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Reflections on *Kokesh v. SEC*: On the Lookout for "Elephants in Mouseholes"

Until June 2017, when the Supreme Court issued its unanimous opinion in *Kokesh v. SEC*,[1] the Securities and Exchange Commission ("SEC" or "Commission") took the position that it could obtain disgorgement from defendants no matter how long ago the alleged wrongdoing occurred. *Kokesh* changed that, holding that SEC disgorgement is a penalty, not an equitable remedy, and therefore subject to the five-year statute of limitations codified in 28 U.S.C. § 2462 ("§ 2462"). Courts and the SEC have been grappling with the ramifications of *Kokesh* ever since.

As we begin 2018, we pause here to survey the decision's immediate effects and to consider additional questions we expect will be addressed as the ramifications of the decision unfold.[2] The most obvious and immediate effects of *Kokesh* follow from the decision's most direct holding: the Commission has acknowledged that it can no longer seek disgorgement for conduct outside of a five-year statute of limitations, and defendants have challenged previous disgorgement orders and holdings for conduct that occurred outside that time period. Meanwhile, courts and others, including Congress and the IRS, have considered other consequences of *Kokesh*, including:

- Can the SEC continue to obtain disgorgement at all? Can other agencies?
- Are other SEC remedies also "penalties"?
- Is disgorgement an "Excessive Fine" within the meaning of the Eighth Amendment?
- Is disgorgement paid to a government agency deductible for U.S. federal tax purposes?

After a brief recap of the case, we review the state of play involving remedies in the wake of *Kokesh*. In short, many things have changed.

The Commission's Enforcement Action and the Supreme Court's Opinion in *Kokesh*

The relevant facts and case history in *Kokesh* were straightforward. The SEC filed its civil action against Charles Kokesh, the owner of two investment advisers that advised business development companies, in October 2009. The Commission alleged that between 1995 and 2009, through his firms, Kokesh violated antifraud and other provisions of the federal securities laws by misappropriating $34.9 million from business development companies, and caused the filing of "false and misleading SEC reports and proxy statements."

After a jury verdict in the Commission's favor, the court ordered Kokesh to pay a $2,354,593 civil monetary penalty, $34.9 million in disgorgement, and $18.1 million in prejudgment interest. The district court applied § 2462's five-year limitations period to the civil monetary penalty, but agreed with the Commission that the statute of limitations did not apply to disgorgement because it was not a "penalty."

On appeal, Kokesh argued that the disgorgement amount should have been only $5 million because the five-year statute of limitations in § 2462 also applied to disgorgement. The U.S. Court of Appeals for the Tenth Circuit upheld the district court's ruling. The Tenth Circuit's opinion, which reflected the majority view among federal courts, created a split with the U.S. Court of Appeals for the Eleventh Circuit, which had held in *SEC v. Graham* that disgorgement was a "forfeiture" and thus subject to § 2462.[3]

The Supreme Court subsequently granted *certiorari* to resolve the circuit split, and unanimously and unambiguously reversed the Tenth Circuit's decision. Although the Court could have ruled narrowly that disgorgement as applied in the case constituted a penalty, it took a different approach by ruling much more broadly: "[w]e hold that SEC disgorgement constitutes a penalty." The Court also held that "[t]he 5-year statute of limitations in § 2462 therefore applies when the SEC seeks disgorgement."[4]

The Court determined that three principles demonstrated that SEC disgorgement was a penalty within the meaning of § 2462:

- First, SEC disgorgement was imposed as a consequence for violations where the victim was the public at large, rather than an aggrieved individual.
- Second, the primary purpose of SEC disgorgement was to deter future violations, which was inherently punitive.
- Third, SEC disgorgement did not directly compensate victims, because a court had discretion over whether disgorged funds would be distributed to harmed investors or transferred to the U.S. Treasury. As a result, the Court held, "[w]hen an individual is made to pay a non-compensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty."

The Court dismissed the Commission's argument that disgorgement was "remedial." Because SEC disgorgement sometimes exceeded profits, the Court found that disgorgement in such cases "does not simply restore the status quo … [but] leaves the defendant worse off."[5] For example, the opinion noted that SEC disgorgement may not consider defendants' expenses that reduced illegal profits, and that courts have ordered insider trading tipper defendants to disgorge the profits of their tippees, even though the tippers never received any profits. Thus, according to the Court, SEC disgorgement was not a remedy that simply returned defendants to their prior position, but rather a sanction that went beyond and penalized defendants for their conduct.

