

Why Kokesh Really Matters

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For U.S. Securities and Exchange Commission enforcement practitioners, perhaps the blockbuster decision of the last U.S. Supreme Court term was *Kokesh v. SEC*[1] — but not for the reason that you might suspect. In *Kokesh*, the Supreme Court held that the disgorgement remedy, when sought by the SEC in an enforcement action, is a “penalty” subject to the five-year statute of limitations found in 28 U.S.C. § 2462. On its own terms, this is a significant decision, as the SEC each year obtains orders for disgorgement in amounts that far outstrip ordered monetary penalties.

In the aftermath of *Kokesh*, the SEC has continued filing enforcement actions in federal district courts seeking disgorgement,[2] as if the import of the decision is only that disgorgement is subject to a five-year statute of limitations. This overlooks two far more significant ramifications of *Kokesh* for SEC enforcement practice. First, if disgorgement is a penalty, rather than an equitable remedy, then there is no statutory authorization for federal district courts to order that penalty. Second, even if disgorgement is an authorized penalty in federal district court enforcement actions, a defendant will be entitled to a jury trial on the amount of disgorgement precisely because it is a penalty. We discuss both of these implications below.

The Holding of *Kokesh*

In *Gabelli v. SEC*,[3] the Supreme Court held that the five-year statute of limitations found in 28 U.S.C. § 2462 is applicable to penalties sought in SEC enforcement actions, and that statute of limitations is not subject to a discovery rule.[4] Rather, the statute of limitations begins to run once the violation is committed regardless of when it is discovered by the SEC.[5] In a footnote in the *Gabelli* opinion, the court left open the question whether the five-year statute of limitations was also applicable to other remedies, such as disgorgement.[6]

In *Kokesh*, the Supreme Court took up the issue left open in *Gabelli*, namely the applicability of the Section 2462 statute of limitations to disgorgement. Section 2462 provides that its limitations period applies to “an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture.” The petitioner in *Kokesh* argued that disgorgement in SEC enforcement actions was both a “forfeiture” and a “penalty.”[7]

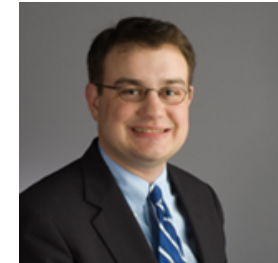
In a unanimous decision, the Supreme Court held that disgorgement in SEC enforcement actions is a “penalty.”[8] The *Kokesh* court’s holding in this regard turned on two features of the disgorgement remedy. First, the court noted that disgorgement is explicitly imposed in order to achieve deterrence, which is a penal concept.[9] Second, the court reasoned that disgorgement in SEC enforcement actions is a penalty because it often exceeds amounts that would be considered



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compensatory and is paid to third parties, such as the district courts or the U.S. Treasury, rather than distributed to an injured party.[10]

While ruling that disgorgement in SEC enforcement actions is subject to the statute of limitations of Section 2462, the court suggested in a footnote that it doubts the authority of federal courts to impose disgorgement at all. As the court stated: “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.”[11] As discussed below, it is with good reason that the Supreme Court reserved judgment on the question whether disgorgement is an authorized remedy in SEC enforcement actions.

Disgorgement is Not Statutorily Authorized in District Court Actions

If disgorgement is a penalty, a question arises concerning the source of authority for courts to impose this remedy. As originally conceived, disgorgement was considered an equitable remedy that courts were authorized to impose pursuant to the federal securities laws’ general grant of equitable jurisdiction to federal district courts. Specifically, Section 27 of the Securities Exchange Act of 1934 and Section 22 of the Securities Act of 1933 grant district courts jurisdiction over “all suits in equity ... brought to enforce” the federal securities laws.[12] Beginning in the early 1970s, courts reasoned that these conferrals of equity jurisdiction also empowered district courts to impose not only injunctions, but also equitable monetary remedies.[13] Even those courts, however, were careful to note that the equitable power did not include the authority to fashion or impose penalties.[14]

Thus, even if equitable monetary remedies are authorized by Section 27 of the Exchange Act and Section 22 of the Securities Act, there is no basis in the federal securities laws for district courts to fashion and impose penalties, like disgorgement. The imposition of penalties is not even arguably within a court’s equitable authority.[15] And it is an “elementary rule that a penalty is not to be readily implied, and, on the contrary, that a person or corporation is not to be subjected to a penalty unless the words of the statute plainly impose it.”[16] The federal securities laws do not authorize, plainly or otherwise, the imposition of a disgorgement penalty in SEC enforcement actions brought in federal district court.[17] To the contrary, the express grant of authority in both the Securities Act and the Securities Exchange Act to impose specified monetary penalties under certain circumstances[18] is inconsistent with the notion that courts are further authorized to order judicially created disgorgement penalties.

In other words, the premise underlying a district court’s supposed equitable power to impose a disgorgement remedy was the belief that disgorgement was not a penalty. The Supreme Court has now rejected that premise. And there is no express statutory authorization to impose a disgorgement penalty in a district court enforcement action. So, while courts are authorized to impose certain civil monetary penalties in SEC enforcement actions, courts have no authority to create and impose disgorgement penalties.

It is worth noting that disgorgement is expressly authorized as a remedy available in cease-and-desist proceedings brought in the administrative forum.[19] However, the Tenth Circuit has ruled that the SEC’s administrative law judges are not

constitutionally appointed.[20] If they are not, cease-and-desist proceedings would not present a viable alternative forum in which the SEC could seek disgorgement. More importantly, it is unlikely that the SEC could bring every litigated enforcement action in an administrative forum, at least not without a significant increase in the number of administrative law judges. Thus, if disgorgement is not available in federal district court enforcement proceedings, then the SEC would, as a practical matter, be limited in its ability to obtain that remedy. It also remains unclear how the Financial Choice Act of 2017[21] — which is pending in Congress and would allow respondents in administrative proceedings to remove their cases to federal district court[22] — would impact the SEC’s ability to recover disgorgement with regard to any such removed actions.

