Simpson Thacher

Report from Washington

The Supreme Court Unanimously Holds That SEC Claims for Disgorgement in Civil Suits are Subject to Five-Year Statute of Limitations

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On June 5, 2017, in *Kokesh v. SEC*, No. 16-529, the Supreme Court unanimously held that SEC claims for disgorgement in civil suits for securities violations must be brought within five years of the date the claims accrue. Otherwise, such claims are time-barred by the five-year statute of limitations in 28 U.S.C. § 2462 because disgorgement operates as a penalty under that statute. The Court's ruling resolves a circuit split but, despite widespread commentary to the contrary, will not meaningfully affect the mainstream SEC enforcement program, which principally is focused on conduct within the limitations period. Resolution of the case will also likely spur an uptick in the number of settled SEC actions in the coming months, as the Staff presents to the Commission settlement recommendations that had been temporarily deferred pending the *Kokesh* decision. Those cases, including some that will likely involve dated conduct, will represent the first tangible evidence of the impact of *Kokesh* in the form of lower disgorgement amounts.

"Statutes of limitations . . . are 'vital to the welfare of society' and rest on the principle that 'even wrongdoers are entitled to assume that their sins may be forgotten.'"

— Justice Sotomayor

Background

In addition to civil fines and injunctions barring future violations by the defendant, the SEC has often sought, since the 1970s, to require defendants to disgorge profits resulting from violations of the securities laws. Although Congress has authorized disgorgement in the SEC's own administrative proceedings, 15 U.S.C. § 78u–2(e), and monetary penalties in civil suits, 15 U.S.C. §77t(d), it has never specifically authorized civil disgorgement as a remedy in civil suits by the SEC. Disgorgement, therefore, remains an implied equitable remedy to be defined and applied by the courts.

Although SEC claims seeking injunctions are not subject to any statute of limitations, under 28 U.S.C. § 2462 claims for civil monetary penalties must be brought within five years of the date the claim accrues. *Gabelli v. SEC*, 568 U.S. 442, 454 (2013). Section 2462 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." Prior to the Court's ruling in *Kokesh*, application of § 2462 to claims seeking civil disgorgement varied by circuit. The First Circuit, *SEC v. Tambone*, 550 F.3d 106, 148 (2008), and the D.C. Circuit, *Riordan v. SEC*, 627 F.3d 1230, 1234 (2010), agreed that § 2462 did not apply to claims for disgorgement. The Eleventh Circuit, however, held in 2016 that disgorgement was a form of forfeiture subject to § 2462. *SEC v. Graham*, 823 F.3d 1357, 1364 (2016).

In 2009, the SEC filed a complaint against Charles Kokesh, seeking an injunction, a civil monetary penalty, and disgorgement for misappropriating $34.9 million from multiple business development companies ("BDCs") between 1995 and 2009. *Kokesh v. SEC*, No. 16-529, 581 U.S. --, slip op. at 3–4 (2017). A jury found Kokesh liable for converting the assets of the BDCs, assisting in defrauding the BDCs, and causing "the filing of false and misleading SEC reports and proxy statements." *Id.* The district court enjoined Kokesh from violating certain provisions of the federal securities laws, imposed a civil penalty of approximately $2.35 million, and required Kokesh to disgorge $34.9 million. *Id.* Kokesh argued that $29.9 million of the ordered disgorgement was time-barred because disgorgement is either a penalty or a forfeiture and is therefore subject to § 2462's five-year limit. *See id.* The district court rejected that argument and the Tenth Circuit affirmed. *See SEC v. Kokesh*, 834 F.3d 1158 (10th Cir. 2016).

"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."

— Justice Sotomayor

Summary of the Court's Decision

In a unanimous decision delivered by Justice Sotomayor, the Court held that disgorgement in a civil suit for violation of the securities laws is a penalty that is subject to § 2462's five-year statute of limitations. The opinion began by noting the history of remedies sought by the SEC and the lack of statutory authorization for civil disgorgement. It then turned to § 2462's text and determining what is a "penalty."

The Court defined a "penalty" as "a 'punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws.'" *Kokesh v. SEC*, No. 16-529, 581 U.S. --, slip op. at 5 (2017) (quoting *Huntington v. Attrill*, 146 U.S. 657, 667 (1892)). According to the Court, that definition leads to the conclusion that a remedy's status as a penalty depends on two things: first, whether the wrong it redresses is a public or private wrong and, second, whether the remedy is imposed to punish and deter, rather than to compensate a victim for his or her loss.

The Court found that disgorgement redresses a public wrong—a violation against the United States, not a particular individual. The Court also concluded that disgorgement is imposed primarily as a deterrent and that there is no statutory requirement that courts distribute disgorged funds to a defendant's victims and courts frequently do not do so. Accordingly, the Court held that disgorgement "bears all the hallmarks of a penalty" and "[t]he 5-year statute of limitations in §2462 therefore applies when the SEC seeks disgorgement." *Id.* at 9.

Finally, the Court responded directly to the U.S. government's argument that disgorgement is "remedial," rather than "punitive" because it merely restores the defendant to his or her position before the violation occurred. The Court noted that disgorgement sometimes actually leaves a defendant worse off than if he or she had not violated the securities laws and is therefore punitive.

Implications

The Court's unanimous opinion brings a clear resolution to the circuit split over whether § 2462's five-year statute of limitations applies to SEC claims for disgorgement. Although such claims will now be time-barred after five years, this is not likely to greatly disrupt SEC investigations or enforcement actions. In the short term, the Court's ruling is likely to result in the restructuring of a number of settlements in principle with SEC Staff before being presented to the Commission. In the long term, it will limit the SEC's ability to pursue monetary remedies in a narrow set of cases that take many years to be uncovered, such as long-running and well-concealed Ponzi schemes. The ruling may also discourage the SEC from retroactively targeting conduct that was historically viewed as appropriate within a given industry and it will likely lead to a renewed focus by the SEC Staff on securing tolling agreements and streamlining investigative techniques. Last, the ruling may impact the scope and settlement dynamics of FCPA investigations, which often come to light years after the underlying misconduct. Despite the impact of *Kokesh* on this relatively narrow band of cases, the newly applied statute of limitations should have no effect on the majority of SEC enforcement actions, which are brought within five years after the SEC's claims accrue. The *Kokesh* decision, however, when considered together with greater Commission scrutiny of corporate penalties, suggests that we may be entering an era of more moderate SEC monetary sanctions.

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