

Securities Enforcement Update: Supreme Court Rules that Five-Year Statute of Limitations Applies to SEC Disgorgement Actions

June 6, 2017

On June 5, 2017, the Supreme Court decided *Kokesh v. SEC*,¹ and unanimously held that 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 turned on whether SEC disgorgement, which requires a defendant to give up ill-gotten gains, constituted a “forfeiture” or “penalty” under § 2462. In *Kokesh*, the Supreme Court held that SEC disgorgement actions are “penalt[ies]” within the meaning of § 2462 and are therefore subject to the five-year statute of limitations. As noted [previously](#), when the Supreme Court heard oral argument on this issue in April, multiple Justices expressed discomfort with the SEC’s lack of express statutory authority to seek disgorgement at all. Although the question of the SEC’s authority to seek disgorgement was not presented in *Kokesh*, the opinion includes a footnote making clear that the Supreme Court did not express any “opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context.” By including this footnote, the Supreme Court invites future challenges to the SEC’s disgorgement powers that might have consequences far beyond those accompanying the narrow decision in *Kokesh*.

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, in violation of the Investment Company Act of 1940, 15 U.S.C. § 80a-36; the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-5, 80b-6; and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m, 78n. The district court imposed a civil monetary penalty, ordered disgorgement, 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. Specifically, the court ordered Kokesh to pay a civil penalty of \$2,354,593, which represented “the amount of funds that [Kokesh] himself received during the limitations period,” and

¹ No. 16-529 (U.S. June 5, 2017).

ordered Kokesh to pay \$34.9 million in disgorgement, \$29.9 million of which “resulted from violations outside the [five-year] limitations period.”

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 contradicted 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 Holds that the Five-Year Statute of Limitations Applies

A unanimous Supreme Court held that disgorgement in the context of SEC enforcement actions is a “penalty” under § 2462. Citing Supreme Court precedent dating back more than a century, the Court identified two principles that were most relevant to this determination. First, a sanction is a “penalty” when it seeks to address a public wrong. Second, a “penalty” is imposed to punish and to “deter others from offending in a like manner.” A “penalty” therefore contrasts with other remedies that seek to redress private wrongs and aim to compensate victims for their losses.

The Court held that SEC disgorgement actions shared all of the “hallmarks of a penalty.” First, the SEC seeks disgorgement to remedy violations committed against the United States, rather than individuals. Moreover, the Court reasoned, SEC disgorgement “is imposed for punitive purposes.” Finally, SEC disgorgement is not solely meant to compensate victims because “[s]ome disgorged funds are paid to victims; other funds are dispersed to the United States Treasury.” The Court also rejected the SEC’s argument that disgorgement is not punitive and merely restores the status quo because, among other reasons, “SEC disgorgement sometimes exceeds the profits gained as a result of the violation.”

Accordingly, the Court held that SEC disgorgement orders are penalties because they “go beyond compensation, are intended to punish, and label defendants wrongdoers as a consequence of violating public laws.” The five-year statute of limitations therefore applies to SEC disgorgement actions.

Consequences and Future Challenges to SEC Disgorgement Actions

The Court’s ruling that SEC disgorgement actions are subject to a five-year statute of limitations represents a significant limitation on the scope of SEC recoveries. For instance, \$29.9 million of the \$34.9 million disgorgement judgment that the SEC obtained against Kokesh resulted from violations occurring outside of the five-year statute of limitations period.

Perhaps the most interesting issue to arise from *Kokesh* is the Court’s apparent discomfort with the SEC’s pursuit of disgorgement remedies without express statutory authority. At oral argument, multiple Justices expressed frustration on this point. Justice Kennedy, for example, asked, “Is there specific statutory authority that makes it clear that the district court can entertain this remedy?” Likewise, Justice Gorsuch commented that “there’s no statute governing” SEC disgorgement. And Chief Justice Roberts seemed to link the need for a limitations period with the lack of a statutory basis for the remedy, noting: “But it does seem to me that we kind of have a special obligation to be concerned about how far back the government can go when it’s something that Congress did not address because it did not specify the remedy.”

Although the Court did not address the SEC’s authority to seek disgorgement in *Kokesh*, it did include a footnote that may set the stage for future challenges—the Court was careful to explain that it was not offering an “opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context.” The Court noted that “[t]he sole question presented in this case” was the statute of limitations issue.

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