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SEC Disgorgement Issue Ripe For High Court Review

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Earlier this month, the U.S. Securities and Exchange Commission joined in on a request that the U.S. Supreme Court review a long-simmering issue that has federal circuit courts and government agencies at odds: Does the five-year statute of limitations in 28 U.S.C. § 2462 apply to SEC disgorgement claims?


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When the SEC brings, or threatens to bring, an enforcement action, it wields many potential weapons in the form of relief sought — both monetary and nonmonetary. The statute of limitations on any "action, suit or proceeding" that seeks to enforce "any civil fine, penalty or forfeiture, pecuniary or otherwise ..." is five years under Section 2462. Because SEC investigations can take years to conclude, defendants are often faced with the prospect of paying disgorgement relating to very old conduct. Often the potential amount of disgorgement (and prejudgment interest) can be significant.

However, there is no consensus in the courts as to whether Section 2462 applies to disgorgement or other equitable relief such as a bar or censure.[1] And even federal agencies don't agree on the issue. In May, the IRS famously found itself tangled in this debate when it determined that disgorgement paid to the SEC was a nondeductible "fine or penalty" under Internal Revenue Code § 162(f), directly contradicting the SEC's position on the nature of disgorgement.[2] Even the SEC, while generally maintaining that disgorgement is not a penalty or forfeiture under Section 2462, has taken a contrary position in at least one bankruptcy proceeding.[3] This issue is ripe for Supreme Court review, and, rather than permitting the SEC to reach back in time for an infinite, or at least indefinite, time period, the statute should be interpreted to bar the SEC from seeking disgorgement more than five years after the alleged wrongful conduct.[4]

The Supreme Court Speaks and the Circuits Split

In 2013, the Supreme Court touched on the scope of Section 2462 in SEC v. Gabelli, -- U.S --, 133 S.Ct. 1216 (2013). In Gabelli,the court analyzed whether the accrual of the statute of limitations could be tolled where the conduct of the defendant prevented the government from discovering the alleged wrongful conduct. The court held that this "discovery rule" did not apply and, thus, Section 2462 barred the SEC's action for

civil penalties.[5] In this context, the court defined a penalty as "go[ing] beyond compensation ... intended to punish, and label[ing] defendants wrongdoers."[6] The Supreme Court in Gabelli clearly set forth the policy behind enforcing the statute to avoid "leav[ing] defendants exposed to Government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future."[7] The court went on to say that it "'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'"[8] The court declined to weigh in on the application of Section 2462 to disgorgement.[9]

In May 2016, the Eleventh Circuit confronted this issue in SEC v. Graham.[10] It held that disgorgement constituted "forfeiture" under Section 2462 and declaratory relief was a penalty as defined by Gabelli, but that injunctive relief was not subject to Section 2462 because it was not a "penalty." The Eleventh Circuit's analysis focused on the "ordinary meaning" of Section 2462's terms, as determined from dictionary definitions and the usage of these terms in prior precedent.[11] Of particular note concerning disgorgement, Graham identified recent Supreme Court precedent in which forfeiture and disgorgement are effectively synonyms.[12] Therefore, under the Eleventh Circuit's analysis, any claim for disgorgement was time-barred after five years, but claims for injunctive relief were not.

Varying from the Eleventh Circuit's focus on "ordinary meaning," the Tenth Circuit in SEC v. Kokesh analyzed the statutory language of Section 2462 with greater emphasis on "historical meaning." The Tenth Circuit likewise held that injunctive relief is generally not a penalty,[13] but the court departed from the Eleventh Circuit's interpretation of "forfeiture."[14]

The Tenth Circuit read this term "in the context of government causes of action — 'an action, suit or proceeding ....'"[15] Pursuant to this reading, the court interpreted "forfeiture" to refer to a particular type of in rem procedure in which the government acquires property or proceeds used in, or acquired as a result of, criminal activity.[16] It held that Congress "contemplate[ed] the meaning of forfeiture in this historical sense," because "the term forfeiture is linked in section 2462 to the undoubtedly punitive actions for a civil fine or penalty," thereby attaching an additional, unstated requirement for "forfeiture" based on syntactical proximity.[17] However, the Tenth Circuit failed to consider the prepositional phrase "for the enforcement of" that connects "an action, suit or proceeding" with "any civil fine, penalty, or forfeiture," in Section 2462 when parsing this language.[18] This phrase specifies that the government causes of actions subject to Section 2462 are those enforcing a "civil fine, penalty, or forfeiture ...." It is therefore unnecessary to interpret the cause of action Congress intended with the word "forfeiture."