The Seventh Amendment Jury Trial Right Applies to the Disgorgement Penalty

The *Kokesh* decision also has significant ramifications for the scope of a defendant’s jury trial right in an SEC enforcement action. Before *Kokesh*, courts took the position that the Seventh Amendment jury trial right does not apply to the imposition and calculation of disgorgement, since it was considered an equitable remedy.[23] Even were there a statutory basis for district courts to impose a disgorgement penalty, courts nonetheless would need to revisit the jury trial question with regard to disgorgement now that it has been deemed a penalty.

In *Tull v. United States*,[24] the Supreme Court held that the jury trial right extends to the finding of “liability” requisite to the imposition of a monetary penalty in a civil government enforcement action brought in federal district court.[25] This jury trial right has been recognized as applying in enforcement actions brought by the SEC seeking civil money penalties.[26] Now that the Supreme Court has ruled that disgorgement in SEC enforcement actions is a “penalty,” it is inevitable that, if disgorgement is authorized as a remedy, a defendant has a right to a jury trial as to his or her liability for such penalty.

As we have explained elsewhere, this Seventh Amendment jury trial right includes the right to a jury finding as to all facts that increase the maximum civil monetary penalty that can be imposed.[27] In the criminal context, the Sixth Amendment jury trial right — which the Supreme Court has stated is “analogous” to the Seventh Amendment jury trial right in civil cases[28] — includes the right to a jury finding as to the amount of gain or loss resulting from the violation to the extent that amount increases the maximum criminal penalty to which a defendant is subject.[29] Similarly, in an SEC enforcement action in federal district court, the Seventh Amendment jury trial right would include a right to a jury finding as to the gain to the defendant resulting from the securities law violation that would then serve as the upper bounds of the disgorgement penalty that the district court could impose.[30]

Conclusion

Kokesh didn’t just limit the availability of disgorgement in federal court, it eliminated it. No court has so held as of yet, but it is only a matter of time. This is the inevitable implication of the Supreme Court’s reasoning. While the SEC won’t give up on disgorgement without a fight, it is a fight the SEC almost certainly will lose. That’s why *Kokesh* really matters.

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[1] 137 S. Ct. 1635 (2017).

[2] See, e.g., SEC v. Carton, No. 17-6764 (S.D.N.Y. filed Sept. 6, 2017) (seeking disgorgement and civil monetary penalties); SEC v. Bennett, No. 17-2453 (D. Md. filed Aug. 25, 2017) (same); SEC v. Tennstar Energy Inc., No. 17-151-WTM-GRS (S.D. Ga. filed Aug. 11, 2017) (same).

[3] 568 U.S. 442 (2013).

[4] *Id.* at 445, 454.

[5] See *id.* at 454.

[6] *Id.* at 447 n.1.

[7] Brief of Petitioner at 8, 12, 23, *Kokesh v. SEC*, No. 16-529 (U.S. Feb. 24, 2017), 2017 WL 766064.

[8] *Kokesh*, 137 S. Ct. at 1645.

[9] *Id.* at 1643-44.

[10] *Id.* at 1644.

[11] *Id.* at 1642 n.3.

[12] 15 U.S.C. § 77v(a) (2012); 15 U.S.C. § 78aa(a) (2012).

[13] See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971).

[14] *Id.* (“[W]e hold that the SEC may seek other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment.”).

[15] See *id.*

[16] See *Keppel v. Tiffin Sav. Bank*, 197 U.S. 356, 362 (1905).

[17] To be sure, the federal securities laws do authorize courts to impose monetary penalties up to “the gross amount of pecuniary gain” by a defendant from his violation. 15 U.S.C. § 77t(d) (2012); 15 U.S.C. § 78u-1(a) (2012). But disgorgement is imposed by courts in addition or as an alternative to these statutory penalties. There is no statutory authorization for an additional penalty in the form of disgorgement.

[18] See 15 U.S.C. § 77t(d) (2012); 15 U.S.C. § 78u-1(a) (2012).

[19] 15 U.S.C. § 77h-1(e) (2012); 15 U.S.C. § 78u-3(e) (2012).

[20] *Bandimere v. SEC*, 844 F.3d 1168, 1181 (10th Cir. 2016) (finding that SEC ALJs are “inferior officers who must be

appointed in conformity with the Appointments Clause”), rehearing denied, 855 F.3d 1128 (10th Cir. 2017).

[21] H.R. 10, 115th Cong. (1st Sess. 2017).

[22] *Id.* § 714.

[23] See, e.g. *SEC v. Tome*, 833 F.2d 1086, 1096 n.7 (2d Cir. 1987) (“[T]he Seventh Amendment right to a jury trial does not apply to the equitable actions for disgorgement”).

[24] 481 U.S. 412, 414 (1987).

[25] *Id.* at 427.

[26] See *SEC v. Lipson*, 278 F.3d 656, 662 (7th Cir. 2002) (holding that defendant was entitled under *Tull* to a jury trial as to liability when the SEC sought a civil money penalty).

[27] Matthew T. Martens, Jaclyn N. Moyer & Derek A. Woodman, [The Scope of SEC Defendants’ Jury Trial Right: Part 1](#), *Law360* (July 1, 2016).

[28] *Feltner v. Columbia Pictures Television Inc.*, 523 U.S. 340, 355 (1998).

[29] *S. Union Co. v. United States*, 567 U.S. 343, 349-50 (2012).

[30] *Martens et al.*, *supra* note 27.