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Note

KOKESH v. SEC: THE SUPREME COURT REDEFINES AN EFFECTIVE SECURITIES ENFORCEMENT TOOL

CONOR DALY*

The Securities and Exchange Commission ("SEC" or "Commission") possesses expansive powers to enforce the securities laws of the United States.[1] Among those powers is the SEC's ability to disgorge the wrongful profits of those who violate federal securities laws.[2] Despite the Commission's broad powers, the general statute of limitations, Section 2462,[3] restricts the time frame in which the SEC can seek certain civil remedies for misconduct.[4] In *Kokesh v. SEC*,[5] the Supreme Court of the United States determined whether the five-year statute of limitations for enforcement proceedings applies when the SEC seeks disgorgement of a defendant's ill-gotten profits.[6] The Supreme Court held that disgorgement "operat[ed] as a penalty" under the statute of limitations, and therefore, the SEC must commence an enforcement action within five years of the date of the wrongdoing in order to successfully seek disgorgement.[7]

The Court reached the correct decision in this case because the SEC used the disgorgement remedy to punish defendants for wrongs against the United States and to deter others from committing the same violations.[8] Further, the Supreme Court correctly found that the SEC did not utilize the civil remedy to compensate victims for their losses or merely return defend-

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1. SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984).
2. *See id.* at 201 (describing disgorgement as belonging within the "catalogue of permissible equitable remedies" available to the SEC).
3. 28 U.S.C. § 2462 (2012).
4. Gabelli v. SEC, 568 U.S. 442, 449, 451–52, 454 (2013) (holding that the discovery rule does not apply to § 2462 when the SEC seeks civil penalties against defendants over five years after the alleged securities fraud occurred).
5. 137 S. Ct. 1635 (2017).
6. *Id.* at 1640–41.
7. *Id.* at 1645.
8. *See infra* Part II.A.

ants to where they were before their misconduct.[9] The Court's decision, however, will likely burden the SEC's enforcement capabilities because the Commission now has less settlement leverage for violations over five years old.[10] Further, while this decision will likely restrain the SEC's Division of Enforcement, it may also lead to substantially larger costs for defendants that are ordered to disgorge their illegal profits, since civil penalties are likely not covered by insurance policies or deductible under the Internal Revenue Code.[11]

I. BACKGROUND

Section I.A of this Part discusses the formation and responsibilities of the Securities and Exchange Commission, as well as the Commission's power to enforce federal securities laws. Section I.B discusses the purpose and application of the statute of limitations for enforcing civil penalties[12] and the Supreme Court's interpretation of "penalty" under other federal laws in prior cases. Section I.C describes the procedural background of *Kokesh v. SEC*. Section I.D summarizes the reasoning of the Supreme Court in holding that Section 2462 applies to disgorgement orders.

A. *The Origins, Purpose, and Powers of the SEC*

After the stock market crash in 1929 and the resulting Great Depression, Congress passed a series of laws[13] designed to prevent the abuses[14] in the securities industry that contributed to the economic downfall of America in the 1930s.[15] Congress's main intention for passing these new regulatory schemes was to "achieve a high standard of business ethics in the securities industry."[16] Specifically, Congress enacted the Securities Exchange Act of 1934 "[t]o provide for the regulation of securities exchanges" and "to

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9. *See infra* Part II.B.

10. *See infra* Part II.C.1.

11. *See infra* Part II.C.2.

12. 28 U.S.C. § 2462 (2012) ("[A]n 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)).

13. Such legislation included the Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2012), the Securities Exchange Act of 1934, 15 U.S.C §§ 78a–78pp (2012), the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79-79 (repealed 2005), the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb(2012), the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-64(2012), and the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21 (2012). SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

14. Though many actions were proscribed under these acts, examples of abuses which Congress sought to prevent include investment advisers sharing in the profits of their clients or engaging in activities that would impact an adviser's ability to give impartial investment advice to their clients. *Capital Gains*, 375 U.S. at 189 (citing H.R. DOC. NO. 477, at 67, 29 (1940)).

15. *Id.* at 186.

16. *Id.* (citing H.R. REP. NO. 73-85 (1933)).

prevent inequitable and unfair practices on such exchanges."[17] Under these laws, the SEC has broad authority to investigate potential violations of federal securities laws and issue subpoenas[18] for evidence related to an investigation.[19]

Further, Congress provides the SEC with broad powers to enforce federal securities laws in court.[20] Whenever the SEC determines that someone is in violation, the Commission can seek an injunction against such actions.[21] The SEC can also bring an action for civil money penalties[22] in federal court against alleged violators.[23] Under this statutory scheme and the broad equitable powers of the federal courts, the SEC can bring a variety of injunctive and ancillary remedies to enforce federal securities laws.[24]

Beside injunctions, a form of ancillary or non-injunctive relief the SEC can seek in federal district courts is the disgorgement of illegally obtained profits.[25] Federal courts describe disgorgement as "a method of forcing a defendant to give up the amount by which he was unjustly enriched."[26] Upon a showing of federal securities law violations, a federal court may order the disgorgement of a reasonable estimation of the defendant's illegally obtained profits.[27] The court must separate the defendant's illegally and legally obtained profits when calculating the disgorgement amount,[28] and "because of the difficulty of determining with certainty the extent to which a defendant's gains resulted from his frauds—especially profits from transactions in securities whose market price has been affected by the frauds—

17. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881, 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)).

18. Those who receive a subpoena from the SEC are not subject to penalties for refusing to obey, but the Commission may enforce compliance with the investigation in federal court. SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735, 741 (1984) (citing 15 U.S.C. §§ 77v(b), 78u(c) (2012)).

19. *Id.* (citing 15 U.S.C. §§ 77s(b), 78u(a), (b) (2012)).

20. SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984).

21. 15 U.S.C. § 77t(b) (2012) ("Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the [securities laws] . . . the Commission may, in its discretion, bring an action in any district court of the United States . . . to enjoin such acts or practices, and upon a proper showing, a permanent or temporary injunction . . . .").

22. A civil money penalty is used to punish a defendant "for violating a public law" and goes farther than just compensating the victim for their loss. SEC v. Kokesh, No. 09-cv-1021, 2015 U.S. Dist. LEXIS 179999, at *21 (D.N.M. Mar. 30, 2015) (quoting United States v. Telluride Co., 146 F.3d 1241, 1246 (10th Cir. 1998)).

23. 15 U.S.C. § 77t(d)(1) (2012).

24. *Materia*, 745 F.2d at 200–01.

25. *Id.* at 201.

26. SEC v. Razmilovic, 738 F.3d 14, 31 (2d Cir. 2013) (quoting SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 102 (2d Cir. 1978)).

27. *Id.* (quoting SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d Cir. 1996)).

28. *Id.* (quoting CFTC v. British Am. Commodity Options Corp., 788 F.2d 92, 93 (2d Cir. 1986)).

the court need not determine the amount of such gains with exactitude."[29] The SEC has sought disgorgement for a variety of securities law violations, such as pump-and-dump schemes,[30] Ponzi schemes,[31] and misappropriations of funds from investors.[32] While federal courts view disgorgement as part of their equitable powers,[33] Congress has only given the SEC express statutory authority to seek disgorgement in administrative proceedings.[34] Federal courts, however, have authorized the SEC to seek any form of ancillary relief, including disgorgement, "where necessary and proper to effectuate the purposes of [a] statutory scheme."[35]

B. *The Statute of Limitations and the Supreme Court's Interpretation of "Penalty"*

Under the statute of limitations, any "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."[36] While applicable to securities law enforcement, this statute is broad in scope and applies to a variety of penalty provisions[37] in the United States Code.[38] This statute is considered a "catch-all statute of limitations in situations where Congress did not specifically include a time limitation in [a] statute."[39] Under the statute, "a claim

29. *Id.*

30. *See, e.g.*, SEC v. World Info. Tech., Inc., 590 F. Supp. 2d 574–75, 577–78 (S.D.N.Y. 2008) (ordering the disgorgement of profits gained through a "pump-and-dump" scheme to create artificial demand in stock before sale at an inflated price).