Limits on the Scope of Permissible Disgorgement

The first, and most straightforward, effect of *Kokesh* has been that the SEC has amended its requests for disgorgement in pending cases to reflect the five-year statute of limitations period. For example, in *SEC v. Durham*, the Commission conceded that its originally requested disgorgement amount was "likely inconsistent with the statute of limitations for securities fraud disgorgement recently recognized by the Supreme Court in *Kokesh*."[6] Even though the district court found there was "little doubt" that the defendant benefitted from "significant" ill-gotten gains, it held that the Commission failed to establish a specific disgorgement amount and denied its motion for summary judgment on the issue of disgorgement.[7] In both *SEC v. Collyard* and *In the Matter of Lynn Tilton, et al.*, the Commission conceded that § 2462 now time-barred disgorgement for certain conduct.[8] In *Tilton*, the SEC reduced the amount of its disgorgement claim to include only allegedly illicit gains within the five-year statute of limitations. In *Collyard*, the SEC conceded that § 2462 precluded any disgorgement as the violative conduct took place more than five years prior to initiation of the SEC's enforcement action, and the previously-entered disgorgement order was vacated.[9]

Efforts to Modify Previously Awarded Disgorgement

In addition, defendants have sought to enforce *Kokesh* retrospectively and modify previously disgorged gains that fell outside the five-year statute of limitations period. So far, however, defendants have not been successful when seeking to amend previously entered judgments under Federal Rule of Civil Procedure 60(b) ("Rule 60(b)"), based on the change in law.

In *SEC v. Radius Capital Corp.*, the defendant asked the court to reconsider the previously awarded disgorgement amount.[10] Before *Kokesh* was decided, the district court had rejected the defendant's argument that disgorgement for violations relating to a sale of mortgage backed securities was time-barred by the five-year statute of limitations, and ordered $1.4 million in disgorgement. After *Kokesh*, the defendant argued that $399,175.40 of the disgorgement award was time-barred. The court denied the defendant's motion to amend the disgorgement award under Rule 60(b), on the grounds that, "[a] change in the decisional law is not an 'extraordinary circumstance' sufficient to invoke Rule 60(b)(6)." The district court added that, "Eleventh Circuit precedent is clear that a later ruling that is contrary to a ruling that was correct when it was decided does not constitute an extraordinary circumstance justifying relief."[11]

Respondents in SEC administrative proceedings have also petitioned for review of previously ordered disgorgement. In *The Matter of Larry C. Grossman*, the Commission found that Grossman violated the securities laws and, among other consequences, ordered disgorgement.[12] Grossman initially argued, and the Commission rejected, that the § 2462 five-year statute of limitations applied to his conduct. After *Kokesh*, Grossman filed for review of the Commission's order against him. The Eleventh Circuit vacated and remanded for the Commission to "reconsider its order of disgorgement in light of the Supreme Court's decision in *Kokesh*."[13] On August 31, 2017, the Commission ordered the parties to submit briefs regarding the issue, and a decision has not yet been issued.[14]

Is Disgorgement still Available as a Remedy?

As predicted, defendants have eagerly challenged whether disgorgement is available as a remedy *at all*. Footnote 3 of the *Kokesh* opinion ("Footnote 3") 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. The sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period.

To date, all courts that have squarely addressed whether an award of disgorgement survives *Kokesh* have found that it does, relying on long settled pre-*Kokesh* case law and refusing to find that Footnote 3 was intended to impact how courts apply disgorgement principles.

In *SEC v. Jammin Java Corp.*, after the court granted summary judgment, the defendant sought to bar the Commission from obtaining disgorgement entirely, citing *Kokesh*.[15] The district court noted that "Congress does not 'hide elephants in mouseholes.' The question before this Court is if the Supreme Court does."[16] The Court answered this question in the negative and "decline[d] to upset decades of settled jurisprudence with such uncertain justification."[17] The court noted that "the overwhelming weight of authority – indeed the virtually unanimous consensus – has been in favor of ordering disgorgement when appropriate."[18] Addressing Footnote 3, the court found that after *Kokesh*, courts "have generally continued to assume the power to order disgorgement while recognizing that some amount of uncertainty has been introduced into the legal landscape."[19]

It is worth noting, however, that while no court has found *Kokesh* to preclude disgorgement as a remedy, some courts have acknowledged that Footnote 3 has sewn doubt about its future viability. For example, in *Osborn v. Griffin*, a non-securities case involving an inheritance dispute, the Sixth Circuit noted in a footnote, "indeed the [equitable disgorgement] theory may not even be applicable in SEC contexts for much longer in light of the Supreme Court's recent opinion in the matter."[20]

The issue of whether disgorgement survives *Kokesh* may next arise in a yet to be resolved class action. Craig Jalbert, in his capacity as a trustee of the "F2 Liquidating Trust," filed a class action lawsuit against the SEC in October 2017 challenging whether disgorgement was an available remedy "on behalf of himself and all others similarly situated."[21] Jalbert alleged that "the Trust is representative of the putative class" because F-Squared Investment, Inc. paid $30 million in disgorgement to the SEC in 2014 to resolve a cease-and-desist proceeding.[22] Jalbert's lawsuit alleges that the SEC has improperly sought and obtained disgorgement in both administrative proceedings and federal court actions since the 1970s without statutory basis, and sought the return of $14.1 billion in disgorgement paid over the prior six years. The action was filed in the United States District Court for the District of Massachusetts and remains pending.

