

ALERTS

Supreme Court: SEC Disgorgement Claims Are Subject to Five-Year Statute of Limitations

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On June 5, 2017, a unanimous Supreme Court in *Kokesh v. SEC*^[1] held that SEC enforcement actions seeking disgorgement must be brought within the five-year statute of limitations imposed by 28 U.S.C. § 2462. *Kokesh* resolved a split in the Courts of Appeals by concluding that disgorgement in SEC federal court actions is a “penalty,” thus triggering § 2462’s statute of limitations. As a result, we may see the SEC bringing enforcement actions more quickly or becoming more aggressive in pressing parties to agree to toll the applicable limitations period.

Background

Under 28 U.S.C. § 2462, government “enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise,” must be commenced within five years of when the claim accrues. Initially, the only remedies available to the SEC in enforcement actions for violations of the federal securities laws were injunctions barring future violations. Unable to impose monetary sanctions, the SEC urged federal courts to order disgorgement as part of the courts’ “inherent equity power to grant relief ancillary to an injunction.”^[2] Since the 1970s, courts have used this implied authority to order disgorgement in SEC enforcement actions. In 1990, Congress authorized the SEC to seek monetary civil penalties. In *Gabelli v. SEC*, the Court held that the five-year statute of limitations in 28 U.S.C. § 2462 applies to civil penalties sought by the SEC, but did not address whether that limit also applies to disgorgement. 568 U.S. 442, 454, n.1 (2013). Since

Gabelli, the SEC has increasingly sought disgorgement in cases where civil penalties were time-barred.

Proceedings Below

In 2009, the SEC sued Charles Kokesch in federal court, alleging that, through two investment adviser firms, Kokesch misappropriated nearly \$35 million between 1995 and 2009. The SEC sought civil penalties, disgorgement, and an injunction barring future securities law violations. Following a jury verdict for the SEC, the district court addressed the SEC's claims for relief. The district court held that the five-year statute of limitations applied to the SEC's request for a civil penalty but not to its disgorgement request. Agreeing with the SEC, it held that disgorgement was not a "penalty" within the meaning of § 2462.

On appeal, the Tenth Circuit affirmed. 834 F.3d 1158 (2016). It agreed that disgorgement was not a penalty, held that disgorgement was not a forfeiture, and concluded that the statute of limitations in § 2462 did not apply to SEC disgorgement claims. *Id.* at 1164-67. Due to a split in the circuits on whether § 2462 applies to disgorgement, the Supreme Court granted certiorari.[3]

The *Kokesch* Decision

The issue in *Kokesch* was whether disgorgement in SEC enforcement actions is a penalty and, thus, subject to § 2462's limitations period.[4] According to the Court, that question turns on two ways the Court noted that penalties are distinguished from other monetary sanctions. First, penalties typically redress an offense against the state — that is, a public wrong, rather than a wrong to a private individual. Slip op. at 5-6. Second, the purpose of penalties is to punish the wrongdoer and deter others from engaging in similar conduct. *Id.* at 6-7.

These principles, the Court concluded, "readily demonstrate[] that SEC disgorgement constitutes a penalty within the meaning of § 2462." *Id.* at 7. The Court noted that disgorgement is imposed as a consequence of violating public laws — the violation is committed against the United States, even if there may be individual victims. *Id.* at 7-8. Disgorgement is punitive since it deprives the defendant of unlawfully obtained profits and its primary purpose is to deter future violations. *Id.* at 8. Moreover, disgorgement is not compensatory in many cases. The Court noted that while disgorged funds sometimes are paid to victims, often such funds are paid to the U.S. Treasury. *Id.* at 9. In sum, "SEC disgorgement thus bears

all the hallmarks of a penalty: It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate.” *Id.*

The Court rejected the SEC’s argument that disgorgement is remedial and merely restores the status quo, noting that SEC disgorgement “sometimes exceeds the profits gained” through the violation. *Id.* at 10-11. For instance, the Court observed that insider trading tippers often are ordered to disgorge the profits of downstream tippees, even though the tipper did not share in those profits. *Id.* at 10. Similarly, when disgorgement fails to take into account the expenses a defendant incurs in committing a violation, which would reduce the amount of illegal profit, disgorgement punishes rather than restores the status quo. *Id.* Acknowledging that disgorgement has multiple purposes, the Court concluded that because SEC disgorgement orders “go beyond compensation, are intended to punish, and label defendants wrongdoers’ as a consequence of violating public laws,” they are subject to the five-year limitations of § 2462. *Id.* at 11 (quoting *Gabelli*, 568 U.S. at 451-52).

Potential Implications for Parties to SEC Investigations

Beyond increasing SEC incentives to complete investigations in a timely manner, *Kokesh* may result in more SEC requests for tolling agreements for matters that cannot be concluded before the statute of limitations runs. These include some of the SEC’s most challenging investigations, including those related to the Foreign Corrupt Practices Act, accounting fraud, and other complex or novel financial matters. By eliminating the uncertainty as to whether disgorgement claims are governed by the statute of limitations, *Kokesh* may require that parties to SEC investigations consider the benefits of agreeing to, or deciding to resist, the SEC’s requests for tolling agreements. Refusing such requests may force the SEC to bring actions before it otherwise is prepared to do so. It could also cause the SEC to focus more on the remedies that are not subject to applicable limitations periods, including injunctions and the potentially severe collateral consequences of them.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the attorneys in the firm’s Securities Enforcement Group or White Collar Defense & Government Investigations Group.

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[1] *Kokesh v. SEC*, No. 16-529, slip op. (June 5, 2017).

[2] *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 91 (S.D.N.Y. 1970), *aff’d in part and rev’d in part*, 446 F.3d 1301 (2d Cir. 1971).

[3] Compare *SEC v. Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016) (holding that § 2462 applies to SEC disgorgement claims), with *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (holding that § 2462 does not apply to SEC disgorgement claims).

[4] The Court noted that its decision should not “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.” Slip op. 5, n.3.

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