31. *See, e.g.*, SEC v. McGinn, Smith & Co., 98 F. Supp. 3d 506, 521–24 (N.D.N.Y. 2015) (ordering the disgorgement of assets arising out of a Ponzi scheme from a stock account jointly owned by an investment adviser and his wife).

32. *See, e.g.*, SEC v. Loomis, 17 F. Supp. 3d 1026, 1030–32 (E.D. Cal. 2014) (ordering the disgorgement of both the funds which the owner of an investment planning company received for the purchase of unregistered securities and the interest avoided when he used those funds to take out loans).

33. *See* SEC v. Razmilovic, 738 F.3d 14, 31 (2d Cir. 2013) (quoting SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1474 (2d Cir. 1996)).

34. *See* 15 U.S.C. § 78u-2(e) (2012) ("In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement, including reasonable interest.").

35. SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984) (citing SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971)).

36. 28 U.S.C. § 2462 (2012).

37. Other enforcement actions this statute applies to include those under the Clean Air Act, 42 U.S.C. §§ 7401–7671q (2012), New Jersey v. RRI Energy Mid-Atlantic Power Holdings, LLC, 960 F. Supp. 2d 512, 523 (E.D. Pa. 2013), and the Federal Trade Commission Act, 15 U.S.C §§ 41–58 (2012), United States v. Ancorp Nat'l Servs., Inc., 516 F.2d 198, 200 n.5 (2d Cir. 1975).

38. Gabelli v. SEC, 568 U.S. 442, 454 (2013) (holding that civil penalty actions brought by the SEC must be brought within five years of the date the wrongdoing occurred under § 2462).

39. FEC v. Nat'l Republican Senatorial Comm., 877 F. Supp. 15, 17 (D.D.C. 1995).

accrues 'when the plaintiff has a complete and present cause of action'"[40] and not when the plaintiff has "discovered" the cause of action.[41] Under this statute, potential defendants are only subject to penalty enforcement actions for an exact number of years, instead of an indeterminate amount of years.[42] Potential defendants, therefore, may cease to fear defending against a penalty action five years after their wrongdoing, regardless of what the government knows at that point in time.[43] The start of the statute of limitations may be delayed until the wrong is discovered for some plaintiffs,[44] but this exception has never been extended to the government bringing enforcement actions.[45] Therefore, with few exceptions,[46] government agencies such as the SEC, whose purpose is to discover securities fraud and which possesses the tools to do so,[47] must bring a civil enforcement action within five years of date of the wrongdoing.[48]

Under the statute of limitations, the government must bring an enforcement action for penalties "within five years from the date when the claim first accrued."[49] Section 2462, however, does not provide a definition of "penalty" in its text.[50] The Supreme Court has stepped in to define *penalty* in several of its past cases. In *Huntington v. Attrill*,[51] the Court defined a penalty as an action that "denote[s] punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offense against

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40. *Gabelli*, 568 U.S. at 448 (quoting Wallace v. Kato, 549 U.S. 384, 388 (2007)).

41. *Id.* at 449 (quoting Merck & Co. v. Reynolds, 559 U.S. 633, 644 (2010)).

42. *See id.* at 452 ("Yet grafting the discovery rule onto § 2462 would raise similar concerns. It would leave defendants exposed to Government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future.").

43. *Id.* (citing Rotella v. Wood, 528 U.S. 549, 554 (2000)).

44. This principle is called the "discovery rule." *Id.* at 449. The discovery rule is used to allow defrauded "victims who do not know they are injured and who reasonably do not inquire as to any injury" to delay the running of the statute of limitations until they discover the injury. *Id.* at 450–51. This rule applies to private parties unaware of their injuries and not government enforcement authorities. *See id.* (explaining the "good reasons why the fraud discovery rule has not been extended to Government enforcement actions for civil penalties" but has been extended to private parties).

45. *Id.* at 449.

46. Under the fraudulent concealment doctrine, a plaintiff may,

> toll the statute [of limitations] if the plaintiff alleges: (1) that the defendants concealed the cause of action; (2) that the plaintiff did not discover the cause of action until some point within five years of commencing the action; and (3) that the plaintiff's continuing ignorance was not attributable to lack of diligence on its part.

SEC v. Power, 525 F. Supp. 2d 415, 424 (S.D.N.Y. 2007) (citing SEC v. Jones, No. 05 Civ. 7044 (RCC), 2006 WL 1084276, at *6 (S.D.N.Y. Apr. 25, 2006)).

47. *Gabelli*, 568 U.S. at 451.

48. *Id.* at 454.

49. 28 U.S.C. § 2462 (2012).

50. *Id.*

51. 146 U.S. 657 (1892).

its laws"[52] and described the term as "elastic in meaning."[53] The Court found that a remedy that was brought for the purpose of punishing and deterring others from committing the same act constituted a penalty,[54] while a remedy that merely gives compensatory damages to an injured party was not a penalty.[55] Based on these definitions, the Court held that the test to determine whether a remedy qualified as a penalty was "whether the wrong sought to be redressed is a wrong to the public," and therefore penal, "or a wrong to the individual," and therefore nonpunitive.[56]

A few years after the *Huntington* decision, the Court applied the test from that case to a copyright infringement statute[57] in *Brady v. Daly*.[58] In the case, Daly sued Brady for copyright infringement in federal circuit court and sought damages for the infringement under Section 4966 of the Revised Statutes.[59] Brady asserted that the damages[60] sought by Daly under Section 4966 constituted a penalty, which federal district courts had exclusive jurisdiction over and, therefore, that the circuit court[61] that heard the case had no jurisdiction over it.[62] The Court noted that the statute did not mention the word penalty or forfeiture and only provided for damages that directly resulted from the copyright infringement.[63] The Court further noted, "The "whole recovery [was] given to the proprietor, and the statute d[id] not provide for a recovery by any other person in case the proprietor himself neglects to sue."[64] Therefore, because the statute gave only the victim of copyright infringement, and not the public, a right to damages, the Court found that the recovery awarded was not a penalty.[65]

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52. *Id.* at 667 (citing United States v. Reisinger, 128 U.S. 398, 402 (1888); and then citing United States v. Chouteau, 102 U.S. 603, 611 (1880)).

53. *Id.* The Court noted the term's elastic meaning allows it "even to be familiarly applied to cases of private contracts, wholly independent of statutes." *Id.*

54. *Id.* at 668 (quoting Reed v. Inhabitants of Northfield, 30 Mass. (13 Pick.) 94, 100–01 (1832)).

55. *Id.* at 667–68 (quoting Read v. Inhabitants of Chelmsford, 33 Mass. (16 Pick.) 128, 132 (1834)).

56. *Id.* at 668.

57. REV. STAT. § 4966 (1875).

58. 175 U.S. 148, 155–57 (1899) (quoting *Huntington*, 146 U.S. at 667).

59. *Id.* at 150–51.

60. Under the statute, those who infringe on a copyright "shall be liable for damages . . . not less than one hundred dollars for the first, and fifty dollars for every subsequent performance." § 4966.

61. Federal circuit courts at the time had jurisdiction over "all suits at law or in equity arising under the patent or copyright laws of the United States." *Daly*, 175 U.S. at 153 (quoting REV. STAT. § 629(9) (1875)).

62. *Id.* at 152.

63. *Id.* at 154 ("The person wrongfully performing or representing a dramatic composition is, in the words of the statute, 'liable for damages therefor[e].' This means all the damages, that are the direct result of his wrongful act.").

64. *Id.*

65. *Id.* at 156.