Defendants facing disgorgement claims from other agencies have also sought to invoke *Kokesh*. In *FTC v. J. William Enterprises, LLC*, the defendant, in connection with its motion for partial summary judgment, argued that certain relief sought by the FTC, including disgorgement, was unavailable.[23] Defendant claimed that *Kokesh* indicated that the Supreme Court doubted the authority of any federal agency to obtain disgorgement in an enforcement action where disgorgement was not specifically authorized by statute. The district court rejected this argument, noting that *Kokesh* dealt specifically with the securities laws and not the statute at issue, and further stating that "[e]ven assuming arguendo that a finding as to the unavailability of equitable remedies for violations of federal securities law would apply to section 13(b) [of the FTC Act] violations, there was no such finding in *Kokesh*: the Supreme Court specifically declined to address whether courts possessed authority to order disgorgement in SEC enforcement proceedings."[24]

Additionally, in *FTC v. Credit Bureau Center*, the FTC obtained a preliminary injunction, asset freeze, and the appointment of a receiver against Credit Bureau Center ("CBC") and three individual defendants, including the former owner and manager of CBC and two promoters of the fraudulent scheme.[25] CBC and the former owner moved to modify the preliminary injunction to eliminate the asset freeze, dismiss the receiver, and return all documents and property seized on the basis that the purpose of the relief was intended to hold assets for disgorgement and restitution, which they contended were not properly authorized under the FTC Act.[26] They argued that "the Supreme Court, in addressing purportedly parallel securities fraud statutes in *Kokesh* … 'found that disgorgement and restitution were *penalties* designed to deter potential violators and therefore not authorized under the securities statute.'"[27] The court rejected the defendants' argument as a "considerable overstatement" of *Kokesh*, and held that *Kokesh* did not say anything about whether disgorgement and restitution were authorized under the securities statute. Rather, *Kokesh* had stated that "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings."[28] The court concluded that because "there is no contrary Supreme Court authority, controlling Seventh Circuit law, which specifically authorized disgorgement and restitution in FTC suits, still governs."[29]

A district court considered *Kokesh*'s effect on another agency in *CFTC v. Reisinger*, following a jury verdict finding that the defendant violated the Commodity Exchange Act's anti-fraud provision and other CFTC regulations.[30] The defendant objected to the CFTC's request for disgorgement on the grounds that *Kokesh* called "into question" the court's authority to order disgorgement.[31] The court rejected this argument on two grounds. First, the court held that Footnote 3 "explicitly disclaims implying anything about a statutory question, so it does not help Reisinger's argument about what the Commodity Exchange Act authorizes." Second, the court held that Footnote 3 turned on the absence of disgorgement language in the Securities Act, whereas the Commodity Exchange Act explicitly authorized disgorgement and restitution. The court therefore "declines Reisinger's invitation to abrogate this text based on footnote three of *Kokesh*, which does not decide anything. The court remains mindful of the Supreme Court's warning that '[l]anguage in one statute usually sheds little light upon the meaning of different language in another statute, even when the two are enacted at or about the same time.'"[32]

Are other Remedies actually "Penalties"?

In deciding *Kokesh*, the Supreme Court considered the purpose and effects of disgorgement in determining that it was a penalty, rather than an equitable remedy. The Supreme Court concluded that disgorgement was a penalty because it was imposed as a consequence of victimizing the public at large as opposed to individual victims, its primary purpose was to deter future violations, and the funds did not directly compensate victims and could exceed the defendant's actual profits. Since the decision, lower courts have evaluated whether other equitable remedies were actually penalties under this framework, and therefore subject to § 2462.

Injunctions

Courts have reached different conclusions as to whether injunctions are punitive in the wake of *Kokesh.*

In the previously discussed *SEC v. Collyard* matter, the Eighth Circuit reviewed whether an injunction entered by the district court was a penalty, and therefore time-barred after *Kokesh*. The Eighth Circuit noted that there was a "court[s] of appeals split over whether an injunction can be a § 2462 'penalty.'"[33] The court determined that it "need not resolve whether an injunction *can be* a § 2462 'penalty'", but found that the injunction ordered in the case was not a penalty under the *Kokesh* rubric because the injunction was imposed to protect the public, was based on the likelihood of future violations, and was not imposed to deter others from violations or to punish the violator.[34]

However, in *SEC v. Gentile*, the U.S. District Court for the District of New Jersey found that an "obey the law" injunction and penny stock bar requested by the SEC were punitive based on the rationale of *Kokesh.*[35] The court cited *Kokesh's* statement that "[w]hen an individual is made to pay a non-compensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty."[36] The court stated that the requested injunction did not have a retributive effect nor "restore any 'status quo ante,'" but instead merely would have required the defendant to obey the already established securities laws with the only additional effect being to stigmatize the defendant publicly.[37] The court additionally noted that the requested injunction was not remedial because there was no identified victim. Although the SEC argued that the requested injunction was remedial because it would serve to ensure that the defendant would not violate the securities laws again, the court found that the SEC had not adequately demonstrated that the defendant was likely to commit a future violation. Similarly, the court found that the penny stock bar requested by the SEC would not "restore any 'status quo ante'" and the only person who would be impacted by the order would be the defendant. Accordingly, because the SEC sought penal relief based on conduct that fell outside the statute of limitations, the court held that § 2462 applied and dismissed the action as time-barred.

