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Kokesh v. SEC Decision Will Impact FCPA, Other Commission Enforcement Programs

by Adam G. Unikowsky

In *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), the U.S. Supreme Court held that the five-year statute of limitations in 28 U.S.C. § 2462 applies to Securities and Exchange Commission (SEC or the Commission) claims for disgorgement. The Court's holding is a welcome development for defendants in enforcement actions seeking to avoid defending against stale disgorgement claims. *Kokesh* also provided an unexpected, added benefit, indicating that SEC's ability to obtain *any* disgorgement in federal court enforcement actions remains open to question—thus leaving the door open for a future decision that could constrain the Commission to an even greater extent.

Kokesh addressed one of the most powerful arrows in SEC's enforcement quiver: the remedy of disgorgement. When Congress created SEC in 1948, it did not confer any express power to pursue monetary sanctions. Rather, the Commission could only invoke a district court's equitable power to seek injunctions or ancillary relief. In the 1970s, however, SEC began pursuing a newly-invented remedy known as "disgorgement." SEC characterized disgorgement as an equitable remedy ancillary to an injunction, on the theory that that effective relief for violations of the securities laws was impossible unless the wrongdoers were made to disgorge—that is, give up—the proceeds of illegal activity. SEC's first success came in 1970, when it persuaded a court that it possessed the power to impose this sanction. *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77 (S.D.N.Y. 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2d Cir. 1971).

After its success in *Texas Gulf Sulphur*, SEC began seeking disgorgement more frequently. In 1990, Congress authorized SEC to seek monetary penalties as a result of securities violations, but SEC continued seeking disgorgement in almost every case. SEC has also successfully argued for the disgorgement remedy to have a wide scope. For instance, it has persuaded courts to order disgorgement of all proceeds of illegal activity—regardless of whether they reached the wrongdoer. *See, e.g.*, *SEC v. Contorinis*, 743 F.3d 296, 302 (2d Cir. 2014).

One oft-disputed issue was whether a statute of limitations applied to disgorgement. Given that disgorgement itself was an implied remedy, Congress unsurprisingly never enacted a statute of limitations that expressly applied to disgorgement. Civil defendants argued, however, that disgorgement was a form of "penalty" or "forfeiture," and thus subject to the five-year statute of limitations for penalties and forfeitures in 28 U.S.C. § 2462. SEC, by contrast, argued that disgorgement was a non-penal remedy, and that neither § 2462, nor any other statute of limitations, applied.

This issue arose in an enforcement action filed against New Mexico investment advisor Charles Kokesh. In 2009, SEC commenced an enforcement action against Kokesh, alleging violations of the securities laws dating back to 1995. After a jury found Kokesh liable, the district court ordered Kokesh to disgorge over $34 million—which comprised his ill-gotten gains dating back to 1995, 14 years before the filing of the complaint. The Tenth Circuit affirmed, rejecting Kokesh's argument that the five-year statute of limitations applied to disgorgement.

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The Supreme Court reversed, holding that disgorgement is a "penalty" and hence subject to its statute of limitations. The Court explained that "penalty" refers to "something imposed in a punitive way for an infraction of a public law," but "does not include a liability imposed solely for the purpose of redressing a private injury." *Id.* at 1643 (quotation marks and brackets omitted). It concluded that disgorgement qualified as a penalty under that standard for three reasons. First, disgorgement is imposed as a "consequence for violation ... of public laws." *Ibid.* The Court noted that securities enforcement actions can proceed even if the victims are not parties or oppose the lawsuit. Second, "SEC disgorgement is imposed for punitive purposes." *Ibid.* The Court cited lower-court authority holding that disgorgement's primary purpose is to deter violations of the securities laws. Third, "SEC disgorgement is not compensatory." *Id.* at 1644. The Court acknowledged that courts have discretion to order disgorged funds to be paid to victims, but noted that such payments are not required, and some disgorged funds go to the Treasury.

The Court then rejected SEC's primary argument—that disgorgement is not punitive because it restores the status quo. SEC's theory was that disgorgement restores the wrongdoer to the position he would have occupied without the wrongdoing. Thus, SEC insisted, disgorgement is not a penalty; the goal of a penalty is to make the wrongdoer worse off.

The Court gave two arguments for rejecting this theory. First, in many cases, disgorgement does not restore the status quo. The Court cited lower-court cases in which insider traders were required to disgorge unlawful gains that went to third parties, or tippers were forced to disgorge unlawful gains that went to tippees. *Id.* at 1644-45. It also pointed out that "SEC disgorgement sometimes is ordered without consideration of a defendant's expenses that reduced the amount of illegal profit." *Ibid.* As the Court noted, lower courts have justified such broad disgorgement by stressing the need to deter wrongdoing—emphasizing disgorgement's punitive nature.

Second, the Court reasoned that remedies which serve both remedial and non-remedial purposes are classified as punitive. The Court cited authority holding that "civil sanction[s] that cannot fairly be said *solely* to serve a remedial purpose," but instead "constitute[] punishment even in part," are punishment. *Id.* at 1645. The Court recognized that "disgorgement serves compensatory goals in some cases," but found that because it served noncompensatory goals as well, it was a punishment." *Id.*

Kokesh will have a significant effect on SEC's enforcement program, particularly with regard to the Foreign Corrupt Practices Act (FCPA). The lack of a statute of limitations not only allowed SEC to recover large disgorgement judgments and settlements dating back forever in time, but also enhanced SEC's leverage in settlement negotiations. Indeed, many of SEC's high-money FCPA settlements required defendants to disgorge money related to conduct outside the five-year limitations period. The Supreme Court's decision protects defendants subject to stale disgorgement claims by ensuring that disgorgement—like virtually every other monetary remedy—is subject to a time bar. Although SEC can enter into tolling agreements to prevent statutes of limitations from expiring, *Kokesh* may persuade the targets of investigations not to accede.

Kokesh also included a footnote that may have far-reaching implications. At oral argument the Court expressed doubt about whether disgorgement is authorized by statute. In response, Petitioner's counsel expressed similar doubt but urged the Court to take disgorgement as it currently finds it. The Court did so, while noting in a footnote: "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." *Id.* at 1642 n.3.

This footnote signals the Court's willingness to consider an argument that SEC lacks *any* authority to pursue disgorgement in judicial enforcement proceedings—an argument that would likely have failed in lower courts before *Kokesh*, given that courts have been ordering disgorgement for several decades. If such an argument succeeds, the effect on SEC's enforcement program will be even greater.

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