The Supreme Court later applied the *Huntington* test to a statute of limitations[66] similar[67] to Section 2462 in *Meeker v. Lehigh Valley R.R.*[68] In district court, Lehigh Valley Railroad Company was ordered to pay damages for illegal rates it charged to Meeker's coal trading firm.[69] Lehigh Valley, however, argued that the then-current statute of limitations barred Meeker's claims.[70] Comparable to Section 2462, the disputed statute of limitations "place[d] a limitation of five years upon any 'suit or prosecution for any penalty or forfeiture, pecuniary or otherwise, accruing under the laws of the United States.'"[71] The Court found that "penalty" in the statute referred to remedies imposed for punitive reasons and not for redressing private injuries, so the statute of limitations did not apply to the reparation damages awarded to Meeker, even though Lehigh Valley's actions violated public law.[72] Recent Supreme Court cases have echoed the sentiments of *Huntington*, *Brady*, and *Meeker* and found that penalties are remedies that typically "go beyond compensation"[73] and "intend[] to punish culpable individuals."[74]

Prior to *Kokesh*, several United States courts of appeals considered whether Section 2462 applied to disgorgement.[75] Along with the Tenth Circuit,[76] the majority of circuit courts held that the remedy was an equitable remedy and not a penalty, including the D.C.,[77] First,[78] and Ninth[79] Cir-

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66. REV. STAT. § 1047 (1914).

67. This statute of limitations has been called the *predecessor* of 28 U.S.C. § 2462. Johnson v. SEC, 87 F.3d 484, 487 (D.C. Cir. 1996).

68. 236 U.S. 412, 423 (1915).

69. *Id.* at 422.

70. *Id.*

71. *Id.* at 423 (quoting REV. STAT. § 1047 (1914)).

72. *Id.* The Court found that "the liability sought to be enforced [against Lehigh Valley] was not punitive but strictly remedial." *Id.* (quoting REV. STAT. § 1047 (1914)).

73. Gabelli v. SEC, 568 U.S. 442, 451–52 (2013) ("[P]enalties, which go beyond compensation, are intended to punish, and label defendants wrongdoers." (citing *Meeker*, 236 U.S. at 423)).

74. Tull v. United States, 481 U.S. 412, 422 (1987) ("A civil penalty was a type of remedy at common law that could only be enforced in courts of law. Remedies intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo, were issued by courts of law, not courts of equity.").

75. *See, e.g.*, Zacharias v. SEC, 569 F.3d 458, 471 (D.C. Cir. 2009) (considering whether the SEC's "order requiring [defendants] to disgorge all profits (plus prejudgment interest) from their illegal transactions impose[d] a civil penalty"); SEC v. Tambone, 550 F.3d 106, 148 (1st Cir. 2008) (determining whether § 2462 applies to "disgorgement of ill-gotten gains"); SEC v. Graham, 823 F.3d 1357, 1363 (11th Cir. 2016) (considering whether "§ 2462's statute of limitations applies to disgorgement").

76. *See* United States v. Telluride Co., 146 F.3d 1241, 1247 (10th Cir. 1998) (holding that disgorgement was not a penalty under the statute of limitations because of its remedial nature); *see infra* text accompanying notes 117–118.

77. *See Zacharias*, 569 F.3d at 471 (holding the disgorgement of the defendants' illegal profits was not a civil penalty subject to § 2462).

78. *See Tambone*, 550 F.3d at 148 (holding that § 2462 only applied to "penalties sought by the SEC" and not disgorgement or injunctions).

cuits. In fact, the only court of appeals that held the statute of limitations applied to disgorgement was the Eleventh Circuit in *SEC v. Graham*.[80] However, the Eleventh Circuit found that disgorgement was functionally synonymous with "forfeiture," another remedy subject to Section 2462.[81] Therefore, while this holding created a circuit split regarding the applicability of Section 2462 to disgorgement,[82] no court of appeals held that disgorgement was a penalty under the statute of limitations before the Supreme Court decided *Kokesh*.[83]

C. Lower Court Decisions in Kokesh v. SEC

Charles Kokesh owned and operated two investment adviser firms ("Advisers"), which gave investment advice to several business development companies[84] ("Funds").[85] Each of the Advisers had compensation contracts with the Funds signed by Mr. Kokesh, which prohibited payments to the Advisers not enumerated in the agreements.[86] On October 27, 2009, the SEC filed a complaint against Mr. Kokesh, alleging that from 1995 to 2007, he misappropriated nearly $35 million from the Funds; filed "false and misleading SEC reports and proxy statements" to hide the misappropriations; and executed contracts with "illegal performance-fee provisions."[87] After a five-day trial during early November 2014, the jury found against Mr. Kokesh on all claims.[88]

The jury found that Mr. Kokesh directed the Advisers' treasurer to withdraw $23.8 million from the Funds to compensate the Advisers' employees and $5 million to pay for rent.[89] Mr. Kokesh also directed his firms to take $6.1 million from the Funds that were described as "tax distribu-

79. *See* SEC v. Rind, 991 F.2d 1486, 1493 (9th Cir. 1993) ("[A]ctions for disgorgement of improper profits are equitable in nature.").

80. 823 F.3d 1357, 1363 (11th Cir. 2016).

81. *Id.* The Eleventh Circuit noted that because it held that disgorgement was considered forfeiture under § 2462, the court did not need to "reach the defendants' alternative argument that" the remedy was a penalty. *Id.* at 1363 n.3.

82. *Compare Zacharias*, 569 F.3d at 471 (holding the disgorgement of the defendants' illegal profits was not a civil penalty subject to § 2462), *with Graham*, 823 F.3d at 1363 (finding no significant difference between forfeiture and disgorgement and, therefore, disgorgement is subject to § 2462).

83. 137 S. Ct. 1635 (2017).

84. These companies "raised money from investors through public securities offerings and invested in private start-up companies that focused on technology, biotechnology, and medical diagnostics." SEC v. Kokesh, 834 F.3d 1158, 1161 (10th Cir. 2016), *rev'd*, 137 S. Ct. 1635 (2017).

85. SEC v. Kokesh, No. 09-cv-1021, 2015 U.S. Dist. LEXIS 179999, at *1–2 (D.N.M Mar. 30, 2015), *aff'd*, 834 F.3d 1158 (10th Cir. 2016), *rev'd*, 137 S. Ct. 1635 (2017).

86. *Kokesh*, 834 F.3d at 1161.

87. *Kokesh*, 2015 U.S. Dist. LEXIS 179999, at *2.

88. *Id.*

89. *Kokesh*, 834 F.3d at 1161.

tions"[90] in the SEC reports he signed, although he only paid approximately $10,000 in federal taxes that year.[91] All of these payments were either not explicitly permitted under the contract or expressly prohibited by the contracts' language and, therefore, in violation of the agreements.[92] Though the agreements were amended at one point to allow for reimbursement for controlling-person salaries, Mr. Kokesh misrepresented himself as the only controlling-person and reported a much smaller salary than he had received[93] in a proxy statement.[94] Mr. Kokesh was found in "direct violation" of Section 37 of the Investment Company Act of 1940[95] for "'knowingly and willfully' convert[ing] investment-company assets to his own use or to the use of another"[96] and was also found to have aided and abetted violations of several federal securities laws[97] for "'knowingly and substantially assisting" the Advisers" to engage in securities fraud.[98]

After the rendering of the verdict, the SEC sought entry of final judgment ordering Mr. Kokesh "(1) to pay a civil money penalty, (2) to be permanently enjoined from violating . . . federal securities laws, and (3) to disgorge" money misappropriated during the various violations.[99] However, because some of the claims brought by the SEC accrued outside of the five-year statute of limitations period,[100] the district court could not order civil money penalties[101] for those specific claims.[102] Under the statute, "any civil fine, penalty, or forfeiture" cannot be ordered five years after a civil action is brought.[103] The district court, however, found that neither an injunction

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90. Mr. Kokesh received ninety percent of these distributions. *Id.*

91. *Id.*

92. *Id.*

93. Mr. Kokesh reported an average salary of $221,000 from 1998 to 2000, while the accurate figure was $771,000. SEC v. Kokesh, No. 09-cv-1021, 2015 U.S. Dist. LEXIS 179999, at *3 (D.N.M Mar. 30, 2015), *aff'd*, 834 F.3d 1158 (10th Cir. 2016), *rev'd*, 137 S. Ct. 1635 (2017).

