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The U.S. Supreme Court Puts S.E.C. Disgorgement Actions on the Clock

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The U.S. Supreme Court continues to limit the timeframe in which the U.S. Securities and Exchange Commission ("S.E. C.") can seek to levy monetary penalties in enforcement actions it brings against violators of the federal securities laws. Most recently, the Court limited to five years the window of time in which the S.E.C. can bring a claim to "disgorge," or take away, ill-gotten gains from a defendant's securities fraud. These rulings may result in quicker or more aggressive enforcement actions by the S.E.C. against companies or individuals accused of securities fraud, even perhaps before investigations are complete. The holdings may also affect the willingness of corporate or individual defendants to enter into "tolling agreements" with the S.E.C. that would toll (or stop) the limitations period while the parties discuss a potential resolution or settlement.

On June 5, 2017, the U.S. Supreme Court decided ***Kokesh v. U.S. Securities and Exchange Commission***, holding that the S.E.C.'s disgorgement remedy in S.E.C. enforcement actions constitutes a "penalty," and is thus subject to the five year statute of limitations under 28 U.S.C. 2462. The *Kokesh* Court resolved a federal circuit court of appeals split on whether Section 2462 applies to S.E.C. disgorgement claims.

Section 2462 requires in relevant part that an "action, suit or proceeding for the enforcement of any civil *fine, penalty or forfeiture*, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." (emphasis added). Disgorgement is an equitable remedy available to the S.E.C. in enforcement actions that requires the defendant to "give up those gains properly attributable to the defendant's interference with the claimant's legally protected rights."

The court in *Kokesh* pointed out that to be considered a "penalty," a remedy must "punish" a crime or offense against the laws of the State, and not simply compensate victims of fraud. "'Penalties' in the context of §2462 'go beyond compensation, are intended to punish, and label defendants wrongdoers.'" *Kokesh*, ___ S Ct. ___ (quoting *Gabelli v. S. E.C.*, 133 S. Ct. 1216, 1223 (2013)). The S.E.C. argued that the five year limitations period of Section 2462 did not apply because disgorgement is not a "penalty," but rather a "remedial" remedy that serves the "compensatory goals" for victims of securities fraud.

The Court rejected the S.E.C.'s position, and found disgorgement to be a "penalty" for three articulated reasons:

1. Disgorgement is imposed as a "consequence for violating . . . the public laws," and may proceed even if the victim of the fraud does not support or is not a party to the disgorgement proceeding. So, according to the Court, disgorgement is not merely a tool for compensating securities fraud victims, but rather 'to remedy harm to the public at large,' 'independent of the claims of individual investors.'

2. S.E.C. disgorgement is imposed primarily for punitive purposes — to punish offenders of the securities laws and "deter violations of the securities laws by depriving violators of their ill-gotten gains. Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because 'deterrence is not a legitimate nonpunitive governmental objective."

3. S.E.C. disgorgement is often not compensatory. While some disgorged funds are paid to victims at the discretion of the district court, "other funds are dispersed to the Unites States Treasury. When an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty."

In 2013, the Supreme Court found that the civil penalties the S.E.C. may impose in its enforcement actions was a "penalty" subject to the five year limitations period in Section 2462. *Gabelli*, 133 S. Ct. 1216 (2013). Importantly, the Court in *Gabelli* also ruled that the "discovery rule" did not apply to toll the five year limitations period in S.E.C. enforcement actions. In other words, a claim "first accrues" under Section 2462 when the violation occurs, not when the S.E.C. discovered or should have discovered the claim with reasonable diligence. As relevant to the *Kokesh* decision, the Court in *Gabelli* so found in part because the "case involves penalties, which go beyond compensation, are intended to punish, and label defendants as wrongdoers." *Gabelli*, 133 S. Ct. at 1223. The *Gabelli* Court noted that the issue of whether Section 2462 applied to bar the disgorgement claims was not before it. *Gabelli*, 133 S Ct. at 1220 n.1.

Since the *Kokesh* Court has now labeled disgorgement a penalty, the reasoning in *Gabelli* squarely applies such that the S.E.C.'s disgorgement actions will not have the benefit of the "discovery rule" and must be brought within five years of the violation being remedied.

If you have any questions about any of the issues discussed herein, or state and federal securities laws in general, please contact Matthew Allen, Thomas Cranmer, or any Miller Canfield attorney.

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