The Ninth Circuit's Stance

The Ninth Circuit has not directly weighed in on how to interpret Section 2462's language, but it has come close in at least one instance.[19] In SEC v. Rind, 991 F.2d 1486 (9th Cir. 1993), 20 years before the Supreme Court's decision in Gabelli, the court found — without directly addressing Section 2462 — that no statute of limitations applies to the SEC's civil enforcement actions.[20]

In Rind, the defendant argued that SEC actions for civil enforcement, including those seeking disgorgement, should be subject to a one-year statute of limitations and a three-year statute of repose.[21] The defendant described such disgorgement actions as "seeking money damages in the same manner as any private plaintiff."[22] In support of this argument, the defendant relied on certain state statutes of limitations as well as the Supreme Court's decision in Lampf Pleva Lipkind Prupis & Petigrow v. Gilbertson. 501 U.S. 350 (1991), which held that a one-year statute of limitations and a three-year period of repose, inferred from similar limitations periods throughout the federal securities

laws, would apply to private actions under Section 10(b) of the 1934 Act and Rule 10b-5.[23]

The Rind court was unpersuaded for two reasons. First, unlike a private plaintiff, the SEC is protecting the public interest by enforcing the federal securities laws.[24] Second, the Ninth Circuit posited that disgorgement has a deterrent purpose against future violations, while money damages compensate victims for prior actions.[25] What Rind's analysis, predicated on congressional silence and state statutes, did not consider is the language in Section 2462, and the congressional intent behind that language. Only one of the relevant terms of Section 2462 (i.e. "civil fine, penalty, or forfeiture, pecuniary or otherwise") is even tangentially examined in Rind — "penalty." There is no mention of forfeiture, which, as Kokesh and Graham make clear, is pertinent to any analysis of disgorgement.

Obviously, like the Tenth and Eleventh Circuits, the Ninth Circuit would benefit from Supreme Court clarification of this issue. Indeed, in the absence of Supreme Court guidance, the Ninth Circuit has begun applying the reasoning in Rind to related subject areas, such as the reimbursement provisions of Sarbanes-Oxley Act Section 304.[26] Such guidance would ideally provide a clear timetable for SEC civil enforcement actions while shielding defendants from unpredictable remedies that could "be brought at any distance of time."[27]

Finality at Last?

The lack of clarity poses a substantial risk for litigants on both sides of an SEC enforcement action. Without a clear cutoff date for disgorgement, the SEC and defendants alike are forced to conduct litigation without being able to assess the financial stakes.

The fact that the SEC joined in the Kokesh petition for certiorari to the Supreme Court suggests that all sides of this issue concur on the need for a better answer to the question presented: "Does the five-year statute of limitations in 28 U.S.C. § 2462 apply to claims for 'disgorgement'?"

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[1] SEC v. Kokesh, -- F. 3d --, No. 15-2087, 2016 WL 4437585 (10th Cir. Aug. 23, 2016), petition for cert. filed, (U.S. Oct. 19, 2016) (No 16-529) (holding § 2462 is inapplicable to disgorgement action) and SEC v. Graham, 823 F.3d 1357 (11th Cir. 2016) (holding § 2462 barred untimely disgorgement action).

[2] See C.C.A. 2016-19-008 (May 06, 2016) (determining that disgorgement paid to SEC could not be deducted from taxes under I.R.C. § 162(f), which disallows deductions for "any fine or similar penalty paid to a government for the violation of any law").

[3] See, e.g., SEC v. Telsey, 144 B.R. 563, 565 (Bankr. S.D. Fla. 1992) ("With regard to the SEC's argument that [this disgorgement] is excepted from discharge pursuant to § 523(a)(7) [which provides that a debtor may not discharge debt for a fine, penalty, or forfeiture] ....").

[4] In addition to disgorgement, declaratory relief, and injunctive relief, the SEC often seeks to impose

associational or industry bars or suspensions against the subjects of its enforcement actions. It is unclear whether Section 2462 applies to these forms of relief. See Johnson v. SEC, 87 F.3d 484, 485 (D.C. Cir. June 21, 1996) (holding censure and suspension are penalties under § 2462) and In re Blizzard, S.E.C. Release No. 229, 80 S.E.C. Docket 1464, at *20 (Admin. Proceeding File No. 3-10007, June 13, 2003) (same); but see SEC v. Brown, 740 F. Supp. 2d 148, 157 (D.D.C Sept. 27, 2010) (holding § 2462 did not bar officer-and-director suspension against defendant because it was focused on risk of future harm as opposed to the defendant's past actions).

