

The High Court Rejects SEC Efforts to Avoid Limitation Period Again

28 U.S.C. §2462 imposes a five year statute of limitations in “an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture” Twice the SEC has told the Supreme Court that Section 2462 does not apply to remedies in its enforcement actions. Twice a unanimous Court has rejected the SEC’s position. First, the Court in *Gabelli v. SEC* held that the limitations period applied to civil penalties. 568 U.S. 442, 454 (2013). Second, on June 5, 2017, the Court in *Kokesh v. SEC*, No. 16-529, held that the limitations period applies to the SEC’s requests for disgorgement.

The Facts

Charles Kokesh owned two investment adviser firms that provided advice to business-development companies. The Commission brought a civil injunctive action alleging that Mr. Kokesh misappropriated almost \$35 million through his advisory firms from four clients over a fourteen year period. The complaint alleged that Mr. Kokesh caused false and misleading reports to be filed with the agency in an effort to conceal the wrongful conduct.

Following a five day trial a jury returned a verdict in favor of the Commission. The district court then directed that Mr. Kokesh pay disgorgement of \$34.9 million, rejecting a claim that the amount was delimited by the five year statute of limitations imposed by Section 2462. Conversely—and consistent with *Gabelli*—the court did apply the limitation period to the Commission’s request for a civil penalty for \$2,354,593—the amount of money Mr. Kokesh received during the period permitted by the statute. The court ordered an additional \$18.1 million in prejudgment, which it calculated using the fourteen year disgorgement period. The Tenth Circuit affirmed. 834 F.3d 1158 (2016).

Analysis

The Supreme Court granted certiorari to resolve a circuit split over whether SEC disgorgement claims are subject to Section 2462’s five year limitations period. Justice

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Sotomayor, writing for the unanimous Court, began by reviewing the range of remedies available to the SEC in an enforcement action. Originally, the only statutory remedy available was an injunction barring future violations of the securities laws. Although the statutes did not authorize monetary remedies, the Commission convinced the court in *SEC v. Texas Gulf Sulphur Co.* that the courts' "inherent equity power to grant relief ancillary to an injunction" afforded an avenue in which to order disgorgement. 312 F. Supp. 77, 91 (S.D.N.Y. 1970), *aff'd in part and rev'd in part*, 446 F. 2d 1301 (2d Cir. 1971). The Court went on to note that disgorgement is a type of restitution measured by the defendant's improper gain. In awarding disgorgement, the point was to deprive an SEC defendant of any reward for violating the law such that the public would be protected and the defendant be deterred from future violations. In 1990, Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act authorizing Congress to, among other things, seek monetary civil penalties. The court looked to the Act in canvassing the array of enforcement tools available to the Commission.

In addressing the question presented, the Court in *Kokesh* noted that statutes of limitations are "vital to the welfare of society" in that they entitle wrongdoings to eventually be forgiven. The limitation in Section 2462 applied "if SEC disgorgement qualifies as either a fine, penalty, or forfeiture." Citing *Huntington v. Attrill*, 146 U.S. 657, 667 (1892), the Court defined "penalty" as a "punishment," whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws." (alteration in original). The Court emphasized two points as critical in assessing whether a remedy is a penalty. First, a sanction is a penalty if the wrong being redressed is to the public. SEC enforcement actions are brought to remedy a violation of law against the United States, not for an aggrieved individual, the Court found. The SEC conceded this point, admitting that in seeking disgorgement it is acting in the public interest to remedy a harm inflicted on the public at large.

Second, a sanction is a penalty if it is sought to deter others from similar misconduct. Since *Texas Gulf*, courts have repeatedly made it clear that disgorgement is imposed to deter violations of the securities laws by depriving the person of any benefit from the wrongful conduct. This point is bolstered by the fact that disgorgement awards are not compensatory. To the contrary, they are paid to the district court which has discretion to determine how, and to whom, the money will be distributed. Indeed, disgorgement awards have been authorized whether the money will be paid to investors or not. "When an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation the payment operates as a penalty," the Court concluded.

Finally, the Court rejected the SEC's claim that disgorgement is remedial and thus not subject to the statute of limitations. The Court concluded that it remains unclear whether disgorgement, as applied in SEC enforcement actions, simply returns a defendant to his prior position. The Court cited other instances—such as insider trading cases—where the defendant might be ordered to disgorge both unlawful gains from trading and the benefit obtained by others. Likewise, in many instances the amount ordered is calculated without regard to the defendant's expenses that may have reduced the amount of the

illegal profits. The denial of such a deduction makes disgorgement a punitive remedy. Viewed in this context, the Court held that SEC disgorgement “bears all the hallmarks of a penalty” and is subject to the limitation period imposed by Section 2462.

Future Considerations

The Supreme Court’s conclusion that the five year statute of limitations applies to SEC claims for disgorgement represents another significant limitation on the agency’s enforcement authority. But *Kokesh* may be even more significant than its literal holding in at least two respects. First, the reasoning of the opinion leaves open the possibility that the five year statute of limitations could be applied to SEC requests for an injunction. The statute of limitations applies, the Court found, where the remedy is for a violation of law against the State and is sought to deter others. A request for a permanent injunction prohibiting future violations of the law, although premised on a statute unlike disgorgement, may be viewed as a penalty within this definition—a remedy for a violation of law sought by a federal agency not just to prevent future violations but to deter others. This is particularly true where the misconduct at issue took place years ago as is often the case in SEC actions.

Second, the Court’s ruling calls into question the SEC’s authority to seek disgorgement at any time. During oral argument, the Court probed the SEC’s authority for this remedy, seeking its statutory origin. It found none. Rather, the Court traced the Commission’s claimed authority to decisions such as *Texas Gulf*, which built on the notion of inherent authority, an implied remedy. Yet the increasingly conservative Supreme Court does not favor such remedies. That trend may well be the reason for the statement in footnote two of the opinion which makes it clear that the Court is not validating the SEC’s authority to seek disgorgement. The Court nonetheless left that question for another day. For today *Kokesh* and *Gabelli* establish that the SEC’s monetary remedies are time limited, not open ended tracing back years as was sought in this case.

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