94. *Kokesh*, 834 F.3d at 1161.

95. Investment Company Act of 1940 § 37, 15 U.S.C. § 80a-36 (2012).

96. *Kokesh*, 2015 U.S. Dist. LEXIS 179999, at *2.

97. The provisions included § 205 of the Advisers Act, 15 U.S.C. § 80b-5 (2012); §§ 206(1) and 206(2) of the Advisers Act, 15 U.S.C. §§ 80b-6(1)–(2) (2012); §§ 13(a) and 14(a) of the Exchange Act, 15 U.S.C. §§ 78m, 78n (2012); Exchange Act Rules 12b-20, 13a-1, 13a-13, and 14a-9, 17 C.F.R. §§ 240.12b-20, 13a-1, 13a-13, 14a-9 (2017); § 209(f) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-9(f) (2012); and § 20(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(e) (2012). *Kokesh*, 2015 U.S. Dist. LEXIS 179999, at *5.

98. *Id.* at *4–5.

99. *Id.* at *6.

100. Claims against Mr. Kokesh that accrued on or before October 26, 2004 were not subject to civil penalties. *Id.* at *8.

101. *See supra* note 22 and accompanying text.

102. *Kokesh*, 2015 U.S. Dist. LEXIS 179999, at *7–8.

103. 28 U.S.C. § 2462 (2012) ("Except as otherwise provided by Act of Congress, 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 . . . .").

nor disgorgement serve as a penalty and were, therefore, not subject to the statute of limitations.[104] The district court found that an injunction was not a penalty "because it does not seek compensation unrelated to or in excess of the damage caused by Defendant . . . [and] is precisely tailored to Defendant's wrongs."[105] The district court further reasoned that disgorgement was not a penalty either because ordering Mr. Kokesh to hand over his profits that resulted from his wrongful actions was "quintessentially equitable."[106] Therefore, the District Court ordered an injunction[107] and disgorgement of $34,927,329 against Mr. Kokesh, along with a civil penalty of $2,354,593[108] for claims accrued within the limitations period.[109] Mr. Kokesh appealed to the United States Court of Appeals for the Tenth Circuit on the grounds that the injunction and disgorgement orders were prohibited under the statute of limitations.[110]

The Tenth Circuit affirmed the lower court's injunction and disgorgement orders.[111] The court first considered whether an injunction is a penalty.[112] Noting "everyone has a duty to obey the law," the Tenth Circuit found no reason to deem an injunction as a penalty.[113] The purpose of the injunction was to protect the public from further violations by incentivizing[114] Mr. Kokesh not to break any more laws.[115] The Tenth Circuit then considered whether disgorgement was a penalty or forfeiture under Section 2462.[116] In *United States v. Telluride Co.*,[117] the Tenth Circuit already held that disgorgement was not a penalty under the statute of limitations because of its remedial nature.[118] The Tenth Circuit found that the purpose of disgorgement was not to inflict punishment on the defendant but to eliminate profits reaped from the illegal activities.[119] The court noted that the remedy only "leaves the wrongdoer 'in the position he would have occupied had

104. *Kokesh*, 2015 U.S. Dist. LEXIS 179999, at *32.

105. *Id.* at *21–22 (citing United States v. Telluride Co., 146 F.3d 1241, 1246 (10th Cir. 1998)).

106. *Id.* at *29–30.

107. Mr. Kokesh was enjoined from committing any future violations of securities laws. *Id.* at *7.

108. The district court set the appropriate amount of the civil money penalty as the amount of funds Mr. Kokesh received during the limitations period. *Id.* at *15.

109. *Id.* at *31–32.

110. SEC v. Kokesh, 834 F.3d 1158, 1161 (10th Cir. 2016), *rev'd*, 137 S. Ct. 1635 (2017).

111. *Id.* at 1160.

112. *Id.* at 1162.

113. *Id.*

114. If Mr. Kokesh violated the injunction, he would be held in contempt of court. *Id.*

115. *Id.*

116. *Id.* at 1164.

117. 146 F.3d 1241 (10th Cir. 1998).

118. *Kokesh*, 834 F.3d at 1164 (citing *Telluride*, 146 F.3d at 1247).

119. *Id.* (quoting RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51(4) (AM. LAW INST. 2010)).

there been no misconduct.'"[120] Therefore, while the Tenth Circuit ordered Mr. Kokesh to disgorge more than just the funds that he kept,[121] the court found that it was not a penalty to order a wrongdoer to pay back all of the funds misappropriated by him, regardless of who received the money.[122] While disgorgement-style remedies were recently added to some federal forfeiture statutes,[123] the Tenth Circuit noted that such expansion in government power began decades after Section 2462 was passed.[124] Consequently, because courts interpret statutory language as Congress would have understood it at the time of passage,[125] the Tenth Circuit found that disgorgement was not a type of "forfeiture" under Section 2462.[126] Mr. Kokesh appealed the Tenth Circuit's decision, and the Supreme Court of the United States then granted certiorari to hear the case.[127]

D. The Supreme Court's Reasoning in Kokesh v. SEC

In *Kokesh v. SEC*, the Supreme Court of the United States reversed the Tenth Circuit's conclusion that disgorgement was not a penalty under 28 U.S.C. § 2462.[128] The Court unanimously held that disgorgement for securities enforcement was a penalty under the statute of limitations and, therefore, must be brought within five years of the date that the claim ripened.[129] The Court defined a penalty as "a punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws,"[130] which evoked two principles used to construe the meaning of penalty.[131] First, the Court analyzed "whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual."[132] Second, the Court examined whether the remedy "is sought 'for the purpose of punishment, and to deter others from offending in like manner'—as opposed to compensating a victim for his loss."[133] In applying these principles, the Court found that disgorgement is a penalty for three reasons: (1) disgorgement

120. *Id.* (quoting RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. k (AM. LAW INST. 2010)).

121. Some of the money Mr. Kokesh misappropriated went to other people. *Id.*

122. *Id.* at 1164–65 (citing SEC v. Contorinis, 743 F.3d 296, 307 (2d Cir. 2014)).

123. *Id.* at 1166 (citing 18 U.S.C. § 1963(a)(3) (2012)). The statute of limitations applies to civil forfeitures. 28 U.S.C. § 2462 (2012).

124. *Kokesh*, 834 F.3d at 1166. The statute of limitations was codified in 1948. *Id.*

125. *Id.* (quoting Hackwell v. United States, 491 F.3d 1229, 1236 (10th Cir. 2007)).

126. *Id.*

127. Kokesh v. SEC, 137 S. Ct. 1635, 1641 (2017).

128. *Id.* at 1645.

129. *Id.* at 1639, 1645.

130. *Id.* at 1642 (alteration in original) (quoting Huntington v. Attrill, 146 U.S. 657, 667 (1892)).

131. *Id.*

132. *Id.* (quoting *Huntington*, 146 U.S. at 668).

