Securities Litigation & Enforcement News | Alert

January 2017

The Supreme Court Agrees to Determine Whether SEC Actions Seeking Disgorgement are Subject to the Five-Year Limitations Period Set Forth in 28 U.S.C. § 2462

At the urging of both an individual petitioner and the SEC, the Supreme Court has agreed to resolve a recent circuit split as to whether the five-year limitations period applicable to SEC enforcement actions applies to the remedy of disgorgement. *Kokesh v. SEC*, __ S. Ct. __, No. 16-529, 2017 WL 125673 (U.S. Jan. 13, 2017). The issue is whether disgorgement is a "penalty" or "forfeiture" for purposes of the five-year limitations period in 28 U.S.C. § 2462, which applies to government actions seeking a "civil fine, penalty, or forfeiture." If, on the other hand, disgorgement is an equitable remedy akin to injunctive relief, then a long line of cases holds that the statute would not apply. Last year saw two U.S. Courts of Appeal reach diametrically opposed conclusions on this question. In May, the Eleventh Circuit held that disgorgement is a "forfeiture" subject to the five-year limitations period. *See SEC v. Graham*, 823 F.3d 1357, 1363-64 (11th Cir. 2016). Three months later, the Tenth Circuit held that disgorgement is neither a "penalty" nor a "forfeiture" and therefore is not subject to the five-year limitations period. *See SEC v. Kokesh*, 834 F.3d 1158, 1166-67 (10th Cir. 2016).

SEC v. Graham

In *Graham*, the Eleventh Circuit considered whether SEC actions seeking declaratory relief, injunctive relief, and disgorgement of profits from illegal ventures are subject to the five-year limitations period of Section 2462. In determining whether an injunction or a declaratory judgment would be subject to the five-year limitations period, the court considered whether they would constitute a "penalty" within the meaning of the statute and concluded that a "penalty" is a punishment imposed for *past* wrongdoing. *See Graham*, 823 F.3d at 1361. Based on that definition, the Court held that injunctions are not penalties because they prevent *future* harms and, therefore, Section 2462's five-year limitations period is inapplicable to claims for injunctive relief. *See id.* at 1362.

Turning to the question of whether actions seeking declaratory relief are subject to a five-year limitations period, the *Graham* court held that a declaration that defendants violated the securities laws is a "penalty" because it is "backward-looking and operates as a penalty." *Id.* at 1362-63. "A declaration of liability goes beyond compensation and is intended to punish because it serves neither a remedial nor a preventative purpose; it is designed to redress previous infractions rather than to stop any ongoing or future harm." *Id*. at 1362 (citation omitted). Therefore, the court held that the SEC's request for declaratory relief was subject to Section 2462's five-year statute of limitations.

The court did not reach the issue of whether disgorgement is a "penalty," *see id*. at 1363 n.3, but had no difficulty finding that it constitutes a "forfeiture" for purposes of Section 2462. The appellate court agreed with the district court that "'the disgorgement of all ill-gotten gains realized from the alleged violations of the securities laws—*i.e.*, requiring defendants to relinquish money and property—can truly be regarded as nothing other than a forfeiture (both pecuniary and otherwise)[.]'" *Id*. at 1363. Finding "no meaningful difference in the definitions of disgorgement and forfeiture[,]" the court applied Section 2462's five-year limitation to forfeiture actions and barred the SEC's claim for disgorgement. *Id*. at 1363-64.

SEC v. Kokesh

In *Kokesh*, the Tenth Circuit agreed with *Graham* that SEC claims for injunctive relief are not subject to the five-year limitations period because they are remedial and do not constitute a penalty or forfeiture, but parted company with the Eleventh Circuit as to whether disgorgement constitutes a "forfeiture." The Tenth Circuit agreed with the D.C. Circuit in *Riordan v. S.E.C.*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) and the First Circuit in *S.E.C. v. Tambone*, 550 F.3d 106, 148 (1st Cir. 2008), that disgorgement is not a "penalty" because it is remedial: "Properly applied, the disgorgement remedy does not inflict punishment. 'The object of restitution [in the disgorgement context] . . . is to eliminate profit from wrongdoing while avoiding, so far as possible, the imposition of a penalty.'" 834 F.3d at 1164 (citing Restatement (Third) of Restitution and Unjust Enrichment § 51(4)).

