

## CLIENT ALERT

### Supreme Court Rules SEC Disgorgement Is a Penalty Subject to Five-Year Statute of Limitations

Jun.06.2017

On Monday, the U.S. Supreme Court dealt a blow to the SEC's ability to recover purportedly ill-gotten gains from those who run afoul of federal securities laws. In *Kokesh v. SEC*, the Court unanimously held that disgorgement in the securities enforcement context is a "penalty" and therefore subject to the five-year statute of limitations in civil enforcement actions applicable to "any civil fine, penalty or forfeiture." (28 U.S.C. § 2462).

Writing for the Court, Justice Sotomayor noted that SEC disgorgement "bears all the hallmarks of a penalty: It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate." As a result, "any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued." For Charles Kokesh – an investment adviser sued by the SEC in 2009 and from whom the SEC sought a \$34.9 million disgorgement judgement– the decision means that the amount attributed to violations outside of the limitations period (\$29.9 million) is time-barred.

The decision follows in the footsteps of the Court's 2013 *Gabelli v. SEC* decision in which it deemed the five-year limitations period applicable to statutory monetary penalties sought by the Commission, and resolves a split between the Eleventh Circuit – which previously held that disgorgement was subject to the Section 2462 statute of limitations – and the Tenth, First and D.C. Circuits which have held to the contrary. *Kokesh* also aligns with guidance issued by the IRS over one year ago (and discussed in a 2016 Crowell & Moring alert) which states that disgorgement payments to the SEC are penal in nature and therefore not deductible for tax purposes.

The full impact of *Kokesh* remains to be seen, and one open question is whether the SEC will step-up the pace of its investigation and enforcement practices as a result. Furthermore, what *Kokesh* does **not** address is also noteworthy. To this point, the Court emphasized that the decision is limited to the applicability of Section 2462's limitations period, and should not be construed as an opinion on the judiciary's "authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context." This could be a precursor of future challenges to the scope of the SEC's authority to seek disgorgement in federal courts, since Congress has never authorized that form of relief.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

**Thomas A. Hanusik**

Partner – Washington, D.C.

Phone: +1 202.624.2530

Email: [thanusik@crowell.com](mailto:thanusik@crowell.com)

**Daniel L. Zelenko**

Partner – New York

Phone: +1 212.895.4266

Email: [dzelenko@crowell.com](mailto:dzelenko@crowell.com)

**Nimrod Haim Aviad**

Partner – Los Angeles

Phone: +1 213.443.5534

Email: [naviad@crowell.com](mailto:naviad@crowell.com)

**Tiffany Wynn**

Counsel – Washington, D.C.

Phone: +1 202.624.2986

Email: [twynn@crowell.com](mailto:twynn@crowell.com)