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June 2017

U.S. Supreme Court Unanimously Rules SEC Disgorgement Subject to Five-Year Statute of Limitations

On June 5, 2017, the U.S. Supreme Court unanimously held that disgorgement of ill-gotten gains, a remedy commonly sought by the Securities and Exchange Commission ("**SEC**") in its enforcement proceedings, constitutes a "penalty" that is subject to a five-year statute of limitations under 28 U.S.C. § 2462. This decision resolved a split between the circuits, and will lead to greater certainty and predictability in future SEC enforcement efforts.[1]

In *Kokesh*, the SEC commenced an enforcement action against Charles R. Kokesh in 2009 for allegedly misappropriating US$34.9m from four development companies he advised. A jury eventually found Kokesh guilty of securities fraud and the district court ordered Kokesh to pay US$2.4m in civil penalties and US$34.9m in civil disgorgement. The court determined that the five-year statute of limitations in § 2462 applied to the civil penalty, precluding assessment of penalties for conduct occurring prior to 2004, but it did not apply to the disgorgement award. If the statute of limitations did apply to the disgorgement, US$29.9m of it would have fallen outside the limitations period. On appeal, the Tenth Circuit upheld the award, finding that the disgorgement did not operate as either a penalty or a forfeiture subject to § 2462.

On appeal from the Tenth Circuit, the Supreme Court began with a discussion of the origins of disgorgement in SEC cases. Originally, the SEC's statutory authority limited it to seeking injunctions to bar future violations. Beginning in the 1970's, however, federal district courts began ordering those convicted of securities fraud to give up, or "disgorge," their ill-gotten gains in enforcement proceedings. While subsequent law has given the SEC authority to seek civil penalties, the agency frequently continues to seek disgorgement as a remedy. In *Gabelli v. SEC*, the Supreme Court held that § 2462 applied to the SEC's civil penalty authority. 568 U.S. 442, 454 (2013). But the applicability of § 2462 to disgorgement remained an open question subject to a circuit split.

[1] The opinion in *Kokesh v. SEC* is available at https://www.supremecourt.gov/opinions/16pdf/16-529_i426.pdf.

The SEC defended the lower court's ruling by arguing that disgorgement is not a penalty, but an equitable remedy meant only to put the defendant back in the position he was in prior to the illegal conduct. Kokesh, on the other hand, argued that the disgorgement operated as a penalty or forfeiture, and thereby implicated the five-year statute of limitations imposed by § 2462.

In a unanimous opinion authored by Justice Sotomayor, the Supreme Court sided with Kokesh holding that disgorgement does in fact constitute a penalty. As such, any claim seeking disgorgement must commence within five years of the date the claim accrued.

In reaching its conclusion, the Supreme Court relied on two established penal principles. First, that penalties are meant to redress public, rather than individual wrongs. Second, pecuniary sanctions operate as penalties if they seek to punish or deter, rather than compensate. The Court determined that disgorgement is a penalty because: (1) disgorgement is often imposed for violating public laws meant protect the interests of the United States; and (2) disgorgement awards are punitive in nature, aiming to punish the offender and prevent future violations. These points are supported by the fact that disgorgement proceeds are paid to and distributed by the court even when the funds will not be distributed to any victims. Indeed, the proceeds are often simply paid over to the United States Treasury. Finally, the Supreme Court found that disgorgement is not remedial because, in some circumstances, the offender is ordered to return more than the profits they received. As an example, the Court highlighted insider-trading cases where defendants were ordered to disgorge not only their own profits, but the profits their tippees earned.

Because disgorgement is accurately characterized as a penalty, the Supreme Court concluded, it is subject to § 2462's five-year limitations period on actions enforcing civil fines, penalties, and forfeiture.

The *Kokesh* decision is significant because it limits the ability of the SEC to extend its recovery in long-running investigations and lends predictability and stability to those potentially facing SEC enforcement. Going forward, *Kokesh* may lead to the SEC exploring other remedies at its disposal, and more aggressively seeking tolling agreements to suspend the running of the statute of limitations. Therefore, companies and individuals will need to consider the benefits of agreeing to such an arrangement when the SEC might not be prepared to bring an action.

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