

Securities Enforcement Update: Supreme Court to Decide Statute of Limitations for SEC Disgorgement Actions

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On January 13, 2017, the Supreme Court granted *certiorari* in *Kokesh v. SEC*¹ to resolve a circuit split on the issue of whether the five-year statute of limitations in 28 U.S.C. § 2462—which governs SEC suits for “any civil fine, penalty, or forfeiture”—applies to SEC enforcement actions for disgorgement. The question presented turns on whether disgorgement, which requires a defendant to give up ill-gotten gains, constitutes a “forfeiture” under § 2462 and is thus within the applicable five-year statute of limitations. In *Kokesh*,² the Tenth Circuit held that § 2462 does not apply to disgorgement actions, and accordingly, there appears to be no time limit on when the SEC can bring disgorgement actions. The Eleventh Circuit recently reached the opposite conclusion,³ holding that § 2462’s limitations period applies because there is “no meaningful difference in the definitions of disgorgement and forfeiture.” The Supreme Court’s decision will have practical consequences for a wide range of enforcement actions, including Foreign Corrupt Practices Act (“FCPA”) cases.

Background: *Kokesh v. SEC*

The SEC brought an action in 2009 against Charles Kokesh for misappropriating funds from SEC-registered business development companies. Kokesh owned and controlled the entities that served as 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’ treasurer to take \$23.8 million from the funds to pay salaries and bonuses to officers of the advisers and to use \$5 million to pay the advisers’ office rent. Kokesh also directed the advisers to take \$6.1 million in “tax distributions,” of which Kokesh received 90%. Each of these payments violated the agreements between the advisers and the companies.

After trial in federal court in New Mexico, a jury found that Kokesh misappropriated the funds. The district court ordered disgorgement of \$34.9 million based on securities-law violations dating back as early as 1995. If the five-year limitation period in 28 U.S.C. § 2462 applied, the SEC would have been entitled to disgorgement based on violations dating back to only 2004, or approximately \$5 million.

¹ No. 16-529 (U.S. Jan. 13, 2017).

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

³ *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 held that the \$34.9 million disgorgement order is not a "penalty" because it is remedial—a disgorgement order places the wrongdoer in the position he would have been in without the misconduct. Under this view, "the disgorgement remedy does not inflict punishment."

The Tenth Circuit also held that disgorgement is not a "forfeiture" within § 2462. The court reasoned that the meaning of "forfeiture" in § 2462 should be informed by the narrow scope of government forfeiture actions in the "early days of the Republic." Historically, forfeiture actions were *in rem* procedures to recover property used in criminal activity. The *Kokesh* Court concluded that the "nonpunitive remedy of disgorgement does not fit" into this historical context. On this point, the Tenth Circuit joined the First Circuit and D.C. Circuit in holding that § 2462 does not apply to disgorgement actions.

Kokesh exacerbated a direct split with the Eleventh Circuit's decision in *SEC v. Graham*, which addressed an SEC action against four individuals seeking disgorgement and other remedies for the sale of unregistered securities that took place more than five years prior to the action. The Eleventh Circuit found "no meaningful difference in the definitions of disgorgement and forfeiture." Accordingly, it held that the five-year statute of limitations applies to disgorgement actions.

The Supreme Court Will Resolve the Split

Kokesh will be the Supreme Court's second opportunity in four years to interpret the statute of limitations provided in § 2462. In 2013, the Court unanimously held in *Gabelli v. SEC*⁴ that the five-year statute of limitations in § 2462 begins to run when a fraud is complete, not when it is discovered, but the Court expressly declined to address whether the five-year limitations period applies to disgorgement actions.

The SEC commonly brings enforcement actions seeking disgorgement for securities violations occurring more than five years prior to the action. Disgorgement earnings have increased by 60% since 2011, and in 2015 alone, the SEC secured \$3 billion in disgorgement payments. Recognizing the importance of this issue, the SEC joined *Kokesh* in arguing that the Supreme Court should resolve the circuit split even though the SEC had won below. The SEC acknowledged that it "seeks disgorgement in the majority of its enforcement actions," and contended that the Eleventh Circuit's *Graham* decision "stands as a significant obstacle to national uniformity in administration of the securities laws." *Kokesh*, for his part, argued that if the Tenth Circuit's opinion stands, "[e]very participant in the securities industry will be eternally at risk of being confronted with 'stale claims' brought by the SEC decades after the alleged misconduct."

The Second Circuit is scheduled to hear oral argument in March in *SEC v. Wyly*,⁵ which similarly presents the question of whether disgorgement is a "forfeiture" or "penalty" under § 2462. The parties have requested an adjournment given the grant of *certiorari* in *Kokesh*. To the extent the Supreme Court hears oral argument in its April sitting, *Kokesh* will likely be decided by July 2017.

⁴ 133 S. Ct. 1216 (2013).

⁵ No. 15-2821 (2d Cir. 2015).

Consequences

A time limit on actions for disgorgement could significantly affect future SEC enforcement actions, especially FCPA cases, where disgorgement is typically paid by defendants in settled actions. For FCPA cases with a criminal component, the Department of Justice likely will still insist that companies participating in its [FCPA Pilot Program](#) fully disgorge to obtain maximum cooperation credit, but in matters pending exclusively before the SEC, a five-year limit on disgorgement could significantly alter the enforcement dynamic.

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