In *SEC v. Brooks*, the representative of the deceased defendant Brooks' estate argued in a motion to dismiss the SEC's amended complaint that the SEC's disgorgement claim and claim for reimbursement of bonuses and stock sale profits under Section 304 of SOX should be abated due to the defendant Brooks' death.[38] The defendant argued that after *Kokesh*, both claims were penal in nature, and because penal claims do not survive death, these claims must be dismissed. In denying the defendant's motion, the court found that: the Supreme Court's decision in *Kokesh* did not mean that disgorgement was a penalty for survivability purposes; the SEC's disgorgement and reimbursement claims served both remedial and penal purposes; and in the Eleventh Circuit "[a]s the SEC points out in the survival context, dual purpose sanctions are not penal and do not abate upon death."[39] The action is administratively closed pending the Commission's consideration of a proposed settlement.[40]

Professional Bars

The SEC has broad authority to impose associational bars or suspensions with respect to at least seven different categories of securities industry participation.[41] In addition, the SEC possesses authority to bar individuals from participating in penny stock offerings and from serving as an officer or director of public companies.[42] SRO's, in particular FINRA, also have authority to bar or suspend their members, subject to SEC oversight and appellate jurisdiction.[43] Finally, the SEC has authority to suspend or bar individuals from appearing and practicing before it. Defendants in SEC and FINRA actions and proceedings have raised challenges to industry bars in the wake of *Kokesh* on the grounds that they were "impermissibly punitive," and we expect to see more in the future.

In *Saad v. SEC*, the D.C. Court of Appeals considered a former registered representative's petition for review of a Commission order upholding a permanent bar imposed against him by FINRA for violating FINRA Rule 2010 by misappropriating his employer's funds and misleading investigators to conceal his wrongdoing.[44] The defendant asked the court to consider whether the lifetime FINRA bar was a penalty, and thus "impermissibly punitive." The court remanded the case for the Commission to address the "relevance – if any – of the Supreme Court's recent decision in *Kokesh v. SEC*" and decide whether a permanent bar was a remedy or penalty. The court stated that it was required to do this because the "SEC may approve expulsion or suspension of a securities broker as a remedy, but not as a penalty."[45]

In a concurring opinion, Judge Kavanaugh explained that he believed the court was correct to remand the case to the SEC. However, he definitively stated that barring a securities broker from the industry was a penalty and not a remedy after *Kokesh*. In his view, the bar was penal on the same grounds that *Kokesh* found disgorgement to be a punishment: it deterred future wrongdoing, expulsion and suspension were punitive, and it protected the investing public as opposed to providing victim compensation. Judge Kavanaugh stated, "our precedents characterizing expulsions or suspensions as remedial are no longer good law." He concluded, "FINRA and the SEC will have to reasonably explain in each individual case why an expulsion or suspension serves the purposes of punishment and is not excessive or oppressive." Further, he noted that whether FINRA and SEC sanctions were punitive or remedial mattered because "[i]f FINRA and the SEC must justify expulsions or suspensions as punitive (as I believe they must after *Kokesh*), they will have to explain why such penalties are appropriate under the facts of each case."[46]

In a separate opinion, Judge Millet expressed "grave doubts" about the panel's decision to remand for the SEC to address *Kokesh.*[47] Millet found that the SEC had explained its remedial reasons for imposing a permanent bar and that *Kokesh* did not help Saad because the Supreme Court held*:*

> only that "[d]isgorgement" ordered by the Commission in "enforcement proceedings" prosecuted by the Commission itself to punish violations of "public law" "operates as a penalty under § 2462." In multiple respects, that bears no resemblance to FINRA's private decision in this case to disaffiliate from Saad because of his repeated violations of FINRA's own professional rules of conduct.[48]

Judge Millet noted that the Supreme Court has consistently ruled that "occupational debarment" is "nonpunitive."[49] Further, because statutorily "Congress has mandated that any securities-industry self-regulatory organization that wishes to register with the Commission include in its rules the ability" to discipline, suspend, expel members, those tools "cannot categorically be impermissibly 'excessive or oppressive' under Section 78s(e)(2)."[50]

In *In the Matter of Talman Harris and Victor Alfaya*, the Commission sought a permanent collateral bar based on the respondent's guilty plea.[51] In assessing whether such a bar would be punitive after *Kokesh*, the administrative law judge ("ALJ") noted that there was a split in the D.C. Circuit's precedents. The ALJ reasoned that, on the one hand, the D.C. Circuit had held that a SRO lifetime bar must be "remedial and not 'excessive or oppressive'"[52] and that an associational bar imposed by the Commission could be a penalty under certain circumstances.[53] On the other hand, the ALJ noted (as did Judge Millet in *Saad*) that *Kokesh* did not disturb the "on-point" D.C. Circuit precedent.[54] The ALJ therefore concluded that, even if the bar was punitive, the Commission could still impose it because the sanction was appropriate under a *Steadman* factor analysis.[55]

