

Kokesh Spread Could Pose Risk To SEC Enforcement Power

By **Dunstan Prial**

Law360 (June 29, 2018, 7:39 PM EDT) -- While the U.S. Securities and Exchange Commission has highlighted the significant financial impact of a Supreme Court ruling last year that limited the time the agency has to recover ill-gotten funds through disgorgements, the greater concern for the agency going forward is whether the finding will eventually spread to other remedies, legal experts say.

The high court's unanimous decision in *Kokesh v. the SEC* found that disgorgement is a civil penalty and as a result subject to a five-year statute of limitations, a restriction SEC Enforcement Division co-director Steven Peikin recently told a Congressional committee has cost the agency \$800 million in funds it was unable to obtain.

Potentially more troublesome, however, are legal challenges to other SEC remedies based on a *Kokesh* argument that, if successful, could pose a threat to the SEC's enforcement powers that reaches beyond the loss of disgorgement money, experts say.

"*Kokesh* is not entirely about money," said David Chase, a former SEC prosecutor who is now principal in his own Florida-based defense firm. "The *Kokesh* decision may over time expand beyond the rather narrow holding of the Supreme Court that limited it to dealing with the remedy of disgorgement."

Chase said courts have been presented with the issue of whether or not the *Kokesh* finding can be read broadly to, for example, impose a five-year statute of limitations on other forms of remedial relief, such as bars on serving as an officer or director of a publicly traded company or bars from the security industry.

In finding that SEC disgorgement is a civil penalty subject to a five-year statute of limitations, the high court overturned a Tenth Circuit decision upholding \$35 million in disgorgement and \$18 million in prejudgment interest against New Mexico investment adviser Charles R. *Kokesh*.

The ruling was seen as a sharp rebuke to the SEC, which had maintained that its disgorgement was an equitable remedy not subject to any time limits and one that merely reinstates the status quo by requiring defendants to cough up ill-gotten gains.

Chase said the blow dealt to the SEC by the *Kokesh* ruling has a number of likely ramifications, including a "loss of appetite" on the agency's part for older cases because of the inevitability of bumping up against the five-year disgorgement rule.

"The older cases that were in the portfolio or the pipeline of SEC enforcement have probably been shed," Chase said. "And I think it's going to cause enforcement to move quicker on their cases if the cases are a little older."

Eleonora Zlotnikova, who practices securities litigation with Sam P. Israel PC, also predicted a rollback in enforcement actions, especially those that deal with long-running frauds. "It just may not make much sense for the enforcement division to keep going after these things, especially given the apparent lack of resources they're receiving from the current administration," she said.

Zlotnikova said the rationale behind the Kokesh ruling is filtering down to lower courts as they consider whether other forms of relief that the SEC commonly pursues might also be subject to a five-year statute of limitations, such as injunctions and industry bars. Those remedies historically have been looked at as equitable forms of relief, according to Zlotnikova, but the Kokesh decision has potentially opened the door to lower court findings that they are punitive rather than equitable and as a result potentially subject to five-year statutes of limitations, she said.

"Even though the Kokesh opinion itself was clear that it only applied to disgorgement, I think an argument could be made — and there's room to make that argument — that other forms of penalties that the SEC pursues are not solely equitable and could be considered to be punitive," Zlotnikova said.

A footnote in Justice Sonia Sotomayor's written opinion in Kokesh stating that the ruling should not be interpreted as a finding on whether the courts are authorized to order disgorgements in SEC enforcement proceedings could also mean trouble for the SEC, experts say. By adding that footnote, attorneys say the justice left open the question of whether the SEC is, in fact, authorized to order disgorgements, potentially removing that important and lucrative tool altogether.

"The doomsday scenario for the SEC is that one or more federal judges latches onto the court's footnote questioning the viability of the disgorgement remedy generally, but this really hasn't happened so far. What we are seeing are certain spillover effects from Kokesh's logic to other SEC remedies, most specifically industry bars," said Matthew C. Solomon, a partner at Cleary Gottlieb Steen & Hamilton LLP who formerly ran the SEC's litigation program as chief litigation counsel.

Solomon said industry bars are often the "most potent remedy" the SEC has because they enable the agency to "take away someone's livelihood, which is a very serious thing."

The question now presenting itself in lower courts is whether bars — and other non-financial SEC remedies — are considered to be punitive instead of equitable, much like disgorgement in Kokesh.

"Then it becomes questionable in certain cases whether the SEC will be able to persuade federal judges that imposition of an injunction or an industry bar based on conduct that may have occurred many years ago is not, based on all the circumstances, tantamount to a penalty," Solomon said.

An SEC spokesperson didn't immediately respond to a request for comment on this story.

Kokesh was represented by Adam G. Unikowsky, Zachary C. Schauf and James Dawson of Jenner & Block LLP, Clinton W. Marrs of Marrs Griebel Law Ltd., and David A. Strauss and Sarah M. Kinsky of the Jenner & Block Supreme Court and Appellate Clinic at the University of Chicago Law School.

The SEC was represented by Jeffrey B. Wall, Malcolm L. Stewart and Elaine J. Goldenberg of the U.S. Department of Justice and Sanket J. Bulsara, Michael A. Conley, Jacob H. Stillman, Hope Hall Augustini, Daniel Staroselsky and Sarah R. Prins of the U.S. Securities and Exchange Commission.

The case is Kokesh v. SEC, case number 16-529, in the Supreme Court of the United States.

--Editing by Pamela Wilkinson and Alanna Weissman.