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Supreme Court's SEC decision could limit other federal agencies

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The Supreme Court held in *Kokesh v. Securities and Exchange Commission*, No. 16-529, 2017 WL 2407471 (U.S. June 5, 2017), that SEC suits seeking disgorgement of gains obtained in violation of the federal securities laws are subject to a five-year statute of limitations.

The high court's decision is likely to have a significant impact — and not just on the SEC. Many other federal agencies, particularly including the Federal Trade Commission, have long advanced arguments similar to those the Supreme Court unanimously rejected in *Kokesh*.

The Supreme Court's decision that a five-year statute of limitations applies to disgorgement claims will likely limit federal agencies' ability to obtain monetary relief for long-standing misconduct.

More importantly, the court's opinion expresses doubt as to whether any monetary relief is available under statutes that explicitly authorize only injunctions.

A future Supreme Court ruling that monetary relief is indeed unavailable under such statutes would be a bombshell. It would dramatically change how agencies have litigated for decades.

Both for its statute-of-limitations holding and for the doubt that it casts on implied monetary remedies, the effects of *Kokesh* could be felt for years.

KOKESH DECISION

The SEC brought a civil action against Charles Kokesh, accusing him of misappropriating $34.9 million in violation of federal securities laws between 1995 and 2009. The jury found that Kokesh violated the securities laws.

As a remedy, the SEC requested disgorgement of all $34.9 million of Kokesh's ill-gotten gains under three securities statutes — 15 U.S.C.A. §§ 78u, 80b-9 and 80a-41 — that enable district courts to award injunctions but do not expressly authorize disgorgement.

Kokesh agreed the court could order disgorgement. But he argued that $29.9 million of the amount sought fell outside the five-year statute of limitations under 28 U.S.C.A. § 2462, which applies to government actions for a "civil fine, penalty, or forfeiture."

U.S. Magistrate Judge Stephan M. Vidmar of the District of New Mexico held that the statute of limitations did not apply because disgorgement is not a "penalty."

He ordered disgorgement of all $34.9 million and awarded an additional $2.3 million in civil fines as well as $18.1 million in prejudgment interest.

The 10th U.S. Circuit Court of Appeals affirmed.

In a unanimous opinion written by Justice Sonia Sotomayor, the Supreme Court reversed.

The court held that the SEC's claim for disgorgement sought a "penalty" against Kokesh and therefore was subject to the five-year limitations period.

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A remedy is a "penalty" if it addresses a wrong to the public rather than to individual victims and if its purpose is to punish the defendant and deter others from committing future violations, the court explained.

The court determined that SEC disgorgement claims satisfy both elements.

Violations of the securities law are a wrong "against the United States rather than an aggrieved individual," the opinion said.

The court added that disgorgement serves punitive purposes by depriving violators of their ill-gotten gains and deterring others.

In many cases, SEC disgorgement is not compensatory because the funds do not go to the victims; some funds are dispersed to the U.S. Treasury, the top court said.

It noted that disgorgement "sometimes exceeds" the defendant's profits and therefore leaves the defendant "worse off."

And the court held that, even if disgorgement sometimes serves compensatory goals, it nevertheless serves retributive and deterrent purposes and therefore is a penalty.

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EFFECT OF THE RULING

The decision in *Kokesh* will have a huge impact on the SEC.

The Supreme Court's ruling categorically subjects disgorgement claims to the
five-year statute of limitations. "Any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued," the court said.

That holding will limit the SEC's ability to obtain monetary relief for long-standing securities violations, a remedy that the agency has aggressively pursued in recent years.

As noted, $29.9 million of the $34.9 million that the SEC sought in disgorgement in *Kokesh* fell outside the five-year window.

Defendants facing SEC suits will now be sure to raise statute of limitations as a defense when the SEC seeks disgorgement of gains dating back more than five years.

But the impact of *Kokesh* is likely to be felt far beyond the SEC.

This is because many other federal agencies have similarly attempted to sidestep the same five-year statute of limitations.

The Federal Trade Commission, for example, routinely argues that it faces no statute of limitations when it seeks monetary relief under Section 13 of the Federal Trade Commission Act, 15 U.S.C.A. § 53(b), in suits alleging unfair and deceptive business practices.

Until now, courts have generally agreed. For example, in *United States v. Dish Network LLC*, 75 F. Supp. 3d 942, 1004 (C.D. Ill. 2014), the court held that "claims for equitable relief under Section 13(b) are simply not subject to any statute of limitations."

That reasoning is now in doubt.

Though disgorgement is a claim for equitable relief, the Supreme Court held in *Kokesh* that it functions as a penalty when the government seeks to take funds from the defendant and place them in the U.S. Treasury.

The FTC typically seeks that remedy.

Indeed, the 2nd U.S. Circuit Court of Appeals has held that, when the FTC obtains monetary relief under Section 13, the agency "may, as a matter of grace, attempt to return as much of the disgorgement proceeds as possible, [but] the remedy is not, strictly speaking, restitutionary at all, in that the award runs in favor of the Treasury, not of the victims."[1]

The *Kokesh* decision holds that this type of relief is a penalty that is subject to the five-year statute of limitations. As a result, defendants facing FTC actions under Section 13 based on long-standing conduct would do well to raise, and preserve for appellate review, a statute of limitations defense.