In terms of the impact of *Kokesh* on other professional bars, as previously noted, one court found that a penny stock bar was punitive in the circumstances in which it was sought to be imposed in that case.[56]

Similar challenges to officer and director bars are an almost certainty, as defendants argued even before *Kokesh* that such bars were penalties and accordingly subject to § 2462's five-year statute of limitations.[57] Before *Kokesh*, courts were split on whether officer and director bars were penal or remedial. In *SEC v Quinlan*, the district court granted summary judgment to the SEC based on the defendant's criminal convictions and imposed an injunction and a permanent officer and director bar, finding that the statute of limitations did not apply to claims for this relief. The defendant appealed, and the Sixth Circuit affirmed the district court's decision on the grounds that the district court's conclusions that "there was a risk of recurrence, that the risk to the investing public outweighed the severe collateral consequences of the equitable relief, and, therefore, that the permanent injunction and officer and director bar were remedial rather than punitive" were supported by the record and established that the equitable relief was not a penalty subject to § 2462.[58]

In contrast, in *SEC v. Bartek* the Fifth Circuit held that an officer and director bar was a penalty. The district court had denied the SEC's request for a permanent injunction and officer and director bar against the defendants, finding that, as a matter of law, such relief is "construed as penalties because: (1) these remedies would have significant collateral consequences to the Defendants; (2) they do not address the past harm caused by the Defendants; and (3) the remedies do not focus on preventing future harm due to the low likelihood that the Defendants would engage in similar harmful behavior in the future."[59] The SEC appealed, and the Fifth Circuit affirmed the district court's decision, concluding that "[b]ased on the severity and permanent nature of the sought-after remedies, the district court did not err in denying the SEC's request on grounds that the remedies are punitive, and are thus subject to § 2462's time limitations."[60]

Restitution

The issue of whether restitution is still an equitable remedy in a CFTC action after *Kokesh* was addressed in *CFTC v. Southern Trust Metals, Inc., et al.*[61] In that case, the CFTC moved for contempt based on a defendant's failure to satisfy a judgment that ordered him to pay $2,103,617.00 in restitution and a $357,032.00 civil penalty. At the time of the motion, the defendant had only paid $500 towards restitution and nothing towards his penalty. In response, the defendant argued that restitution to the CFTC was no longer equitable relief after *Kokesh*, and therefore was not subject to enforcement by contempt. The magistrate judge found that the defendant's arguments "lack[ed] any merit" and the court affirmed and adopted the magistrate's findings.[62]

Can Disgorgement be an "Excessive Fine"?

In *SEC v. Metter*, the defendant sought to have the Second Circuit overturn the district court's disgorgement order against him on the grounds that it violated the Eighth Amendment's Excessive Fines Clause.[63] Following a bifurcated settlement in which the defendant consented to a judgment imposing permanent injunctions but reserved the right to litigate the amount of disgorgement and penalty to be imposed against him, the district court imposed joint and several disgorgement liability of $52,236,995. The Second Circuit agreed with the defendant's argument that "in light of the Supreme Court's recent decision in *Kokesh* … the disgorgement liability imposed in this matter was essentially punitive in nature and thus was a fine within the meaning of the Excessive Fines Clause of the Eighth Amendment." The court determined, however, that the disgorgement amount imposed was not "grossly disproportional," and therefore not excessive for the related conduct.[64] In considering whether the disgorgement ordered was proportional, and while acknowledging the case was a civil enforcement action and not a criminal prosecution, the court examined the four "*Bajakajian* factors" and found that because "the disgorgement ordered almost precisely equaled the gains from the illicit conduct to the entity controlled by Metter, the resulting financial penalty was directly keyed to the scope of the wrongdoing."[65]

Is Disgorgement Paid to the Government Deductible for U.S. Federal Tax Purposes?

The implications of *Kokesh* could reach well beyond the securities context to tax law. In our June 2017 Client Alert, we anticipated that the Supreme Court's characterization of disgorgement as a penalty might lead the Internal Revenue Service (the "IRS") to take the position that disgorgement payments were not deductible under Section 162(a) of the Internal Revenue Code, due to the operation of Section 162(f). Until recently, the wording of Section 162(f) was simply that no deduction should be allowed under Section 162(a) of "any fine or similar penalty paid to a government for the violation of any law." Under that version of Section 162(f), the IRS Office of Chief Counsel confirmed in a Chief Counsel Memorandum (the "Memorandum") that the IRS has taken the position after *Kokesh* that disgorgement payments in the securities enforcement context are barred from deduction by Section 162(f).[66]

