# Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Disgorgement is a 'penalty' subject to 5-year limitations period, (Jun. 5, 2017)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The Supreme Court ruled that SEC disgorgement constitutes a penalty and is thus subject to the five-year limitations period of 28 U.S.C. §2462. Writing for a unanimous Court, Justice Sotomayor said that disgorgement "bears all the hallmarks of a penalty: It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate" (*Kokesh v. SEC*, June 5, 2017, Sotomayor, S.).

The petitioner was ordered to pay the SEC over $53 million in disgorgement and interest for alleged violations that occurred as far back as 1995. Under §2462, a five-year statute of limitations period applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." The petitioner argued that disgorgement fell within this limitations period, but both the district court and a Tenth Circuit panel disagreed. Disgorgement, the latter reasoned, is remedial in nature and neither a penalty nor a forfeiture under the statute.

**Characteristics of a penalty.** The Court held in *Gabelli v. SEC* (U.S. 2013) that §2462's five-year limitations period applies when the SEC seeks statutory monetary penalties. Now examining whether the statute also set a time limit on disgorgement, the Court began with two principles derived from the definition of "penalty" in *Huntington v. Attrill* (U.S. 1892) (a penalty is a "punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws"). First, whether a sanction is a penalty turns in part on whether it seeks to redress a wrong to the public or to the individual. Second, a pecuniary sanction operates as a penalty only if it is sought for the purposes of punishment and deterrence, as opposed to compensating a victim for his loss.

These principles "readily demonstrate[]" that disgorgement constitutes a penalty for several reasons. First, courts impose disgorgement as a consequence for violating public laws. The government conceded in its brief that when the SEC seeks disgorgement, it acts in the public interest to remedy harm to the public at large. Second, the deterrent effect of SEC disgorgement is not incidental; courts have consistently held that this is its primary purpose. Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive. Finally, SEC disgorgement is not necessarily compensatory. Disgorged profits are paid to the district court, which retains the discretion to determine how and to whom the money will be distributed. Some disgorged funds are paid to victims, but others go to Treasury.

**Disgorgement can exceed defendant's net gain.** The Court also rejected the premise of the government's argument that disgorgement is remedial because it restores the status quo. SEC disgorgement sometimes exceeds the defendant's profits, as when an insider trader or tipper is ordered to disgorge benefits accruing to third parties. And, as demonstrated by this case, SEC disgorgement is sometimes ordered without consideration of the defendant's expenses. "In such cases, disgorgement does not simply restore the status quo; it leaves the defendant worse off."

While disgorgement does serve compensatory goals in some cases, sanctions frequently serve more than one purpose. Because disgorgement orders go beyond compensation, are intended to punish, and label defendants wrongdoers for violating public laws, they represent a penalty and fall within the §2462 limitations period.

The case is No. 16-529.

Attorneys: Adam G. Unikowsky (Jenner & Block LLP) for Charles R. Kokesh. Jeffrey B. Wall, U.S. Department of Justice, for the SEC.

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