133. *Id.* (quoting *Huntington*, 146 U.S. at 668).

serves as a repercussion for violating public laws;[134] (2) it is used punitively to deter violations of public laws;[135] and (3) the remedy does not serve a compensatory purpose.[136]

The Court began by examining the history and purpose of the Commission.[137] The Securities Exchange Act of 1934 created an agency with the power "to prescribe 'rules and regulations . . . as necessary or appropriate in the public interest or for the protection of investors'"[138] and the power to investigate potential violations of securities laws.[139] The agency is able to bring enforcement claims in federal court if evidence of a securities violation is discovered.[140] Though at first the only remedy the SEC could bring was an injunction,[141] courts began to order disgorgements in the 1970s "to 'deprive . . . defendants of their profits in order to remove any monetary reward for violating' securities laws and to 'protect the investing public by providing an effective deterrent to future violations.'"[142] Congress further permitted the SEC to seek monetary civil penalties[143] in the 1990s.[144] With a variety of effective tools and remedies available to enforce federal securities laws, the Court noted that the SEC still pursues disgorgement in its enforcement actions.[145]

The Court then used two principles to interpret the term "penalty" in the context of the statute of limitations.[146] The first principle analyzed whether the sanction is used to remedy a wrong to a person or to the public.[147] The second principle considered whether the remedy is used to deter future violations and punishment or to recompense a victim for their loss.[148]

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134. *Id.* at 1643.

135. *Id.*

136. *Id.* at 1644.

137. *Id.* at 1639–40.

138. *Id.* at 1640 (alteration in original) (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 728 (1975)).

139. *Id.* (quoting SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735, 741 (1984)).

140. *Id.*

141. *Id.* (citing 1 T. HAZEN, LAW OF SECURITIES REGULATION § 1:37 (7th ed., rev. 2016)).

142. *Id.* (alteration in original) (quoting SEC v. Tex. Gulf Sulphur Co., 312 F. Supp. 77, 92 (S.D.N.Y. 1970)).

143. The law permits the Commission to impose a civil penalty to be paid by the defendant, and the size of the penalty is determined by the egregiousness of the wrongful act. 15 U.S.C. § 77t(d) (2012).

144. *Kokesh*, 137 S. Ct. at 1640. This remedy was authorized as part of the Securities Enforcement Remedies and Penny Stock Reform Act. *Id.* (citing Securities Enforcement and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 932 (codified at 15 U.S.C. § 77t(d) (2012))).

145. *Id.*

146. *Id.* at 1642.

147. *Id.* (quoting Huntington v. Attrill, 146 U.S. 657, 667 (1892)); *see supra* text accompanying note 132.

148. *Kokesh*, 137 S. Ct. at 1642 (quoting *Huntington*, 146 U.S. at 667); *see supra* text accompanying note 133.

The Court previously used these principles to construe the meaning of penalty for other statutes of limitations[149] and the statutory predecessor[150] of Section 2462.[151] The Court held that a remedy that provides compensation for a private wrong is not a penalty,[152] while a remedy that is "imposed in a punitive way for an infraction of a public law" is a penalty.[153]

In applying these two principles to disgorgement, the Court held that the remedy is a penalty under the statute of limitations.[154] First, the Court argued that disgorgement sought by the SEC was ordered for a violation of a public law.[155] When such a remedy is sought, the Court noted it was ordered for a violation committed against the United States and may ensue regardless of the victim's support of or participation in the civil action.[156] Second, the remedy is used for punitive purposes.[157] Since the SEC began to seek disgorgement "courts have consistently held that '[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains.'"[158] The Court observed that civil remedies used to deter violations of the law are intrinsically punitive.[159] Third, the Court found the disgorgement brought by the SEC was often not compensatory.[160] When the remedy is ordered, the ill-gotten gains are paid to the district court, and it is up to that court to decide how the money will be allocated.[161] Though the disgorged profits may go to the victims of the violation, the courts are not obligated by statute to give any of the money to them.[162]

In response to the SEC's claim that disgorgement was not punitive and merely returned the defendant to the place he was in prior to the violation, the Court noted that the remedy sometimes left the defendant worse off than before.[163] For example, someone who engaged in insider trading may have to pay back both their own profits and the gains of third parties that benefit-

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149. *Kokesh*, 137 S. Ct. at 1642 (quoting Brady v. Daly, 175 U.S. 148, 153–54 (1899)).
150. REV. STAT. § 1047 (1913); *see supra* notes 66–67 and accompanying text.
151. *Kokesh*, 137 S. Ct. at 1642 (citing Meeker v. Lehigh Valley R. Co., 236 U.S. 412, 421–22 (1915)).
152. *Id.* (citing *Daly*, 175 U.S. at 154).
153. *Id.* at 1643 (quoting *Meeker*, 236 U.S. at 423).
154. *Id.*
155. *Id.*
156. *Id.*
157. *Id.*
158. *Id.* (alteration in original) (quoting SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997)).
159. *Id.* (quoting Bell v. Wolfish, 441 U.S. 520, 539 n.20 (1979)).
160. *Id.* at 1644.
161. *Id.* (quoting *Fischbach Corp.*, 133 F.3d at 175).
162. *Id.*
163. *Id.* at 1644–45.

ted from their wrongful conduct.[164] In this case, Mr. Kokesh's business expenses that reduced his overall profit were not considered when calculating the disgorgement.[165] The Court noted that, although disgorgement could serve a compensatory goal, a civil remedy that also served a retributive or deterrent purpose was punishment.[166] Accordingly, the Court concluded that disgorgement serves as a penalty under the statute of limitations and reversed the judgment of the Court of Appeals for the Tenth Circuit.[167]

II. ANALYSIS

In *Kokesh v. SEC*, the Supreme Court of the United States held that disgorgement in securities enforcement operates as a penalty under the statute of limitations and must be brought within five years of the date the claim accrued.[168] This Part will first discuss that the Court made the correct judgment in this case because the SEC used disgorgement to punish defendants and not to compensate victims.[169] This Part will then highlight the significant implications of *Kokesh*'s holding for the Commission, which now has a limited time frame to seek disgorgement and, consequently, less settlement leverage.[170] Finally, this Part will discuss the heightened costs potentially facing defendants subject to disgorgement since disgorged profits likely will not be tax deductible or covered by most insurance policies.[171]

A. *The Supreme Court Correctly Determined That the SEC Uses Disgorgement to Punish Defendants for the Violation of Federal Securities Laws*

In applying the first principle from *Huntington v. Attrill* to determine whether a civil remedy is a penalty, the Court rightfully found that the SEC uses disgorgement in enforcement actions to remedy a wrong to the public.[172] The first *Huntington* principle considers whether the remedy is utilized to redress a wrong to an individual or a wrong to the public.[173] When requesting disgorgement, the SEC seeks to remedy a wrong against the United States, and not an individual person, which is why the SEC may enforce federal securities laws violations in court without the consent of the

164. *Id.* at 1644 (quoting SEC v. Contorinis, 743 F.3d 296, 302 (2d Cir. 2014)).
165. *Id.*
166. *Id.* at 1645 (quoting Austin v. United States, 509 U.S. 602, 610 (1993)).
167. *Id.*
168. *Id.* at 1639.
169. *See infra* Part II.A–B.
170. *See infra* Part II.C.1.
171. *See infra* Part II.C.2.
172. *Kokesh*, 137 S. Ct. at 1643.
173. Huntington v. Attrill, 146 U.S. 657, 668 (1892); *see supra* text accompanying note 132.

victim of the wrongdoing.[174] The Commission has long taken the position that its "primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals."[175] The SEC continued to recognize this function in its brief for *Kokesh*.[176]

Further, the SEC uses disgorgement to discourage others from committing federal securities laws violations.[177] The Supreme Court has noted that remedies imposed for the purpose of deterring violations of laws are punitive.[178] The Commission has long said that, even in cases where the Commission asked for disgorged profits to be paid to those harmed, it solely acted to deter others from committing securities violations.[179] In fact, the SEC's policy for enforcement proceedings is to target violations predominantly "based on the message that will be sent to the public and to the industry about the reach of its enforcement actions and the amount of investor harm."[180] In its role as a law enforcement agency, the SEC has stated that it seeks disgorgement because injunctions against future violations alone cannot provide effective deterrence.[181] Federal courts have also held that the primary purpose of the civil remedy is deterrence[182] and that effective SEC deterrence is dependent on the disgorgement remedy.[183] Therefore, the SEC uses disgorgement to vindicate the public interest while enforcing federal securities laws.

