Supreme Court Holds That Five-Year Statute of Limitations Applies to SEC Disgorgement Actions

On June 5, 2017, the Supreme Court of the United States unanimously held in *Kokesh* v. *SEC* that disgorgement collected by the Securities and Exchange Commission (SEC) is a "penalty" subject to the five-year statute of limitations on civil penalties under 28 U.S.C. § 2462.[1] The decision resolves a circuit split over whether disgorgement is a "penalty or forfeiture" within the meaning of § 2462.

I. Background

Unless another statute specifies otherwise, § 2462 sets a five-year limitations period for claims seeking certain sanctions. It states:

> Except as otherwise provided by Act of Congress, 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 if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.[2]

In its 2013 decision in *Gabelli* v. *SEC*, the Supreme Court held that civil penalties sought by the SEC are subject to a five-year statute of limitations under § 2462, but expressly reserved the question of whether the statute applies to claims for disgorgement.[3] Following *Gabelli*, the Eleventh Circuit held in *SEC* v. *Graham* that SEC disgorgement claims were subject to the five-year statute of limitations because "for the purposes of § 2462 forfeiture and disgorgement are effectively synonyms."[4]

Kokesh arose from an SEC enforcement action in which the SEC alleged that petitioner Charles Kokesh violated various securities laws by concealing the misappropriation of $34.9 million from four business development companies between 1995 and 2006. The SEC's action sought monetary penalties, disgorgement, and an injunction barring Kokesh from future violations. A jury found Kokesh liable for the securities laws violations and, consistent with *Gabelli*, the district court determined that monetary penalties could be imposed only for conduct that occurred in the five years before the SEC filed the suit. With respect to the $34.9 million disgorgement judgment, however, the court concluded that § 2462 did not apply because disgorgement was not a "penalty" within the meaning of the statute.[5]

Three months after the Eleventh Circuit's decision in *Graham*, the Tenth Circuit affirmed the district court's decision in *Kokesh*, holding that disgorgement was neither a penalty nor a forfeiture.[6] The Supreme Court

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[1] *Kokesh* v. *SEC*, No. 16-529, 2017 WL 2407471, at *2 (U.S. June 5, 2017).

[2] 28 U.S.C.A. § 2462 (Westlaw through P.L. 115-34 (excluding P.L. 115-31 and 115-33)).

[3] 133 S. Ct. 1216, 1220, n.1 (2013).

[4] *SEC* v. *Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016). Because the Court determined that disgorgement was a "forfeiture," the Court declined to address whether disgorgement was a "penalty." *Id*. at n.3.

[5] *SEC* v. *Kokesh*, No. 09-CV-1021 SMV/LAM, 2015 WL 11142470, at *2 (D.N.M. Mar. 30, 2015).

[6] *SEC* v. *Kokesh*, 834 F.3d 1158, 1167 (10th Cir. 2016).

granted certiorari to resolve this disagreement among the circuits over whether disgorgement claims in SEC proceedings are subject to the five-year limitations period established by § 2462.[7]

II. Supreme Court Opinion

In an opinion authored by Justice Sonia Sotomayor, the Court reversed the Tenth Circuit's decision and unanimously held that "[d]isgorgement in the securities-enforcement context is a 'penalty' within the meaning of § 2462, and so disgorgement actions must be commenced within five years of the date the claim accrues."[8] At the outset, the Court explained that the SEC's statutory authority in enforcement actions historically had been limited to seeking injunctions barring future violations of the securities laws. Beginning in the 1970s, federal district courts, at the SEC's request, began ordering equitable disgorgement in SEC enforcement proceedings "in order to remove any monetary reward for violating securities laws and to protect the investing public by providing an effective deterrent to future violations."[9] While Congress since has authorized the SEC to implement a "panoply of enforcement tools" including civil monetary penalties, the SEC "has continued its practice of seeking disgorgement in enforcement proceedings."[10]

The Court stated there are two principles that make a sanction a "penalty." First, "a sanction represents a penalty [where] the wrong sought to be redressed is a wrong to the public."[11] Second, "a pecuniary sanction operates as a penalty only if it is sought for the purpose of punishment, and to deter others from offending in like manner—as opposed to compensating a victim for his loss."[12]

Applying these principles, the Court ruled that SEC disgorgement constitutes a penalty for three reasons. First, "SEC disgorgement is imposed by the courts as a consequence for violating . . . public laws" or wrongs "committed against the United States rather than an aggrieved individual."[13] Second, "courts have consistently held that the primary purpose of disgorgement orders is to deter violations of the securities laws . . . . Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive."[14] Third, disgorgement has been imposed "regardless of whether the disgorged funds will be paid to such investors as restitution. . . . 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."[15]

The Court rejected the government's argument that disgorgement is simply a remedial, not punitive, measure because disgorgement "restor[es] the status quo" and only "returns the defendant to the place he would have occupied had he not broken the law."[16] The Court reasoned that while "disgorgement serves compensatory

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[7] *See also Riordan* v. *SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (holding that § 2462 does not apply to SEC disgorgement claims); *SEC* v. *Tambone*, 550 F.3d 106, 148 (1st Cir. 2008), *withdrawn*, 573 F.3d 54 (1st Cir. 2009) (§ 2462 "applies only to penalties sought by the SEC, not its request for injunctive relief or the disgorgement of ill-gotten gains").

[8] *Kokesh* v. *SEC*, No. 16-529, 2017 WL 2407471, at *2 (U.S. June 5, 2017).

[9] *Id*. at *3 (citing *SEC* v. *Texas Gulf Sulphur Co*., 312 F. Supp. 77, 91-92 (S.D.N.Y.1970), *aff'd in part and rev'd in part*, 446 F.2d 1301 (2d Cir. 1971) (internal quotations and citations omitted).

[10] *Id*. at *4.

[11] *Id*. at *5.

[12] *Id*. (internal quotations and citations omitted).

[13] *Id*. at *7.

[14] *Id*. (internal quotations and citations omitted).

[15] *Id*. at *8 (internal quotations and citations omitted).

[16] *Id*.

goals in some cases," in other cases disgorgement "leaves the defendant worse off."[17] Thus, "because disgorgement orders go beyond compensation, are intended to punish, and label defendants wrongdoers as a consequence of violating public laws, they represent a penalty and thus fall within the [five]–year statute of limitations of § 2462."[18]

III. Significance of the Decision

Although *Kokesh* resolved the circuit split over the applicability of the statute of limitations to disgorgement claims, the Court expressly stated in footnote three of the opinion that the decision does not address "whether courts possess authority to order disgorgement in SEC enforcement proceedings" or "whether courts have properly applied disgorgement principles."[19] In other words, because the Court left unresolved these critical questions, there may be more lower court decisions ahead. Although the *Kokesh* decision limits the SEC's ability to obtain disgorgement in older cases, it may have little practical impact on the SEC's enforcement program in light of the prior *Gabelli* decision, which held that the statute of limitations for civil penalties is five years. Following *Gabelli*, the SEC has been more diligent in bringing enforcement actions more promptly and entering into tolling agreements to avoid concerns with statutes of limitation.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Kimberly Petillo-Décossard at 212.701.3265 or kpetillo-decossard@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; David Slovick at 212.701.3978 or dslovick@cahill.com; or Sara Ortiz at 212.701.3368 or sortiz@cahill.com.

[17] *Id*. at *9.

[18] *Id*. (internal quotations and citations omitted).

[19] *Id*. at n.3.

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