Kokesh can also affect enforcement actions brought by the Commodity Futures Trading Commission. Like the SEC and FTC, the CFTC has argued that the five-year statute of limitations does not apply when the CFTC is seeking equitable relief, such as disgorgement and restitution.[2]

That argument will be much more difficult to maintain after *Kokesh*.

These are just two examples of other federal agencies that may be impacted by *Kokesh*. More broadly, whenever any federal agency claims the power to disgorge gains dating back to time immemorial, courts and especially defendants should be wary.

Defense counsel should carefully study the Supreme Court *Kokesh* opinion and specifically note Justice Sotomayor's statement that statutes of limitations "are 'vital to the welfare of society' and rest on the principle that 'even wrongdoers are entitled to assume that their sins may be forgotten.'"

IMPLIED MONETARY REMEDIES

Of perhaps even greater significance is the fact that the Supreme Court's *Kokesh* decision casts doubt on whether the SEC may obtain disgorgement at all.

At oral argument, several justices questioned whether the SEC may obtain disgorgement under statutes that do not expressly authorize that remedy. Chief Justice John Roberts commented that "the SEC devised this remedy or relied on this remedy without any support from Congress."

Justice Anthony Kennedy asked: "Is it clear that the district court has statutory authority to do this? ... Is there specific statutory authority that makes it clear that the district court can entertain this remedy?"

Justice Samuel Alito said that "in order to understand what [disgorgement] is, it would certainly be helpful and maybe essential to know what the authority for it is."

And Justice Sotomayor asked, "Can we go back to the authority?"

She cited a 1990 amendment to the securities laws that authorizes civil penalties but not disgorgement as "the only authority I can imagine" for disgorgement. But she also asked, "How could that be the basis of disgorgement?"

That doubt is an undercurrent in Justice Sotomayor's opinion.

The opinion explains that, initially, the only statutory remedy available to the SEC in an enforcement action was an injunction barring future violations of securities laws.

Starting in the 1970s, courts began to order disgorgement as part of "their 'inherent equity power to grant relief ancillary to an injunction,'" the opinion said.

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And the court explained that after Congress amended the securities laws in 1990 to allow the SEC to obtain monetary civil penalties, the SEC continued to seek disgorgement in enforcement actions.

The opinion then dropped an ominous 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."

In the Supreme Court's vernacular, that is a strong signal that the court doubts whether the SEC may obtain disgorgement at all.

And that doubt should worry the SEC.

The SEC seeks disgorgement in most of its enforcement actions based on courts' *implied* powers to award disgorgement when they are sitting in equity and Congress has authorized injunctions. If courts were to hold that they lack statutory authority to order disgorgement, it would produce a sea change in SEC litigation practices.

The SEC would be forced to find some other statutory basis for monetary relief, ask Congress to amend the securities laws to give courts express authorization to award disgorgement, or simply forgo such relief.

The *Kokesh* ruling could also affect the FTC.

The agency frequently seeks disgorgement and restitution under Section 13 of the FTC Act, which authorizes only "a temporary restraining order," a "preliminary injunction," and a "permanent injunction."[3]

In fact, in a *different* section of the FTC Act, Congress authorized the FTC to obtain "the refund of money or return of property [and] the payment of damages" — but that section contains additional restrictions on the FTC's powers, including a three-year statute of limitations.[4]

Despite the presence of a separate statute that specifically authorizes monetary relief, certain appeals courts have held that district courts have the inherent authority to award disgorgement and restitution under Section 13 because Section 13 authorizes injunctions.[5]

Kokesh suggests that the Supreme Court might disagree.

This issue will also affect all other federal agencies that say courts can order monetary relief that is not expressly authorized by statute.

Defendants facing that argument should oppose the agency's claim, preserve the issue for appeal, and present it to the Supreme Court in a future petition for certiorari if necessary.

After *Kokesh*, the Supreme Court is primed to review and resolve that question in the not-too-distant future. WJ

NOTES

[1] *FTC v. Bronson Partners LLC,* 654 F.3d 359, 373 (2d Cir. 2011).

[2] *See, e.g., U.S. Commodity Futures Trading Comm'n v. Reisinger,* No. 11-cv-8567, 2013 WL 3791691, at *8 (N.D. Ill. July 18, 2013).

[3] 15 U.S.C.A. § 53(b) (West 2017).

[4] 15 U.S.C.A. § 57b(b) (West 2017).

[5] *See Bronson Partners,* 654 F.3d at 365 ("While the provision's express text refers only to injunctive relief, ... [w]e join [other] courts and hold that Section 13(b) of the FTC Act permits courts to grant ancillary equitable relief, including equitable monetary relief.").

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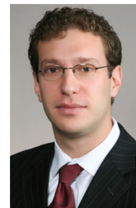

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