174. *Kokesh*, 137 S. Ct. at 1643.

175. 41 SEC ANN. REP. 97–98 (1975).

176. Brief for Respondent at 22, Kokesh v. SEC, 137 S. Ct. 1635 (2017) (No. 16-529) ("When the SEC seeks disgorgement, it acts in the public interest, to remedy harm to the public at large, rather than standing in the shoes of particular injured parties.").

177. *Kokesh*, 137 S. Ct. at 1643.

178. Bell v. Wolfish, 441 U.S. 520, 539 n.20 (1979) (citing Kennedy v. Mendoza-Martinez, 372 U.S. 144, 168 (1963)).

179. *See* Dolgow v. Anderson, 43 F.R.D. 472, 483 (E.D.N.Y. 1968), *rev'd on other grounds*, 438 F.2d 825 (2d Cir. 1970) ("While in rare cases, as an adjunct to injunctive relief, the Commission has urged a court to deprive violators of their illegal gains by directing that these be paid to individuals who have been injured by their violations, *even in such cases the Commission does not seek to make investors whole*; it seeks merely to deter violators by making violations unprofitable.").

180. James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L. J. 737, 763 (2003).

181. *Dolgow*, 43 F.R.D. at 483.

182. *See, e.g.*, SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) ("The primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains."); SEC v. Rind, 991 F.2d 1486, 1490 (9th Cir. 1993) ("The theory behind [disgorgement] is deterrence and not compensation.").

183. *See* SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1104 (2d Cir. 1972) ("The deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."); SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971) ("It would severely defeat the purposes of the [Securities Exchange Act of 1934] if a violator of Rule 10b-5 were allowed to retain the profits from his violation.").

B. Strictly Punitive—The Court Properly Held the SEC Does Not Utilize Disgorgement to Compensate Victims or Remedy a Wrong

The Court correctly found that the SEC's use of disgorgement in securities law enforcement does not compensate the victim for their loss or only extract the defendant's ill-gotten gains when applying the second *Huntington* principle.[184] The second *Huntington* principle determines whether the remedy is sought to compensate a victim for their losses or to punish the defendant.[185] The SEC argued in *Kokesh* that disgorgement orders are often compensatory and, therefore, "unambiguously nonpunitive."[186] However, federal courts have decided "[t]he primary purpose of disgorgement [was] not to refund others for losses suffered but rather 'to deprive the wrongdoer of his ill-gotten gain.'"[187] This is evinced by the fact that, if the SEC successfully seeks a disgorgement order, the disgorged profits are paid to the federal district court and not directly to the aggrieved individual.[188] Even though a district court may choose to give the disgorged funds to the victim of the violation, it has no legal obligation to do so.[189] Funds have been distributed to other recipients, such as the United States Treasury.[190] In fact, from 1998 to 2002, 35 out of 87 SEC enforcement actions that successfully sought disgorgement either distributed the funds to the U.S. Treasury or had made no payment at all.[191] In fiscal year 2015, the SEC successfully obtained over $4 billion from disgorgement and civil penalties, but only $158 million was distributed to defrauded investors.[192] In enforcement actions, the SEC focuses primarily on extracting profits from those who violated securities laws and less on what happens to those funds.[193] For example, from 1987 to 1994, the agency collected data on the application of disgorgement

184. Kokesh v. SEC, 137 S. Ct. 1635, 1644 (2017).

185. Huntington v. Attrill, 146 U.S. 657, 668 (1892); *see supra* text accompanying note 133.

186. Brief for Respondent at 10, Kokesh v. SEC, 137 S. Ct. 1635 (2017) (No. 16-529).

187. SEC v. Bilzerian, 29 F.3d 689, 697 (D.C. Cir. 1994) (quoting SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978)).

188. *See* SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) ("Once the profits have been disgorged, it remains within the court's discretion to determine how and to whom the money will be distributed . . . .").

189. *Kokesh*, 137 S. Ct. at 1644.

190. *Fischbach Corp.*, 133 F.3d at 171.

191. U.S. SEC. & EXCH. COMM'N, REPORT PURSUANT TO SECTION 308(C) OF THE SARBANES-OXLEY ACT OF 2002, at 5, 10 (2003). Thirty-eight of those actions paid defrauded investors either directly or through alternative methods and the remaining cases were expected to pay those harmed by the fraud, though no payments had been made yet. *Id.* at 10–11.

192. Jonathan N. Eisenberg, *13 Observations about the SEC's Enforcement Program*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 18, 2016), https://corpgov.law.harvard.edu/2016/04/18/13-observations-about-the-secs-enforcement-program/. This is the lowest amount of disgorged funds the SEC has distributed to investors since the Commission started disclosing this information in fiscal year 2012. *Id.*

193. Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW. 317, 321 (2008).

orders against defendants, but the agency kept no information on how much money was disgorged or where it was distributed.[194]

Further, the Court correctly held that disgorgement often does not return the defendant back to the place they would have been if the violation had never occurred.[195] The SEC argued that disgorgement was not a penalty because it merely restored the status quo and lessened the harm done by the defendant's wrongdoing.[196] Disgorgement, however, can exceed the defendant's total profits gained from the securities law violation.[197] For example, a defendant that engaged in insider trading may have to disgorge both their own profits and the profits of third parties that resulted from the defendant's wrongdoing.[198] A defendant subject to disgorgement could be held jointly and severally liable for the profits of someone else that engaged in the same wrongdoing.[199] In Mr. Kokesh's case, the amount the SEC disgorged did not consider his overall business expenses that reduced his overall profit.[200] Further, the Commission and federal courts "generally say that disgorgement can be ordered even against defendants who no longer possess or have access to the tainted profits, or never possessed them at all."[201] The SEC, however, does grant disgorgement waivers to defendants that cannot pay the disgorgement order, though both the SEC and a court must approve the waiver.[202] Though disgorgement may serve a compensatory purpose, the Supreme Court has previously held that civil penalties can

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194. U.S. GEN. ACCOUNTING OFFICE, GAO-94-188, SECURITIES ENFORCEMENT: IMPROVEMENTS NEEDED IN SEC CONTROLS OVER DISGORGEMENT CASES 3 (1994).

195. Kokesh v. SEC, 137 S. Ct. 1635, 1644 (2017).

196. Brief for Respondent at 17, Kokesh v. SEC, 137 S. Ct. 1635 (2017) (No. 16-529) (quoting SEC v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 95 (2d Cir. 1978)).

197. *Kokesh*, 137 S. Ct. at 1644.

198. *See* SEC v. Contorinis, 743 F.3d 296, 302 (2d Cir. 2014) (discussing tipper-tippee context).

199. Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 7 (2013), http://www.hblr.org/2013/11/the-equity-facade-of-sec-disgorgement/.

200. Petition for Writ of Certiorari at 22–23, Kokesh v. SEC, 137 S. Ct. 1635 (2017) (No. 16-529) ("[T]he amount that [Kokesh] has been ordered to disgorge far exceeds any amount that [Kokesh] ever received, and instead reflects payments to separate corporations, unrelated officers of those corporations, and even landlords.").

201. Ryan, *supra* note 199, at 5; *see, e.g.*, SEC v. Whittemore, 659 F.3d 1, 9 (D.C. Cir. 2011) (quoting SEC v. Banner Fund Int'l, 211 F.3d 602, 617 (D.C. Cir. 2000)) (explaining that "a disgorgement order pertains to 'a sum equal to the amount wrongfully obtained, rather than a requirement to replevy a specific asset,' and 'establishes a personal liability, which the defendant must satisfy regardless [of] whether he retains the selfsame proceeds of his wrongdoing'" (alteration in original)).

