

Footnote In Kokesh Signals Bigger Changes On The Horizon

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The U.S. Supreme Court held recently that the U.S. Securities and Exchange Commission is subject to a five-year statute of limitations on disgorgement claims. While many have recognized the ruling is no doubt a major victory for certain defendants, the immediate effects of imposing a five-year statute of limitations for disgorgement may be more limited than some are anticipating. A far more intriguing element of the opinion is found in a footnote, in which the court dropped an unobvious hint casting doubt on the SEC's ability to use disgorgement as a remedy at all. The window left partially open by the court may present an opportunity to an aggressive litigant bold enough to challenge the SEC's long-established disgorgement authority.

Supreme Court Rules § 2462's Five-Year Statute of Limitations Applies to Disgorgement

The justices unanimously held that SEC actions for disgorgement are subject to the five-year statute of limitations period set forth in 28 U.S.C. § 2462, which requires that "enforcement of any civil fine, penalty, or forfeiture" be "commenced within five years from the date when the claim first accrued."

Since the 1970s, the SEC has used its perceived authority to seek disgorgement as a tool to claw back ill-gotten gains earned by its targets from the charged conduct. This has included more than \$4 billion in recoveries each of the past three years.[1] Because, until now, the SEC considered disgorgement to be an equitable remedy — and, notably, because "disgorgement" is missing from the plain language of § 2462, which specifies only fines, penalties and forfeitures — the agency has not considered itself constrained by § 2462's limitations period. In *Kokesh*, the commission sought \$34.9 million in disgorgement for conduct dating back 14 years. The trial court held that disgorgement was not a "penalty" and therefore was not subject to the five-year statute of limitations for "any civil fine, penalty, or forfeiture" under § 2462. The Tenth Circuit affirmed.

Prior to the Supreme Court's ruling, the First Circuit[2] and the D.C. Circuit[3] had agreed with the Tenth Circuit that the statute of limitations under § 2462 did not apply to disgorgement, while the Eleventh Circuit had held the statute of limitations did apply.[4]



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With this month's decision, the Supreme Court held that disgorgement is a "penalty within the meaning of § 2462, and so disgorgement actions must be commenced within five years of the date the claim accrues." [5] The court determined that disgorgement is a penalty because (1) the SEC seeks the remedy on behalf of the United States and not the aggrieved individual(s); (2) the primary purpose of the remedy is punitive in nature; and (3) disgorgement is often not compensatory. [6] The court explained: "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." [7]

The Immediate Effects of the Decision

The Kokesh decision will undoubtedly affect SEC investigations and enforcement actions. Most obviously, the five-year statute of limitations apparently means that those under SEC investigation no longer have to worry about facing disgorgement for misconduct that occurred prior to those five years. This ruling grants a degree of predictability over the total funds subject to possible disgorgement claims and may assist SEC defendants and respondents in better gauging the total cost of a settlement in an enforcement action when deciding how to respond to an SEC invitation for settlement discussions.

However, the tangible benefits may be blunted because the enforcement staff may increasingly require those under investigation to enter into tolling agreements of § 2462's statute of limitations as a condition of entering settlement discussions, which would allow the commission to continue to collect disgorgement beyond the limitations period. [8]

But while the Kokesh opinion restricts the ability of the enforcement staff to continue its disgorgement collection efforts to the statutory period, the agency currently has a number of other equitable remedies with which to address misconduct that currently falls outside the limitations period.

The SEC has authority to impose "any equitable relief that may be appropriate or necessary for the benefit of investors." [9] That equitable relief may include at least:

- Enjoining violations of securities laws;
- Prohibiting individuals from serving as officers or directors of public companies; and
- Revoking or suspending a license so that an individual cannot work in the securities industry.

While statutory remedies are subject to § 2462, the five-year statute of limitations does not apply to these and other equitable remedies, unless they seek to punish. [10] The commission's remaining equitable remedies are powerful. It may be of small comfort to a person facing expulsion from their chosen industry to know that their potential disgorgement has been limited.