[5] The discovery rule is applicable to claims sounding in fraud, wherein there is a risk that the conduct giving rise to a claim may be concealed by such fraud. Gabelli, 133 S.Ct. at 1221.

[6] Gabelli, 133 S.Ct. at 1223.

[7] Id.

[8] Id. (marks omitted).

[9] Gabelli, 133 S.Ct. at 1220, n. 1 ("The SEC also sough injunctive relief and disgorgement, claims the District Court found timely on the ground that they were not subject to § 2462. *Those issues are not before us.*") (emphasis added).

[10] SEC v. Graham, 823 F.3d 1357 (11th Cir. 2016) (holding § 2462 barred untimely disgorgement action).

[11] Graham, 823 F.3d at 1363 ("Following the same principles of statutory interpretation as we did with the term 'penalty,' we look to the ordinary meaning of "forfeiture.").

[12] Graham, 823 F.3d at 1363 ("The Supreme Court, too, has used the terms [disgorgement and forfeiture] interchangeably. See United States v. Ursery, 518 U.S. 267, 284, 116 S.Ct. 2135, 135 L.Ed.2d 549 (1996) ('Forfeitures serve a variety of purposes, but are designed primarily to confiscate property used in violation of the law, and to require disgorgement of the fruits of illegal conduct.').").

[13] Kokesh, 2016 WL 4437585, at *3 ("We fail to see how an order to obey the law is a penalty.").

[14] Kokesh, 2016 WL 4437585, at *5-6.

[15] Kokesh, 2016 WL 4437585, at *5.

[16] Kokesh, 2016 WL 4437585, at *5 (citing Black's Law Dictionary's definition of civil forfeiture).

[17] Kokesh, 2016 WL 4437585, at *6.

[18] Kokesh, 2016 WL 4437585, at *5 (emphasis added).

[19] In addition to Rind, discussed infra, the Ninth Circuit has recently weighed in on a related issue involving the SEC's ability to seek disgorgement from "CEOs and CFOs" under SOX 304 without regard for personal misconduct. See SEC v. Jensen, 835 F.3d 1100, 1104 (9th Cir. Aug. 18, 2016) ("[T]he disgorgement remedy authorized under SOX 304 applies regardless of whether a restatement was caused by the personal conduct of an issuer's CEO and CFO or by other issuer misconduct."). Under this

analysis, such disgorgement was found to be an equitable remedy. This conclusion has limited applicability to the issue of whether disgorgement is subject to Section 2462's time bar, because SOX 304 allows for disgorgement without regard for personal wrongdoing, meaning disgorgement under SOX 304 is truly not designed to penalize the individual affected.

[20] Rind, 991 F.2d at 1488, 1490 ("The district court held that the Commission was not bound by a statute of limitations ... we affirm.") ("The fact that [Congress] did not enact an express statute of limitations for lawsuits instituted by the Commission, therefore, must be interpreted as deliberate."). The court also determined that the defendant was not entitled to a trial under the Seventh Amendment because disgorgement is a form of equitable relief. Id. at 1492-93. This analysis suffers from similar infirmities contained within its analysis of the appropriate limitations period, as discussed infra.

[21] Rind, 991 F.2d at 1489.

[22] Rind, 991 F.2d at 1489.

[23] Lampf, 501 U.S. at 364. Lampf's holding was superseded by Section 27A of the Securities and Exchange Act of 1934, which provides that an action that was commenced "on or before June 19, 1991" is governed by the limitation period "provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991," See Wegbriet v. Marley Orchards Corp., 793 F. Supp. 965, 967 (E.D. Wa. 1992).

[24] Rind, 991 F.2d at 1490.

[25] Rind, 991 F.2d at 1490.

[26] See SEC v. Jasper, 678 F.3d 1116, 1130 (9th Cir. 2012) ("Ninth Circuit law is clear that the reimbursement provision of SOX 304 is considered an equitable disgorgement remedy and not a legal penalty.").

[27] Gabelli, 133 S.Ct. at 1223.