As recently as 2016, the IRS had taken the position that disgorgement could sometimes be compensatory and sometimes be penal, meaning that a disgorgement payment could be deducted under Section 162(a), depending on the facts and circumstances under which the payment was made. The Memorandum, at least in the securities enforcement context, provided a more definite answer. The Memorandum first set out the general principle that, in order for a payment to a government to be deductible under Section 162(a), it must have been made as "a remedial measure to compensate another party,"[67] rather than as a punitive measure to punish past violations or deter future violations. Applying this principle to the issue of disgorgement payments, the Memorandum stated that "[b]ecause, as the Supreme Court held [in *Kokesh*], disgorgement payments are penalties and are not compensatory, Section 162(f) prohibits a deduction under Section 162(a) for an amount paid as disgorgement for violating a federal securities law."[68] The IRS thus has taken the position that, in the securities enforcement context, disgorgement is penal and, therefore, amounts characterized as disgorgement are not deductible because of Section 162(f).

The position taken by the IRS in the Memorandum is certain to be taken by the IRS currently and in the future in light of changes made to Section 162(f) in the recently enacted tax reform law. The law completely rewrote Section 162(f) and, inter alia, limited deductibility of amounts paid to a government to those amounts that are explicitly characterized as either restitution or an amount paid to bring the taxpayer into compliance with the law. Due to this change, any disgorgement amount incurred after the effective date of December 22, 2017 would not be deductible under Section 162(a).

The law also adds a new provision, Code Section 6050X, which requires government entities that are complainants or investigators with regard to a violation of any law to report to the IRS any amount paid (greater than $600) pursuant to a settlement or court order. Such report must identify what, if any, portion of the amount paid represents restitution or costs of coming into compliance with the law.

Conclusion

Kokesh changed the paradigm for remedies in SEC enforcement actions. Courts, and the SEC itself, have reacted decisively and limited disgorgement in post-*Kokesh* cases to conduct within the five-year statute of limitations period. On the other hand, defendants have had little success when seeking to amend previously awarded disgorgement amounts. Yet, as we predicted, the potential ramifications of *Kokesh* go well beyond what initially meets the eye. As stated in *SEC v. Jammin Java*, there is now "uncertainty" in this "legal landscape." *Kokesh*'s full impact is likely to be complex, far reaching, and the subject of litigation for some time to come, with consequences, as we are starting to see, that will not be limited to disgorgement or the SEC. Whenever potential "remedial" relief looms in connection with an enforcement action, the impact of *Kokesh* on that potential relief should be considered. There just may be "elephants in mouseholes."

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[1][1] *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

[2] This article supplements our initial analysis. See King & Spalding LLP, Client Alert, Reflections on Kokesh v. SEC: Potential Ramifications of SEC Disgorgement Being a Penalty (June 14, 2017) ("June 2017 Client Alert"), https://s3.amazonaws.com/kslaw-staging/attachments/000/004/567/original/ca061417.pdf?1498139481.

[3] *SEC v. Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016).

[4] *Kokesh*, 137 S.Ct. at 1642, 1644.

[5] *Id*. at 1639.

[6] *SEC v. Durham*, No. 1:11-cv-00370-JMS-TAB, 2017 WL 3581640, *8 (S.D. Ind. Aug. 18, 2017).

[7] *Id*. at *7.

[8] *SEC v. Collyard*, 861 F.3d 760 (8th Cir. 2017); *In the Matter of Lynn Tilton; Patriarch Partners LCC; Patriarch Partners VIII, LLC; Patriarch Partners XIV, LCC: and Patriarch Partners XV, LLC,* Release No. 1182, 2017 WL 4297256 (Sept. 27, 2017).

[9] 861 F.3d at 768. *See also SEC v. Jankovic*, No. 15 Civ. 1248 (KPF), 2018 WL 301160 (S.D.N.Y Jan. 4, 2018) (the SEC did not seek disgorgement on the total proceeds received from investors through the fraud, $1.95 million, because of the *Kokesh* decision, which made it clear that SEC disgorgement claims are subject to the § 2462 five-year statute of limitations.)

[10] *SEC v. Radius Capital Corp*., No. 2:11-cv-116-FtM-29MRM, 2017 WL 3446912 (M.D. Fla. Aug. 11, 2017); *See also SEC v. Amerindo Inv. Advisors Inc*., No. 05-cv-5231 (RJS), 2017 WL 3017504, at *8 (S.D.N.Y. July 14, 2017) (the defendant made the same arguments under 60(b) and the district court found them meritless, as there were no "exceptional circumstances" and the facts did not meet the other 60(b) factors.).

[11] *Radius*, 2017 WL 3446912, at *3.