202. U.S. GOV'T ACCOUNTING OFFICE, GAO-02-771, SEC ENFORCEMENT: MORE ACTIONS NEEDED TO IMPROVE OVERSIGHT OF DISGORGEMENT COLLECTIONS 6, 25 (2002), https://www.gao.gov/new.items/d02771.pdf.

serve many purposes, and a civil action that does not serve a strictly remedial purpose, but also a deterrent purpose, is punishment.[203]

C. Higher Stakes—The SEC's New Time Crunch and Potential Increased Costs for Defendants

While the Supreme Court reached the correct decision in *Kokesh v. SEC*, this case will likely have significant impact on both the SEC and defendants in enforcement actions. The agency will likely have less leverage in settlement negotiations and pursue older misconduct less aggressively or not at all.[204] Further, defendants that are ordered to disgorge their ill-gotten profits will face higher costs because penalties are often not covered by insurance or tax deductible.[205]

1. New Restraints on the SEC's Division of Enforcement

The *Kokesh* decision comes at a time when the Securities and Exchange Commission is facing budget constraints under the current administration.[206] In order to brace for the impact from potential budget cuts, the SEC's Division of Enforcement has imposed a hiring freeze, a ban on nonessential travel, and has reduced the use of outside contractors for their work.[207] Even before *Kokesh*, the number of enforcement actions brought by the SEC was predicted to fall significantly.[208] In addition to its budget and resource constraints, the post-*Kokesh* SEC will have less settlement leverage in multi-year enforcement actions now that defendants no longer face risk of disgorgement for conduct over five years old.[209] This reduced leverage may potentially affect the enforceability of a number of cases, as it takes a considerable amount of time for the SEC to bring an enforcement action.[210] As reported in the SEC's Annual Performance Report for the fis-

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203. Austin v. United States, 509 U.S. 602, 610 (1993) (quoting United States v. Halper, 490 U.S. 435, 448 (1989)).

204. *See infra* Part II.C.1.

205. *See infra* Part II.C.2.

206. Matt Robinson & Benjamin Bain, *Wall Street Cops Reined in as SEC Braces for Trump Budget Cuts*, BLOOMBERG (Mar. 6, 2017, 9:00 AM), https://www.bloomberg.com/news/articles/2017-03-06/wall-street-cops-reined-in-as-sec-braces-for-trump-budget-cuts.

207. *Id.*

208. *Id.*

209. Mary Jo White et al., *What* Kokesh v. SEC *Means for Enforcement Actions*, LAW360 (June 8, 2017), https://www.law360.com/articles/932661/what-kokesh-v-sec-means-for-enforcement-actions.

210. *See* Eisenberg, *supra* note 192 ("In FY 2015, the average time between opening a matter under inquiry and commencing an enforcement action was 24 months.").

cal year 2015, the average time between an opening of an investigation and commencement of an enforcement action was twenty-four months.[211]

With the current and looming budget cuts to the agency, the SEC may also be less motivated to investigate older securities law violations.[212] If investigating an older potential violation, the Division of Enforcement will likely push tolling agreements on defendants in order to extend the limitations period, but due to its reduced leverage in enforcement actions, it may be difficult for the Commission to obtain these agreements.[213] Further, because disgorgement is considered a civil penalty, the amount of money the SEC can now take from a defendant is more restricted, for regulations limit the amount of money the agency can take from defendants through civil penalties.[214] Under current regulations, the Commission is authorized to collect from a natural person up to approximately $1,000,000 in civil penalties, depending on the severity of the violation.[215]

The SEC serves the American public by protecting investors and ensuring fair and transparent markets.[216] The Commission's Division of Enforcement plays an especially important role in the agency's mission by bringing hundreds of civil actions in courts every year,[217] in which the SEC seeks to deter wrongdoing in the securities markets.[218] Prior to *Kokesh*, disgorgement was the SEC's most powerful remedy and brought in more than double the amount of damages as other remedies.[219] However, the *Kokesh* decision deals a considerable blow to the SEC's power to effective-

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211. *Id.*; *see* U.S. SEC. & EXCH. COMM'N, FY 2017 CONGRESSIONAL JUSTIFICATION, FY 2015 ANNUAL PERFORMANCE REPORT, AND FY 2017 ANNUAL PERFORMANCE PLAN 38 (2016), https://www.sec.gov/about/reports/secfy17congbudgjust.pdf (listing the average months between beginning of investigation and filing of enforcement action for that investigation for fiscal years 2011 to 2015).

212. White et al., *supra* note 209.

213. *Id.*

214. Peter J. Henning, *Supreme Court Casts Doubts on a Potent S.E.C. Weapon*, N.Y. TIMES: DEALBOOK (June 12, 2017), https://www.nytimes.com/2017/06/12/business/dealbook/supreme-court-casts-doubts-on-a-potent-sec-weapon.html.

215. 17 C.F.R. § 201.1001 (2017); *Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission (as of January 15, 2018)*, U.S. SEC. & EXCH. COMM'N (last modified Jan. 15, 2018), https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm.

216. *What We Do*, U.S. SEC. & EXCH. COMM'N (last modified June 10, 2013), https://www.sec.gov/Article/whatwedo.html.

217. *Id.*

218. *See* Mary Jo White, SEC Chair, Address at the IOSCO Annual Conference: The Challenge of Coverage, Accountability and Deterrence in Global Enforcement (Oct. 1, 2014), https://www.sec.gov/news/speech/2014-spch100114mjw ("The SEC also concentrates on bringing new and innovative actions to enlarge our enforcement footprint and to strengthen deterrence of wrongdoing.").

219. Antoinette Gartrell, *Justices' Ruling Will Limit SEC Settlement Clout, Lawyers Say*, BLOOMBERG BNA (June 5, 2017), https://www.bna.com/justices-ruling-limit-n73014451932/.

ly enforce federal securities laws through disgorgement.[220] For example, in Mr. Kokesh's case, because the vast majority of the disgorgement was for misconduct over five years old, the disgorgement was reduced from about $30 million to $5 million.[221] Consequently, this decision may significantly reduce the disgorgement orders for older misconduct, which may harm the SEC's mission to deter certain securities law violations and, ultimately, protect investors. Research has found that aggressive SEC enforcement deters future misconduct.[222] Due to the *Kokesh* holding, however, the Commission will likely be less inclined to aggressively pursue disgorgement for long-term and well-hidden misconduct,[223] such as Ponzi schemes[224] and Foreign Corrupt Practices Act ("FCPA") violations.[225] In sum, *Kokesh* may contribute to a considerable decline in the SEC's enforcement capabilities.

2. *Higher Costs for Misconduct Within Section 2462*

While the *Kokesh* decision likely restrains the SEC's Division of Enforcement in certain cases, there are also financial implications for defendants in securities enforcement actions. For instance, now that disgorgement is considered a penalty, insurers may not indemnify defendants that are or-

220. *See* Sarah N. Lynch & Lawrence Hurley, *Supreme Court Limits SEC's Power to Recover Ill-Gotten Gains*, REUTERS (June 5, 2017, 10:19 AM), https://www.reuters.com/article/us-usa-court-sec/supreme-court-limits-secs-power-to-recover-ill-gotten-gains-idUSKBN18W1UQ (noting that the new restriction "will especially affect complicated cases that require more time for the SEC to investigate").

221. Andrew J. Morris, "Kokesh v. SEC"*: Its Wide-Ranging (and Mostly Good) Implications for Disgorgement Actions*, WLF LEGAL PULSE (June 14, 2017), https://wlflegalpulse.com/2017/06/14/kokesh-v-sec-its-wide-ranging-and-mostly-good-implications-for-disgorgement-actions/.

