

## Supreme Court Unanimously Holds that SEC Disgorgement is Subject to Five Year Statute of Limitations

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A unanimous Supreme Court held on June 5, 2017, that the SEC's ability to recover funds through disgorgement is subject to a five-year statute of limitations. The SEC routinely seeks disgorgement as an equitable remedy in actions alleging securities law violations and asserted that disgorgement was not a penalty subject to the five year statute of limitations under 28 U.S.C. § 2462. The Supreme Court disagreed, finding that because disgorgement is a punitive sanction, it is a penalty. The decision resolves a previous circuit split regarding the application of Section 2462 to SEC disgorgement actions.<sup>1</sup> The Supreme Court's decision likely will impact the conduct of the SEC staff in ongoing and future investigations.

In *Kokesh v. Securities and Exchange Commission*, the petitioner was an investment advisor who provided advice to business-development companies. In 2009, the SEC brought an enforcement action against Kokesh alleging that he misappropriated funds from four of the development companies he advised between 1995 and 2009. Following a five-day trial, a jury found that Kokesh had violated the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Securities Exchange Act of 1934.

The district court imposed a civil penalty of \$2.4 million and disgorgement of \$34.9 million, \$29.9 million of which was attributed to conduct that occurred outside of the five-year limitation period in 28 U.S.C. § 2462. Section 2462 establishes a five-year limitation period for an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture. In awarding the entire disgorgement amount, the district court held that disgorgement was not a penalty and therefore not subject to that five-year limitation. Kokesh appealed the decision, and the Court of Appeals for the Tenth Circuit affirmed.

The Supreme Court reversed, holding that disgorgement is indeed a penalty subject to the limitation period in Section 2462. According to the Court, disgorgement (i) is imposed as a consequence for violating public laws, (ii) is imposed for punitive purposes, and (iii) in many cases, is not compensatory. In other words, it "bears all the hallmarks of a penalty."

The Court rejected the SEC's argument that disgorgement is simply remedial. Disgorgement does not "simply return[] the defendant to the place he would have occupied had he not broken the law," the Court held. In some cases, for example, SEC disgorgement can exceed the profits gained through unlawful activity, leaving the defendant worse off than he or she was prior to the unlawful conduct.

The Court's holding in *Kokesh* is a major development in the world of SEC enforcement. As demonstrated by the facts of *Kokesh*, the SEC often seeks disgorgement based in large part on alleged conduct that occurred outside a five-year limitations period. This holding limits the Commission's ability to pursue complete disgorgement in many cases involving older conduct and

will likely change the Enforcement Staff's calculus in making charging recommendations. The holding could also remove some of the Commission's leverage in negotiating settled enforcement actions.

As a practical matter, the decision likely will encourage the Commission's enforcement staff to push the pace of investigations. With additional pressure to bring a case within five years of an action occurring, companies responding to Staff investigations may experience accelerated timelines, less flexibility in responding to subpoenas and information requests, and more frequent requests for tolling agreements to suspend the running of that five-year statute of limitations.

Read *Kokesh v. Securities and Exchange Commission* [here](#).

For more information please contact one of the lawyers listed below.

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<sup>1</sup> Compare *SEC v. Graham*, 823 F. 3d 1357 (11th Cir. 2016) (holding that disgorgement fell within the ordinary meaning of forfeiture and was subject to § 2462 limitations) with *SEC v. Kokesh*, 834 F.3d 1158 (10th Cir. 2016) (joining the First and D.C. Circuits and holding that disgorgement was remedial, not punitive)