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Kokesh v. SEC: U.S. Supreme Court Holds That a Five-Year Statute of Limitations Applies When the SEC Seeks Disgorgement in Enforcement Actions

The Decision Builds Upon the Court's 2013 Holding That the Statute of Limitations Applies When the SEC Seeks Civil Monetary Penalties

SUMMARY

Yesterday, the U.S. Supreme Court resolved a split among three Circuit Courts of Appeals concerning whether the five-year statute of limitations of 28 U.S.C. § 2462 applies to SEC enforcement actions seeking disgorgement. In *Kokesh v. SEC*, No. 16-529, the Court unanimously held that in SEC enforcement actions, disgorgement operates as a penalty and is therefore subject to the five-year limitations period. After *Kokesh*, the SEC no longer may use disgorgement to obtain money from defendants for claims that accrue outside the five-year limitations period. *Kokesh* also may apply to enforcement actions brought by other government agencies, such as the CFTC. Companies facing government enforcement actions should consider the limitations on disgorgement during any settlement or tolling agreement discussions.

BACKGROUND

Until the 1970's, the only statutory remedy available to the SEC in an enforcement action was an injunction barring future violations of securities laws.¹ Courts then began ordering disgorgement—a form of restitution measured by the defendant's wrongful gain—as part of the courts' inherent authority to grant equitable relief.² In 1990, Congress passed legislation authorizing the SEC to seek civil monetary penalties. Nonetheless, in the ensuing decades, the SEC continued to seek disgorgement—in addition to civil monetary penalties—in enforcement proceedings.³

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Under 28 U.S.C. § 2462, a five-year statute of limitations applies to any government “action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise.” In 2013, the Supreme Court held in *Gabelli v. SEC*, that the five-year limitations period applies when the SEC seeks civil monetary penalties.⁴

Despite *Gabelli*, courts remained divided over the related question of whether § 2462 applies to government claims for disgorgement imposed as a sanction for violating the federal securities laws. The D.C. Circuit had held that “disgorgement is not a ‘civil penalty,’” and therefore is “not subject to the five-year statute of limitations” under § 2462.⁵ The Eleventh Circuit, conversely, had held that “for the purposes of § 2462 forfeiture and disgorgement are effectively synonyms; § 2462’s statute of limitations applies to disgorgement.”⁶

THE *KOKESH* DECISION

In 2009, the SEC commenced an enforcement action against Charles Kokesh, a New Mexico-based investment advisor. Alleging that Kokesh had misappropriated \$34.9 million from various victims, the SEC sought civil monetary penalties, disgorgement, and an injunction barring Kokesh from future violations of the securities laws.⁷ After a jury found against Kokesh at trial, the district court considered what penalties to impose. With respect to the SEC’s request for a civil monetary penalty, the district court held that § 2462’s five-year limitations period applied and, accordingly, ordered Kokesh to pay \$2.3 million, a sum that excluded any funds that Kokesh had received outside of the limitations period. With respect to the SEC’s request for disgorgement, however, the district court ordered Kokesh to surrender the entire \$34.9 million, reasoning that “because disgorgement is not a ‘penalty’ within the meaning of § 2462, no limitations period applied.”⁸ The Tenth Circuit affirmed.⁹ The Supreme Court granted certiorari “to resolve disagreement among the Circuits over whether disgorgement claims in SEC proceedings are subject to the 5-year limitations period of § 2462.”¹⁰

The Supreme Court reasoned that § 2462 applied if SEC disgorgement qualifies as either “a fine, penalty, or forfeiture.” The Court held that “[d]isgorgement, as it is applied in SEC enforcement proceedings, operates as a penalty under § 2462,” and therefore “any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued.”¹¹ The Court provided three reasons for its holding. *First*, SEC disgorgement is a remedy for wrongs “committed against the United States rather than an aggrieved individual.”¹² *Second*, “SEC disgorgement is imposed for punitive purposes,” namely, deterrence.¹³ *Third*, “SEC disgorgement is not compensatory,” because while some disgorged funds are paid to victims, other funds are dispersed to the United States Treasury.¹⁴ The Court rejected the Government’s position that “SEC disgorgement is not punitive but ‘remedial.’” The Court reasoned that “SEC disgorgement sometimes exceeds the profits gained as a result of the violation,” and therefore in such cases “does not simply restore the status quo; it leaves the defendant worse off.”¹⁵

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In a footnote, the Court explicitly reserved opinion on the more fundamental questions of “whether courts possess authority to order disgorgement in SEC enforcement proceedings or . . . whether courts have properly applied disgorgement principles in this context.”¹⁶

IMPLICATIONS

Kokesh has significant implications for SEC enforcement actions, which—following *Gabelli*—have been increasingly reliant on disgorgement. In 2015, for example, the SEC obtained \$3 billion in disgorgement payments versus \$1.2 billion in civil monetary penalties.¹⁷ *Kokesh* removes the uncertainty as to whether the five-year limitations period of § 2462 applies to SEC enforcement actions seeking disgorgement. For claims that accrue outside the five-year limitations period, the SEC’s ability to bring an enforcement action or negotiate a settlement is substantially reduced.

Kokesh also may impact government enforcement actions by other agencies. Although the Court expressly limited its opinion to the application of § 2462 in SEC enforcement actions,¹⁸ courts recognize that “§ 2462 applies to a wide variety of agency actions and contexts.”¹⁹ For example, the Court’s reasoning likely applies to CFTC enforcement actions, which operate similarly to SEC enforcement actions.²⁰

Potentially most important, *Kokesh* explicitly left open the question of whether courts in fact have inherent authority to order disgorgement in SEC enforcement actions. That point was one on which several Justices appeared to express skepticism at oral argument.²¹ Accordingly, it is conceivable that the Court could further revisit that fundamental question in future Terms, potentially further restricting the SEC’s ability to seek disgorgement in enforcement actions.

Following *Kokesh*, companies facing government enforcement actions should consider the limitations on disgorgement during any resolution or tolling agreement discussions.

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ENDNOTES

- 1 *Kokesh v. SEC*, No. 16-529, slip op. at 2–3 (U.S. June 5, 2017).
- 2 *Id.* at 3.
- 3 *Id.*
- 4 *Gabelli v. SEC*, 568 U.S. 442, 454 (2013).
- 5 *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (citing *Zacharias v. SEC*, 569 F.3d 458, 471–72 (D.C. Cir. 2009)).
- 6 *SEC v. Graham*, 823 F.3d 1357, 1363–64 (11th Cir. 2016).
- 7 *Kokesh*, slip op. at 3–4.
- 8 *Id.* at 4.
- 9 *Id.*
- 10 *Id.* at 5.
- 11 *Id.* at 11.
- 12 *Id.* at 7–8.
- 13 *Id.* at 8.
- 14 *Id.* at 8–9.
- 15 *Id.* at 9–10.
- 16 *Id.* at 5 n.3.
- 17 See SEC, Select SEC & Market Data: Fiscal 2015 at 2 (2016),
<https://www.sec.gov/reportspubs/select-sec-and-market-data/secstats2015.pdf>.
- 18 *Kokesh*, slip op. at 5 n.3.
- 19 *Graham*, 832 F.3d at 1364.
- 20 See, e.g., *CFTC v. Reisinger*, 2013 WL 3791691, at *7–9 (N.D. Ill. July 18, 2013) (applying § 2462 to CFTC enforcement action).
- 21 See Transcript of Oral Argument at 7–9, 13, 15–16, 32–33, 65, *Kokesh v. SEC*, No. 16-529 (Apr. 18, 2017).

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