222. *See* Diane Del Guercio et al., *The Deterrence Effect of SEC Enforcement Intensity on Illegal Insider Trading: Evidence from Run-up Before News Events*, 60 J. L. & ECON. 269, 271 (2017) ("Under more aggressive enforcement, traders with access to inside information before its public announcement should fear detection and punishment, and thus less illegal trading will occur.").

223. Fortunately for the SEC, the majority of its enforcement actions commence within five years of the misconduct, so this decision will not likely adversely affect many of the Commission's enforcement proceedings. Paul C. Curnin, Kokesh v. SEC*: Supreme Court to Discuss Application of Statute of Limitations to SEC Disgorgement*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 4, 2017), https://corpgov.law.harvard.edu/2017/05/04/kokesh-v-sec-supreme-court-to-discuss-application-of-statue-of-limitations-to-sec-disgorgement/.

224. *Id.*

225. *See* Brad S. Karp, *Five-Year Statute of Limitations Applies to Claims for Disgorgement Brought by the SEC*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 12, 2017), https://corpgov.law.harvard.edu/2017/06/12/five-year-statute-of-limitations-applies-to-claims-for-disgorgement-brought-by-the-sec/ ("Several recent settlements of SEC enforcement actions brought under the Foreign Corrupt Practices Act . . . have involved conduct spanning many years."). The Foreign Corrupt Practices Act is a law enforced by the SEC and forbids the payment of bribes to foreign government officials in order to gain business. *Foreign Corrupt Practices Act*, U.S. SEC. & EXCH. COMM'N (last modified Feb. 2, 2017), https://www.sec.gov/spotlight/foreign-corrupt-practices-act.shtml.

dered to disgorge their ill-gotten gains within five years of their violation.[226] Courts have previously held that the indemnification of penalties is incompatible with public policy and prevented such coverage.[227] And the prospect is not theoretical. In fact, insurance companies began using this argument to avoid indemnifying disgorged profits to those they insured only a few days after the *Kokesh* decision.[228] Further, many insurance policies include provisions prohibiting the indemnification of civil penalties.[229] This will especially impact individuals subject to large disgorgement orders, as opposed to businesses, for individuals are often unable to pay the disgorgement without indemnification.[230]

Along with insurance implications, disgorgement's classification as a penalty may also affect the tax deductibility of the civil remedy.[231] Under the Internal Revenue Code, one may deduct "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."[232] Payments made for court settlements and judgments are generally deductible as ordinary and necessary business expenses.[233] Before *Kokesh*, the tax code allowed defendants to deduct the disgorgement amount from their taxes.[234] However, the Internal Revenue Code does not allow deductions "for any fine or similar penalty paid to a government for

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226. *See* Andrew Ceresney, *The Impact of the* Kokesh *Decision on Disgorgement For Conduct Within the Statute of Limitations*, BLOOMBERG BNA (June 29, 2017), https://www.bna.com/impact-kokesh-decision-n73014461027/ (describing limitations on insurance coverage for penalties).

227. *See, e.g.*, Twp. of Glouchester v. Md. Cas. Co., 668 F. Supp. 394, 398, 401–02 (D.N.J 1987) (finding that public policy prohibits insurance from covering fines and penalties); City of Fort Pierre v. United Fire & Cas. Co., 463 N.W.2d 845, 848 (S.D. 1990) ("[A]s a general rule, it is against public policy to allow the insured wrongdoer to shift the burden of payment of punitive damages to its insurer.").

228. Howard B. Epstein & Theodore A. Keyes, *SEC Disgorgement: Is It Insurable?*, N.Y. L.J. (July 24, 2017), https://www.law.com/newyorklawjournal/almID/1202793636966.

229. Ceresney, *supra* note 226.

230. *See* Dixie L. Johnson & M. Alexander Koch, *Reflections on* Kokesh v. SEC*: Potential Ramifications of SEC Disgorgement Being a Penalty*, LAW J. NEWSLETTERS (Sept. 2017), http://www.lawjournalnewsletters.com/sites/lawjournalnewsletters/2017/09/01/reflections-on-kokesh-v-sec-2/ (noting the hardship for defendants who lack the support of "their former employer, insurance company or some other source").

231. *See* Ceresney, *supra* note 226 ("If, as *Kokesh* held, disgorgement amounts to a penalty, then presumably the tax code would preclude any deduction as an expense.").

232. 26 U.S.C. § 162(a) (2012).

233. Johnson & Koch, *supra* note 230.

234. *See* Peter J. Henning, *Deducting the Costs of a Government Settlement*, N.Y. TIMES: DEALBOOK (Mar. 24, 2014, 1:17 PM), https://dealbook.nytimes.com/2014/03/24/deducting-the-costs-of-a-government-settlement/ (describing the disgorgement of a CEO's insider trading gains as "an equitable remedy" and, therefore, tax deductible); *see also* Robert W. Wood, *Insurance Industry Settlements Revive Old Questions: When Is a Payment a Nondeductible Penalty?*, 103 J. TAX'N 47, 48 (2005) ("Restitution (or disgorgement of profits) is generally deductible as a business expense.").

the violation of any law."[235] These payments include those "[p]aid in settlement of the taxpayer's actual or potential liability for a fine or penalty."[236] This has a considerable impact on a defendant's costs, for if a settlement or court order is tax deductible, up to half of the payment may be deducted from taxes.[237] However, now that disgorgement is considered a penalty, the IRS will likely bar parties from deducting disgorgement payments from their taxes.[238] In fact, prior to the *Kokesh* decision, the Office of the Chief Counsel for the IRS noted in a memorandum[239] that a "payment imposed primarily for purposes of deterrence and punishment is not deductible," including disgorgement payments to the SEC for FCPA violations.[240] Due to higher tax burdens[241] and insurance insecurity,[242] defendants facing disgorgement in SEC enforcement actions for conduct less than five years old may be more likely to settle, and the now heightened costs of disgorgement may also deter others from violating federal securities laws.

III. CONCLUSION

In *Kokesh v. SEC*, the Supreme Court of the United States held that disgorgement in securities enforcement operated as a penalty under the statute of limitations and must be brought within five years of the date when the claim accrued.[243] The Court reached the right conclusion in this case because the SEC used disgorgement to penalize those who violate federal securities laws and to deter others from committing the same wrongful acts.[244] Further, the Court correctly found that disgorgement in securities enforcement did not refund victims for their losses or return the defendant to the place they were before they violated the law.[245] Despite coming to the correct conclusion, *Kokesh* places new constraints on the SEC's ability to successfully enforce federal securities laws[246] and imposes heightened costs on the remaining defendants who are ordered to disgorge their ill-gotten gains, due to the remedy's reclassification as a penalty.[247]

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235. 26 U.S.C. § 162(f) (2012).

236. Treas. Reg. § 1.162-21(b)(1)(iii) (as amended in 1975).

237. Ceresney, *supra* note 226.

238. *Id.*

239. I.R.S. Gen. Couns. Mem. 201,619,008 (Jan. 29, 2016), https://www.irs.gov/pub/irs-wd/201619008.pdf. It should be noted that the Chief Counsel's opinion from the memorandum is not binding authority. Ceresney, *supra* note 226.

240. I.R.S. Gen. Couns. Mem. 201,619,008 (Jan. 29, 2016), https://www.irs.gov/pub/irs-wd/201619008.pdf.

241. *See supra* notes 231–240 and accompanying text.

242. *See supra* notes 226–230 and accompanying text.

243. Kokesh v. SEC, 137 S. Ct. 1635, 1639 (2017).

244. *See supra* Part II.A.

245. *See supra* Part II.B.

246. *See supra* Part II.C.1.

247. *See supra* Part II.C.2.