Limitations Period for SEC Enforcement Matters

Supreme Court to decide

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On April 18, 2017, the United States Supreme Court heard oral argument in *Kokesh v. Securities and Exchange Commission* to determine whether disgorgement of ill-gotten gains in civil actions brought by the United States Securities and Exchange Commission (SEC) is subject to a five-year statute of limitations period or is an equitable remedy that falls outside the statute. The statute at issue is 28 U.S.C. § 2462, which applies to government actions seeking a "civil fine, penalty, or forfeiture."

The SEC has long taken the position that disgorgement of ill-gotten gains is not subject to any limitations period because it is a remedial measure that prevents unjust enrichment by violators of the securities laws. Until recently, the SEC's position had been upheld by federal appellate courts that considered the issue. Last year, however, the Eleventh Circuit, in *SEC v. Graham*, 823 F.3d 1357 (11th Cir. 2016), held that disgorgement is a "forfeiture" and, accordingly, is subject to the five-year limitations period. Subsequently, the Tenth Circuit, in *SEC v. Kokesh*, 834 F.3d 1158 (10th Cir. 2016), followed prior precedent by holding that disgorgement is neither a "penalty" nor a "forfeiture" and permitted disgorgement for conduct outside of the five-year period. The defendant in that case, Charles Kokesh, successfully petitioned for Supreme Court review. The Court's opinion, likely to be issued by early summer 2017, should resolve the split among the circuits and could limit the SEC's ability to obtain disgorgement for conduct occurring years earlier.

Background

In civil actions, the SEC can seek monetary relief in the form of penalties, disgorgement, or both. Disgorgement, along with accompanying pre-judgment interest, has been a significant tool for the SEC and an important part of its enforcement program for many decades. During fiscal year 2016 alone, the SEC obtained orders for disgorgement totaling $2.81 billion compared to $1.27 billion in civil penalties.[1]

A five-year statute of limitations is imposed under 28 U.S.C. § 2462 for any government "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." In a 2013 opinion, *Gabelli v. SEC*, 133 S. Ct. 1216 (2013), the Supreme Court determined that the five-year period accrues when the fraud is complete, not upon its discovery.[2] In so doing, the Court set "a fixed date when exposure to the Government enforcement efforts ends . . . ." *Id.* at 1221. The Court expressly reserved the question of whether § 2462 applies to disgorgement claims, which is now the subject of the circuit split. *Id.* at 1220 n.1.

The *Kokesh* case commenced in October 2009, when the SEC brought a civil action alleging that Kokesh (an investment adviser) violated federal securities laws between 1995 and 2006 by misappropriating funds from four SEC-registered business development companies. After a jury returned a verdict in favor of the SEC, the district court imposed a monetary penalty of $2.4 million and ordered disgorgement of $34.9 million, of which $29.9 million was based on violations prior to the five-year limitations period. Kokesh appealed, arguing that the district court's disgorgement order was a "penalty" or a "forfeiture" within the meaning of § 2462 and therefore governed by a five-year limitations period.

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The Tenth Circuit affirmed and held that "disgorgement" is neither a penalty nor a "forfeiture." See *Kokesh*, 834 F.3d at 1164. The court reasoned that disgorgement is not a penalty but rather is remedial and does not inflict punishment because it places the wrongdoer in the position he would have been without the misconduct. *Id.* The court also emphasized the historical meaning of forfeiture, which narrowly referred to *in rem* procedures to recover property used in criminal activity, noting that the "nonpunitive remedy of disgorgement does not fit" into this historical context. *Id.* at 1165-66.

The Tenth Circuit's decision in *Kokesh* is at odds with the Eleventh Circuit's conclusion that § 2462's five-year limitations period applies to SEC claims for disgorgement. *Graham*, 823 F.3d at 1363. The Eleventh Circuit held that § 2462 barred the disgorgement sought by the SEC because forfeiture and disgorgement "are effectively synonyms" or, at minimum, that disgorgement is a "subset of forfeiture." *Id.* at 1363-64. While the Eleventh Circuit did not reach the issue of whether disgorgement is a "penalty," it nonetheless concluded that there is "no meaningful difference in the definitions of disgorgement and forfeiture." *Id.* at 1363.

