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SUPREME COURT APPLIES 5-YEAR STATUTE OF LIMITATIONS TO SEC DISGORGEMENT

On June 5, 2017, the U.S. Supreme Court unanimously held in *Kokesh v. Securities and Exchange Commission*[1] that the five-year statute of limitations in 28 U.S.C. §2462 applies to SEC claims for disgorgement. The Court held that disgorgement in a securities enforcement context is a "penalty" within the meaning of §2462, which governs "an action, suit or proceeding for the enforcement of any civil fine, penalty or forfeiture," and therefore disgorgement actions must be commenced within five years of the date the claim arose.

Background

Initially, the only statutory remedy available to the SEC in enforcement actions was an injunction barring future violations of the securities laws. In the absence of statutory authority to seek monetary remedies, the SEC urged courts to order disgorgement as part of the courts' inherent power to grant equitable relief. Beginning in the 1970's, courts ordered disgorgements in SEC enforcement proceedings, as stated in *Kokesh* to "deprive…defendants of their profits 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." In 1990, Congress authorized the SEC to seek monetary civil penalties. Nevertheless, in addition to seeking monetary civil penalties, the SEC continued to seek disgorgement in enforcement proceedings.

In 2013, the Supreme Court held that the five-year statutory limitations in §2462 applies when the SEC seeks civil monetary penalties. Thereafter, the Circuits were split as to whether §2462 applies when the SEC seeks disgorgement. The question before the Supreme Court in *Kokesh* was whether disgorgement is a "civil penalty" and therefore subject to the five-year statute of limitations, or is "not a civil penalty" and therefore not subject to the five-year statute of limitations

[1] *Kokesh v. Securities and Exchange Commission*, Slip Opinion, No. 16-529 (U.S. June 5, 2017) available [here].

The *Kokesh* Case

In 2009, the SEC brought an enforcement action against Charles Kokesh alleging, among other things, that between 1995 and 2009, Kokesh misappropriated $34.9 million, and sought civil monetary penalties, disgorgement and an injunction against Kokesh. A jury found Kokesh liable and the district court ordered him to pay a civil penalty of $2.4 million (the amount that Kokesh received during the five-year limitations period) and disgorgement of $34.9 million – $29.9 million of which resulted from violations outside the five-year limitations period. The district court agreed with the SEC that because disgorgement is not a "penalty" within the means of §2462, the five-year limitations period did not apply. The Court of Appeals for the Tenth Circuit affirmed.

The Supreme Court granted certiorari to resolve disagreement among the Circuits over whether disgorgement claims in SEC proceedings are subject to the five-year limitations period of §2462. In deciding *Kokesh*, the Court held that SEC disgorgement constitutes a "penalty" and therefore *is* subject to the five-year limitations period.

The Supreme Court stated that a "'penalty' is a punishment…imposed and enforced by the State, for a crime or offense against its laws." The Court reasoned that a sanction is a penalty if it seeks to redress a wrong to the public (as opposed to a wrong to an individual) and if it seeks to deter others from committing similar violations (rather than to compensate victims). The Court observed that disgorgement does not necessarily compensate victims because disgorged profits are paid to the district court and it is in the district court's discretion to determine how and to whom the monies will be distributed.

Therefore, the Supreme Court held that SEC disgorgement "bears all the hallmarks of a penalty." The Court concluded that because disgorgement is imposed as a consequence of violating a public law and is intended to deter, not to compensate, the five-year statute of limitations in §2462 applies when the SEC seeks disgorgement.

Implications of the *Kokesh* Decision

By subjecting SEC disgorgement cases to §2462, the Supreme Court limited the SEC's ability to recover monies in matters accruing outside the five-year limitations period. This will curtail the negotiating posture of the SEC and will compel it to accelerate investigations and institute enforcement proceedings in a more timely manner.

The most interesting implication of the *Kokesh* decision, however, lies in a footnote in which the Supreme Court stated explicitly that its decision should *not* be interpreted as an opinion as to whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context. This raises a most important issue as to whether this will spur challenges in the future to the SEC's ability to seek the non-statutory remedy of disgorgement.

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If you are facing disgorgement in an SEC proceeding or would like to discuss how this ruling affects any disgorgement orders to which you are or may be subject, please call Meryl Wiener, any of the undersigned or your regular Warshaw Burstein attorney.

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