[12] *In the Matter of Larry C. Grossman*, Release No. 79009, 2016 WL 5571616 (Sept. 30, 2016).
[13] *In the Matter of Larry C. Grossman*, Release No. 4761, 2017 WL 3836591 (Aug. 31, 2017).
[14] *Id*.
[15] *SEC v. Jammin Java Corp.*, No. 2:15-cv-08921 SVW (MRWx), 2017 WL 4286180, at *2 (C.D. Cal. Sept. 14, 2017).
[16] *Id*. (quoting *Whitman v. American Trucking Association*, 531 U.S. 457, 468 (2001)).
[17] *Id*.
[18] *Id*. *See also SEC v. Drake*, No. 2:17-cv-06204-CAS (GJSx), 2017 WL 6507766, at *7 (C.D. CA. Dec. 18, 2017) (In considering Defendant Drake's motion to dismiss, the court noted that if defendant by his conduct (all of which was alleged took place within the 5 year statute of limitations) was found to have violated the Advisers Act, disgorgement would be a proper remedy because its purpose "is to deprive violators of their ill-gotten gains" citing *Kokesh*.).
[19] *Jammin*, 2017 WL 4286180, at *3; *See also SEC v. Sample*, No. 3:14-CV-1218-B, 2017 WL 5569873 (N.D. Tex. Nov. 20, 2017) (In connection with the Commission's motion for monetary remedies, which the court granted, another defendant made similar arguments in *SEC v. Sample*. The district court stated, "Sample is wrong. *Kokesh* merely held that disgorgement claims are subject to 28 U.S.C. § 2462's five-year statute of limitations … *Kokesh* had no effect on how courts apply disgorgement principles." *Id.* at *2 (citing *Kokesh*, 137 S. Ct. at 1638, 1642)). *Cf. U.S. v. Latorella*, No. 10-10388-DPW, 2017 WL 2785413, at *4 & n.4 (D. Mass. June 27, 2017) (In a parallel criminal action, the court found that the SEC's prayer for disgorgement was "duplicative at best and potentially disruptive of the restitution order" in the criminal case, and caveated that it did so "to the degree that such a remedy is available in a civil enforcement action." The opinion included a footnote stating, "[i]t bears noting that the Supreme Court earlier this month expressly reserved the question 'whether courts possess authority to order disgorgement in SEC enforcement proceedings.'").
[20] *Osborn v. Griffin*, 865 F.3d 417 (6th Cir. 2017) (*citing Kokesh v. SEC*, 137 S.Ct. 1635, 1642 n.3, 198 L.Ed.2d 86 (citing footnote 3)).
[21] *Jalbert v. SEC*, Class Action Complaint, No. 1:17-cv-12103, 2017 WL 4876155, at *2 (D. Mass. Oct. 26, 2017).
[22] *Id*. *See also In the Matter of F-Squared Invs., Inc*., Release Nos. 3988, 31393, 2014 WL 7243183 (Dec. 22, 2014))
[23] *FTC v. J. William Enterprises, LLC*, --- F.Supp.3d ---, 2017 WL 4776669 (M.D. Fla. Oct. 23, 2017).
[24] *Id*. at *2.
[25] *FTC v. Credit Bureau Center, LLC*, No. 17 C 194, 2018 WL 482076 (N.D. Ill. Jan. 14 2018).
[26] *Id.* at *1.
[27] *Id*.
[28] *Id*.
[29] *Id*. at 2 (citing *FTC v. Febre*, 128 F.3d 530, 534 (7th Cir. 1997); *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 571–72 (7th Cir. 1989)).
[30] *CFTC v. Reisinger*, No. 11-CV-08567, 2017 WL 4164197 (N.D. Ill. Sept. 19, 2017).
[31] *Id*. at *3.
[32] *Id*. at *4 (quoting *Russello v. United States*, 464 U.S. 16, 24 (1983)).
[33] *SEC v. Collyard*, 861 F.3d 760, 764 (8th Cir. 2017); *SEC v. Graham*, 823 F.3d 1357, 1361 (11th Cir. 2016) (injunctions look forward in time, whereas penalties look backwards). However, other courts performed a fact specific analysis to consider whether injunctions serve future purposes. *See e.g. SEC v. Bartek*, 484 F. App'x 949, 956–57 (5th Cir. 2012); *SEC v. Quinlan*, 373 F. App'x 581, 586–88 (6th Cir. 2010); *U.S. v. Telluride Co*., 146 F.3d 1241, 1245–48 (10th Cir. 1998).
[34] *Collyard*, 861 F.3d at 764 (emphasis added and internal quotation marks omitted). *See also SEC v. Drake*, 2017 WL 6507766, at *7 (C.D. CA. Dec. 18, 2017) (the SEC's request for an injunction is not time-barred under the statute because the statute only applies to a civil fine, penalty or forfeiture, thus implying that an injunction is none of the above).
[35] *SEC v. Gentile*, No. 16-1619 (JLI), 2017 WL 6371301, at *3-4 (D.N.J. Dec. 13, 2017).
[36] *Id*. at 2.
[37] *Id*. at 4.
[38] *SEC v. Brooks*, No. 07-61526-CIV-ALTONAGA/Goodman, 2017 WL 3315137 (S.D. Fla. Aug. 3, 2017); *U.S. v. Brooks*, 872 F.3d 78 (2d Cir. 2017).
[39] *Id*. at 9.
[40] Order Administratively Closing Case, No. 0:07-cv-61526-CMA, ECF No. 133 (S.D. Fla. Dec. 8, 2017).
[41] Securities Exchange Act of 1934 ("Exchange Act"), Section 15(b)(6) - 15 U.S.C. § 78(u)) (The SEC can impose a collateral bar from associating in any capacity with a broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal advisor, or nationally recognized statistical rating organization.).
[42] Securities Enforcement Remedies and Penny Stock Reform Act of 1990 ("Remedies Act"). The Remedies Act added Section 21d(2) to the Exchange Act and Section 20(e) to the Securities Act of 1933.
[43] 15(A)(g)(2) of the Exchange Act. 15 U.S.C.A. § 78o (West).
[44] *Saad v. SEC*, 873 F.3d 297, 299 (D.C. Cir. 2017). FINRA Rule 2010 requires "[a] member, in the conduct of its business, [to] observe high standards of commercial honor and just and equitable principles of trade." Fin. Ind. Regulatory Auth., Manual, Rule 2010.
[45] *Saad*, 873 F.3d at 304.
[46] *Id*. at 304–06 (Kavanugh concurring).
[47] *Id*. at 307. Judge Miller wrote a "dubitante opinion" on Section II.B of the opinion.
[48] *Id*. at 308.
[49] *Id*. at 305.
[50] *Id*. at 309-310 (Judge Millet also articulated that unlike disgorgement, Commission expulsion also protects the investing public. Additionally, Saad must, and has not, argued the "penalty" definition § 2462 should be extrapolated to his sanction.)
[51] *In the Matter of Talman Harris & Victor Alfaya*, Release No. 1213, 2017 WL 4942807 (Oct. 30, 2017).
[52] *PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1176 (D.C. Cir. 2009) (quoting 15 U.S.C. § 78s(e)(2)).
[53] Compare *Johnson v. SEC*, 87 F.3d 484, 489–92 (D.C. Cir. 1996) (found a six-month bar on acting as a supervisor at a broker-dealer to be punitive), with *McCurdy v. SEC*, 396 F.3d 1258, 1264–65 (D.C. Cir. 2005) (held that the Commission "may impose sanctions for a remedial purpose, but not for punishment," and that the purpose of a one-year suspension from practicing before the Commission as an accountant "was not to punish McCurdy, but rather to protect the public")."
[54] The "on-point circuit precedent" cited is *Kornman v. SEC*, 592 F.3d 173, 187–89 (D.C. Cir. 2010) (affirmed imposition of a permanent bar after considering the Steadman factors); *Horning v. SEC*, 570 F.3d 337, 346 (D.C. Cir. 2009) (similar).
[55] *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *see also In the Matter of Gary M. Kornman*, Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010).