Oral argument

At oral argument, a number of Justices appeared skeptical of the SEC's pursuit of disgorgement without a clear mandate from Congress or clear internal guidelines. Chief Justice Roberts and Justice Kennedy pointed to the lack of express statutory authority for disgorgement, which Justices Sotomayor and Kagan further characterized as "unusual." Justice Gorsuch, the newly appointed member of the Court, stated that "there's no statute governing it . . . [w]e're just making it up."

Nevertheless, the Justices pressed both parties on the meaning of disgorgement. Counsel for Kokesh maintained that disgorgement falls within the "heartland" of the word forfeiture because it requires the wrongdoer to turn over money or property as a result of his wrongdoing. He characterized the SEC's view that disgorgement is an implied remedy as implausible because it enables the SEC to define disgorgement in the "twilight zone of sometimes compensatory, sometimes not," depending on its litigation needs. He instead suggested that citizens should be entitled to basic consistency from their regulators about whether disgorgement is a fine, penalty, or forfeiture.

The SEC countered that disgorgement is neither a penalty nor a forfeiture because its purpose is to remedy unjust enrichment by putting the wrongdoer back in the place he would have been prior to the securities law violation. The Court asked the SEC a number of questions about how disgorgement differs from the specified categories in the statute. For example, Justice Sotomayor asked, "if it looks like a forfeiture, why don't we treat it like a forfeiture?" Justice Kagan took a "commonsensical" approach, suggesting that the SEC has used disgorgement to compensate, to punish, and to deter, and that it would be artificial to tear them apart. Justice Gorsuch observed that disgorgement is often called forfeiture in the criminal context and questioned "[W]hy does the form, whether this is civil versus criminal, make all the difference?"

Several Justices appeared to be concerned about the unlimited nature of disgorgement if no limitations period applies. Chief Justice Roberts, quoting Chief Justice John Marshall, noted that it would be "utterly repugnant" to have a penalty without limit, and that the Court has a special obligation to ensure that the SEC does not reach too far given its lack of express statutory authority. While the SEC represented that it has an incentive *post-Gabelli* to move quickly so it can secure civil penalties, Chief Justice Roberts noted that "if we think that's inappropriate and bad, we're not going to come out the other way because we trust the government not to bring an action like that."

Both parties, in response to questions from Justice Kennedy, agreed that they were seeking a categorical rule, namely that disgorgement is either covered by the statute or it is not. Some Justices, however, hinted that they would not foreclose the possibility of a non-categorical solution in which the limitations period would not apply to disgorgement when its objective under § 2462 is actual victim compensation. This approach could alleviate several Justices' concerns about where disgorgement proceeds go—to the victims or to the Treasury—but such an approach would be difficult without clear guidance on the SEC's use of the funds.

Implications

The Supreme Court's decision in *Kokesh* could have significant implications for parties being investigated by the SEC. If the Court affirms the SEC's position that no limitations period applies to disgorgement, the SEC would retain the ability to seek profits gained or losses avoided based on violations of the federal securities laws without regard to when the misconduct occurred. On the other hand, if the Court adopts the Eleventh Circuit's categorical position in *Graham*, the SEC's ability to seek disgorgement for conduct occurring years earlier would be curtailed. This, in turn, could lead to the SEC expediting investigations, using tolling agreements earlier and more frequently during an investigation, or seeking higher penalty and disgorgement amounts for conduct occurring within the limitations period. In any event, the SEC could continue to pursue other equitable remedies, such as civil injunctions, for older conduct falling outside the statute. **THFJ**

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FOOTNOTES

1. SEC, Select SEC and Market Data, Fiscal 2016, at 2, https://www.sec.gov/reportspubs/select-sec-and-marketdata/secstats2016.pdf.
2. For additional background on the Gabelli case, see Advisories, "Supreme Court: Discovery Rule Does Not Apply to SEC Enforcement Actions for Civil Penalties Under Investment Advisers Act" (March 2013); "Supreme Court Holds 'Discovery Rule' Does Not Apply to Statute of Limitations for Government Enforcement Penalty Actions" (March 2013).