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U.S. Supreme Court Reverses Tenth Circuit –Limits SEC Disgorgement Claims to Five Years

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On June 5, 2017, The United States Supreme Court held that because SEC disgorgement operates as a penalty under 28 U.S.C. §2462, any claim for disgorgement in an SEC enforcement action must be brought within five years of the date the claim accrued. The unanimous decision in *Kokesh v. SEC* resolved a circuit split and overturned a 10th Circuit decision. Each year, the SEC brings hundreds of enforcement actions – seeking disgorgement. In 2015 alone, the SEC extracted \$3 billion in disgorgement payments.

Federal law applies a five-year statute of limitations to penalties, forfeitures, and other punitive remedies sought in civil enforcement matters – a time bar that the Supreme Court upheld unanimously in its 2013 ruling in *Gabelli v. SEC*. The issue of disgorgement, however, was an open question.

Kokesh claimed that disgorgement is either a “forfeiture” or a “penalty” and therefore the statute should apply. He also claimed that disgorgement should fall under the statute because otherwise respondents would be indefinitely liable for alleged misconduct and could face difficult-to-defend-against “stale claims.” The SEC argued that disgorgement was neither a “forfeiture” nor a “penalty” – rather it simply prevents a wrongdoer from enjoying unjust enrichment.

The question faced by the Supreme Court in this case was whether the remedy of disgorgement is “equitable” in nature (and therefore exempt from a five-year statute of limitations) or “punitive” in nature (and therefore subject to the statute).

The case

Charles Kokesh misappropriated \$34.9 million of investors’ funds between 1995 and 2006. The SEC filed an enforcement action in U.S. District Court in New Mexico against Kokesh in 2009. After a jury verdict, the SEC moved for entry of judgment. The District Court ordered civil penalties of \$2.4 million for misconduct between 2004 and 2006 and disgorgement of the entire amount diverted during 1995 to 2006 – \$34.9 million plus an additional \$18 million in prejudgment interest.

In August 2016, the U.S. Court of Appeals for the 10th Circuit held that the

disgorgement order was not “a penalty or forfeiture within the meaning of §2462” and thus was not time-barred by 28 U.S.C. §2462. The 10th Circuit's ruling was in accord with previous decisions in the D.C. Circuit and the First Circuit. Only the 11th Circuit had ruled that disgorgement was effectively the same as a forfeiture and thus subject to the five-year statute of limitations.

Some takeaways

During arguments this past April, new Justice Neil Gorsuch pointedly stated that there was no law governing disgorgements – only SEC regulations. He expressed alarm about a growing administrative state and seemed to signal a belief that this was another example of an agency operating without congressional directive. “We're just making it up,” said Gorsuch.

This decision provides defendants with more certainty about potential liability in the face of SEC enforcement efforts. In addition, defendants that already disgorged profits dating back more than five years could potentially seek to have their cases re-opened.

The SEC may also be compelled now to accelerate the pace of its investigations and enforcement actions – to fit as much of a case as possible into the five-year disgorgement period.

For more information about how the U.S. Supreme Court's decision in *Kokesh v. SEC* might affect your business, please contact Holly Stein Sollod at 303-295-8085.

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