

## Securities Enforcement Update: Supreme Court Hints at Statute of Limitations for Disgorgement Actions, Justices Question SEC's Authority to Seek Disgorgement Altogether

April 26, 2017

On April 18, 2017, the Supreme Court heard oral argument in *Kokesh v. SEC*<sup>1</sup> to resolve a circuit split on the issue of whether the five-year statute of limitations in 28 U.S.C. § 2462—which governs any “action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture”—applies to SEC enforcement actions for disgorgement. As discussed in a prior alert, the question turns on whether disgorgement, which requires a defendant to give up ill-gotten gains, constitutes a “forfeiture” or “penalty” under § 2462. If, as the Tenth Circuit held, § 2462 does not apply, then there is no time limit on when the SEC can bring disgorgement actions.<sup>2</sup> At oral argument, the Court appeared skeptical of that interpretation and seems poised to side with the Eleventh Circuit, which held that § 2462’s five-year limit does apply to disgorgement actions.<sup>3</sup> Perhaps more surprising, however, was the Court’s discomfort at oral argument with the SEC’s lack of express statutory authority to seek disgorgement at all. Justice Gorsuch noted that, “because there’s no statute governing” disgorgement, “[w]e’re just making it up.” Although the question of the SEC’s authority to seek disgorgement is not squarely presented in *Kokesh*, that multiple Justices expressed frustration on this point suggests that the Court may be open to considering the issue in a future case.

### Background: *Kokesh v. SEC*

In 2009, the SEC brought an action against Charles Kokesh for misappropriating funds from SEC-registered business development companies. Kokesh owned and controlled the managing general partners for the companies, which were SEC-registered investment advisers. Payments to the advisers were strictly limited by contracts between the advisers and the companies. According to the SEC, Kokesh directed the advisers to take \$34.9 million from the funds for salaries, bonuses, office rent, and “tax distributions” in violation of the agreements between the advisers and the companies.

After trial in the U.S. District Court for the District of New Mexico, a jury found that Kokesh misappropriated the funds. The district court ordered disgorgement of \$34.9 million and enjoined Kokesh from further violating federal securities laws. Although the SEC did not seek disgorgement until 2009, the district court’s disgorgement order was based on securities violations dating back to as early as 1995.

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<sup>1</sup> No. 16-529 (U.S. Apr. 18, 2017).

<sup>2</sup> *SEC v. Kokesh*, 834 F.3d 1158 (10th Cir. 2016).

<sup>3</sup> *SEC v. Graham*, 823 F.3d 1357 (11th Cir. 2016).

### **The Tenth Circuit Splits with the Eleventh Circuit on the Statutory Question**

On appeal to the Tenth Circuit, *Kokesh* argued that the district court's disgorgement order was a "penalty" or a "forfeiture" and therefore governed by the five-year statute of limitations in 28 U.S.C. § 2462 generally applicable to SEC enforcement actions. Section 2462 provides that any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise" must be "commenced within five years from the date when the claim first accrued." The Tenth Circuit disagreed and held that the \$34.9 million disgorgement order is not a "penalty" because it is remedial and also held that disgorgement is not a "forfeiture" within § 2462.

The *Kokesh* decision contradicts the Eleventh Circuit's decision in *SEC v. Graham*, which found "no meaningful difference in the definitions of disgorgement and forfeiture" and held that the five-year statute of limitations did apply.

### **The Supreme Court Is Skeptical that Disgorgement Actions Have No Time Limits**

At oral argument, a majority of the Justices appeared skeptical, and at times hostile, towards the SEC's position that no statute of limitations applies to disgorgement actions. Chief Justice Roberts quoted with approval former Chief Justice John Marshall's statement that "it was utterly repugnant to the genius of our laws to have a penalty remedy without limit."

Multiple Justices also expressed frustration that the SEC was seeking disgorgement without explicit statutory authority. As Justice Alito explained: "[I]n order to decide whether [disgorgement] is a penalty or a forfeiture, we need to understand what this thing is. And in order to understand what it is, it would certainly be helpful and maybe essential to know what the authority for it is."

Other Justices echoed Justice Alito's concern. Justice Kennedy asked whether there was "specific statutory authority that makes it clear" that courts can order disgorgement. And Chief Justice Roberts recognized that "[o]ne reason we have this problem is that the SEC devised this remedy or relied on this remedy without any support from Congress." The SEC conceded that there is no "specific authorization that says courts may order disgorgement," but noted that courts rely on their equitable and injunctive powers to grant such relief. Yet, as Justice Gorsuch summarized, "because there's no statute governing" disgorgement, "[w]e're just making it up."

### **Potential Consequences**

The SEC has historically sought disgorgement for securities violations occurring more than five years prior to the action. In 2015 alone, the SEC secured \$3 billion in disgorgement payments. If the Supreme Court were to apply the five-year statute of limitations to disgorgement actions, the ruling would impose a significant limitation on the scope of SEC recoveries.

More surprising, however, would be if the Court were to address the antecedent question of whether the SEC has authority to seek disgorgement at all. Justice Alito suggested that determining the source of the SEC's authority to seek disgorgement was a necessary first step to deciding whether a statute of limitations applied: "How do we decide whether it is a penalty or a forfeiture without fully understanding . . . where it comes from and its exact nature?"

While an ultimate ruling that the SEC does not have authority to seek disgorgement would be a dramatic rollback of one of the SEC's most used enforcement tools, as Justice Sotomayor noted, such a ruling would not be the final word on disgorgement. Congress has the power to "pass a statute giving the SEC the authority to bring these actions for however long a period Congress chooses."

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

***New York***

<b>Greg D. Andres</b>	<b>212 450 4724</b>	<a href="mailto:greg.andres@davispolk.com">greg.andres@davispolk.com</a>
<b>Martine M. Beamon</b>	<b>212 450 4262</b>	<a href="mailto:martine.beamon@davispolk.com">martine.beamon@davispolk.com</a>
<b>Angela T. Burgess</b>	<b>212 450 4885</b>	<a href="mailto:angela.burgess@davispolk.com">angela.burgess@davispolk.com</a>
<b>Avi Gesser</b>	<b>212 450 4181</b>	<a href="mailto:avi.gesser@davispolk.com">avi.gesser@davispolk.com</a>
<b>Denis J. McInerney</b>	<b>212 450 4477</b>	<a href="mailto:denis.mcinerney@davispolk.com">denis.mcinerney@davispolk.com</a>
<b>Jennifer G. Newstead</b>	<b>212 450 4999</b>	<a href="mailto:jennifer.newstead@davispolk.com">jennifer.newstead@davispolk.com</a>
<b>Amelia T.R. Starr</b>	<b>212 450 4516</b>	<a href="mailto:amelia.starr@davispolk.com">amelia.starr@davispolk.com</a>

***Menlo Park***

<b>Neal A. Potischman</b>	<b>650 752 2021</b>	<a href="mailto:neal.potischman@davispolk.com">neal.potischman@davispolk.com</a>
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***Washington DC***

<b>Neil H. MacBride</b>	<b>202 962 7030</b>	<a href="mailto:neil.macbride@davispolk.com">neil.macbride@davispolk.com</a>
<b>Linda Chatman Thomsen</b>	<b>202 962 7125</b>	<a href="mailto:linda.thomsen@davispolk.com">linda.thomsen@davispolk.com</a>

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