[56] *SEC v. Gentile*, 2017 WL 6371301 (D.N.J. Dec. 13, 2017).
[57] Before explicit statutory authority was granted, the SEC imposed officer and director bars based on the equitable powers of the court. However, almost all bars the SEC obtained were imposed in the context of settlements as opposed to litigation. Prior to specific statutory authority being granted, only one court imposed an officer and director bar in a litigation context. The SEC gained statutory authority to impose officer and director bars under the Remedies Act. *See* Section 20(b) of the Securities Act and Section 21(d)(1) of the Exchange Act.
[58] *SEC v. Quinlan*, 373 F. App'x 581, 588 (6th Cir. 2010).
[59] *SEC v. Bartek*, 484 F. App'x 949, 956-57 (5th Cir. 2012).
[60] *Id*.
[61] *CFTC v. Southern Trust Metals, Inc., et al.*, No. 14-22739-CIV-KING, 2017 WL 3835692 (S.D. Fla. Sept. 1, 2017).
[62] *Id*. at *2. *See also U.S. v. Brooks*, 872 F.3d 78, 91 (2d Cir. 2017) (the court reasoned that "[t]he Supreme Court concluded that a pecuniary sanction such as disgorgement constitutes a penalty under § 2462 only if its purpose is punishment and deterrence, 'as opposed to compensating a victim for his loss.' *Id*. at 1642. Our holding here is not to the contrary. We agree that restitution's goal is victim compensation, not punishment.")
[63] *SEC v. Metter*, 706 F. App'x 699 (2d Cir. 2017).
[64] *Id*. at 703.
[65] *Id*. at 704; *U.S. v. Bajakajian*, 524 U.S. 321, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998) (The four factors are: (1) the essence of the crime of the defendant and its relation to other criminal activity, (2) whether the defendant fits into the class of persons for whom the statute was principally designed, (3) the maximum sentence and fine that could have been imposed, and (4) the nature of the harm caused by the defendant's conduct.); *See also SEC v. First Jersey Secs., Inc*., 101 F.3d 1450, 1474–75 (2d Cir. 1996).
[66] IRS C.C.A. 201748008 (Dec. 1, 2017).
[67] *Id*.
[68] *Id*.