Civ. P. which requires that injunctions be based on specific facts. See, e.g., *SEC v. Jones*, Civil Action No. 17-11226 (D. Mass. Opinion January 5, 2018).

Second, the teachings of *Kokesh* can further delimit the remedies available to the Commission. If, for example, the injunction sought is viewed as a penalty, the court may decline to enter it as in *Cohen*. Disgorgement, traditionally an equitable remedy, may

also be denied as a time barred penalty as it is presently configured by the agency under *Kokesh*. Finally, even if the disgorgement sought in a particular case is not time barred, if it is viewed as a penalty a court might decline to enter it as inappropriate in view of the fact that Congress has given the SEC statutory authority to seek monetary penalties. Thus, seeking a “disgorgement penalty” and a statutory penalty would be nothing but impermissible piling-on and overkill if not grossly unfair. Viewed in this context the Commission would do well to reconsider not just the application of the statute of limitations when bringing an enforcement action but also the remedies being sought and the manner in which disgorgement is configured – a question left open by *Kokesh*.