The Kokesh decision may also lead the SEC to lean more heavily on its traditional equitable remedies. With the possibility for disgorgement off the table for misconduct beyond the five-year statute of limitations, subjects of enforcement actions can no longer seek to bargain away the more harmful equitable remedies, such as a permanent suspension or expulsion from the industry, by offering to pay larger disgorgement. The decision may also lead the SEC staff to move more quickly in its investigations and be more resistant to Wells deadline extensions that are not paired with a costly tolling agreement. And finally, the severe reputational repercussions of simply being charged in an SEC matter remain unchanged. Regardless of the financial cost of possible disgorgement, the most important strategic consideration for subjects of an SEC inquiry remains to avoid charges.

Thus, on the whole, the SEC's toolbox of equitable remedies remains robust, and, in some instances, the loss of disgorgement as a remedy may work against the interests of investigation subjects.

Opportunities for Real Damage to the SEC's Toolbox

The *Kokesh* decision does offer a hint at the future to the aggressive litigant subject to a disgorgement claim. Justice Sonia Sotomayor included the following pertinent footnote in the court's opinion:

Nothing in this opinion should be interpreted as 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 sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period.[11]

Aggressive litigants may see this language as an invitation from the Supreme Court to challenge whether the SEC is authorized to seek disgorgement in any case.

During oral arguments, questions from several justices indicated that the SEC may not have authority to seek disgorgement. Justice Anthony Kennedy asked, "Is there specific statutory authority that makes it clear that the district court can entertain this remedy?"[12] Justices Sotomayor and Samuel Alito asked for the source of authority for seeking disgorgement.[13] Justice Neil Gorsuch tellingly added that "there's no statute governing [disgorgement]. We're just making it up." [14] With their questioning at oral argument — which spanned across the justices' ideological spectrum — and the inclusion of Justice Sotomayor's footnote in the unanimous decision, the justices may be signaling that the court is willing to listen to future challenges of the SEC's disgorgement authority.

Whether the SEC heeds the potential warning remains to be seen. Even with this clear signal, however, it is doubtful that the enforcement staff will alter its disgorgement position in any material way. Should the staff ignore the clear signal (as it does from time to time), the next aggressive litigant may consider using the prospect that the commission's disgorgement authority may be in question to leverage a beneficial settlement. If pushed by aggressive counsel, the commission staff may be more willing to scale back their demands rather than risk losing the apparent authority to seek disgorgement in any case. The Supreme Court's clear interest in this topic, combined with the unanimous ruling in *Kokesh*, provides the SEC defense bar with the next open question to challenge commission authority.

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[1] Press Release, Securities and Exchange Commission, SEC Announces Enforcement Results for FY 2016 (Oct. 11, 2016), available at <https://www.sec.gov/news/pressrelease/2016-212.html>.

[2] SEC v. Tambone, 550 F.3d 106, 148 (1st Cir. 2008).

[3] Riordan v. SEC, 627 F.3d 1230, 1234 (D.C. Cir. 2010).

[4] SEC v. Graham, 823 F.3d 357, 1363 (11th Cir. 2016).

[5] Kokesh v. SEC, 581 U.S. ___, 2017 WL 2407471, at *1 (2017).

[6] Id. at *8.

[7] Id.

[8] Securities and Exchange Commission, Division of Enforcement, Enforcement Manual § 6.2.1 (Oct. 28, 2016), available at <https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

[9] 15 U.S.C. § 78u(d)(1-6).

[10] SEC v. Graham, 823 F.3d 1357, 1361 (11th Cir. 2016); SEC v. Bartek, 484 Fed. Appx. 949, 956 (5th Cir. 2012); SEC v. Quinlan, 373 Fed. Appx. 581, 586-88 (6th Cir. 2010). However, as demonstrated in Bartek, traditional equitable remedies such as officer/director bars may, based on the facts and circumstances of a case, constitute penalties and therefore can be subject to the five-year statute of limitations under § 2462. 484 Fed. Appx. at 956.

[11] Kokesh v. SEC, 581 U.S. ___, 2017 WL 2407471, at *5, n. 3 (2017).

[12] Transcript of Oral Argument at 7-8, Kokesh v. SEC, 581 U.S. ___ (2017), available at https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/16-529_21p3.pdf.

[13] Transcript of Oral Argument at 9, 13, Kokesh v. SEC, 581 U.S. ___ (2017), available at https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/16-529_21p3.pdf.

[14] Transcript of Oral Argument at 52, Kokesh v. SEC, 581 U.S. ___ (2017), available at https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/16-529_21p3.pdf.