Disagreeing with *Graham*, the Tenth Circuit rejected the argument that disgorgement is a "forfeiture." It acknowledged that "the words *forfeit* and *disgorge* (as well as *relinquish*) capture similar concepts; one subject to formal forfeiture could be said to 'disgorge' what is forfeited." *Id*. at 1165. However, the court explained that the word *forfeiture* in § 2462 must be read in the context of a government civil forfeiture action which, as defined in *Black's Law Dictionary*, is "[a]n in rem proceeding brought by the government against property that either facilitated a crime or was acquired as a result of a criminal activity." *Id.* at 1165-66. After a short review of the history of civil forfeiture actions, the court explained that in such actions "[t]he owner of the seized property could be completely innocent of any wrongdoing, and the value of the property taken have no necessary relation to any loss to others or gain to the owner." *Id*. at 1166. While the court acknowledged that "in recent years federal forfeiture statutes have been expanded to include disgorgement-type remedies" such as the forfeiture of proceeds from criminal activities, it observed that "this is a recent development, occurring decades after § 2462 was enacted in 1948." *Id*. The court concluded: "When the term *forfeiture* is linked in § 2462 to the undoubtedly punitive actions for a *civil fine* or *penalty*, it seems apparent that Congress was contemplating the meaning of *forfeiture* in this historical sense. The nonpunitive remedy of disgorgement does not fit in that company." *Id*.

CONCLUSION

The *Kokesh*, *Riordan*, and *Tambone* line of cases seems overly formalistic and dependent on the fading and somewhat archaic distinctions between "legal" remedies and "equitable" ones. More importantly, those cases do not adequately account for the lack of any meaningful economic distinction between a "penalty" (or "forfeiture") of some amount of money and a disgorgement of the same sum. In either case the government is seizing property, and the finality goals of the statute of limitations are frustrated if the SEC can swoop in many years after the events at issue – and after evidence has been lost, witnesses have died or disappeared, and memories have faded – and extract a pound of flesh that it then labels "disgorgement."

While not directly on point, the Supreme Court's unanimous decision in *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) may affect the Court's disposition of *Kokesh*. In *Gabelli*, the Court held that Section 2462 is not tolled by the "discovery rule" applicable to private securities actions and that the five-year clock for the SEC to seek monetary penalties begins to tick

when the alleged fraud occurs, not when the SEC discovers it. The *Gabelli* Court did not reach the question of whether the SEC's requests for injunctive relief and disgorgement were governed by Section 2462, as those issues were not before it. *See id*. at 1120 n.1. But the Court's refusal to give the government the same leeway accorded private litigants suggests that it may be inclined to hold the government's feet to the fire when it fails to act within the statutory period.

This *GT Alert* was prepared by Greenberg Traurig Shareholder and Co-Chair of the D&O Securities Litigation Practice, **Robert A. Horowitz**, and Shareholders in the Securities Litigation and White Collar Defense & Special Investigations Groups, **Donald S. Davidson**, and **Jason S. Lewis.** Questions about this information can be directed to:

- Robert A. Horowitz | +1 212.801.2194 | horowitzr@gtlaw.com
- Donald S. Davidson | +1 415.655.1317 | davidsonds@gtlaw.com
- Jason S. Lewis | +1 214.665.3606 | lewisjs@gtlaw.com
- Or your Greenberg Traurig attorney

Albany
+1 518.689.1400

Amsterdam
+ 31 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Berlin¬
+49 (0) 30 700 171 100

Berlin-GT Restructuring¯
+49 (0) 30 700 171 100

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Delaware
+1 302.661.7000

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0)203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 55 5029.0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

New York
+1 212.801.9200

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+82 (0) 2.369.1000

Shanghai
+86 (0) 21.6391.6633

Silicon Valley
+1 650.328.8500

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+03.636.6000

Tokyo¤
+81 (0)3 4510 2200

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900