

U.S. Supreme Court: *SEC Disgorgement Powers Down but Not Out*



ROBERT CORNISH

PARTNER, WILSON ELSER MOSKOWITZ
EDELMAN & DICKER LLP

The United States Supreme Court recently delivered a strong blow to the SEC's disgorgement powers in its 9-0 decision in *Kokesh v. SEC*, No. 16-529. In *Kokesh*, the Court held that the five-year statute of limitations of 28 U.S.C. § 2462 applies to SEC enforcement actions seeking disgorgement. The immediate significance of this case to those in the EB-5 industry, however, is that "boilerplate" agreements and offering documents may present new and different risk management considerations for Regional Centers, especially when used with Chinese investors.

In facts that unfortunately mirror recent misconduct in the EB-5 arena, the investment adviser in *Kokesh* allegedly misused \$35 million of managed assets to live a lavish lifestyle, which included among other things a polo chukka and horse stable. The Enforcement Division of the SEC, as it usually does, sought "disgorgement" of those funds, plus interest and fines in excess of the misused funds.

DISGORGEMENT TODAY

Disgorgement has morphed over the past 50 years in SEC actions to encompass a full spectrum of ill-gotten gains, namely to encompass acts that may have occurred more than five years before the filing of such actions. More succinctly, the SEC has used disgorgement as an equitable tool to prosecute stale frauds or those not pursued in a timely manner. The Supreme Court's decision in *Kokesh* essentially puts an

end to what many SEC practitioners call "Zombie Enforcement Actions" for disgorgement. Disgorgement is now to be viewed as a punitive remedy subject to the five-year statute of limitations under 28 U.S.C. § 2462, rather than as an "equitable" remedy outside the statute.

To summarize, the *Kokesh* court identified three reasons to consider the remedy of disgorgement as punitive rather than remedial:

- Disgorgement is a remedy for wrongs "committed against the United States rather than an aggrieved individual"
- Disgorgement is punitive due to its intended effect to deter further bad conduct.
- While some disgorged funds are paid to fraud victims by the SEC, those funds remaining are paid to the U.S. Treasury.

Those reasons notwithstanding, fraudsters are well advised not to uncork champagne bottles in celebration of the *Kokesh* ruling. Equitable tolling doctrines such as "fraudulent concealment" (*SEC v. Wyly*, 950 F. Supp. 2d 547 (S.D.N.Y. 2013)) and "continuing violations" (*SEC v. Strebing*, 114 F. Supp. 3d 1321 (N.D. Ga. 2015)) may still be invoked in civil enforcement proceedings by the SEC under § 2462, except in requests for disgorgement. These concepts were neither raised by the SEC nor addressed by the Court in *Kokesh*. Many tools still remain in the SEC's arsenal.

Also not addressed by either the SEC or the Court in *Kokesh*, and especially important in the EB-5 context, is the application of the five-year limitation period under § 2462 where the defendants are not physically present in the United States. E.g., *SEC v. Straub* 921 F. Supp. 2d 244, 259-261 (five-year limitation is triggered only when the defendants are "within the United States" as provided in § 2462). Whether the literalist reading of § 2462 in *Kokesh* will render cases such as *Straub* of questionable force remains to be seen.

RISK MANAGEMENT ISSUES

As previously noted, the recent decision in *Kokesh* presents several risk management issues for operators of Regional Centers, including but not limited to the following:

- Regional Centers may wish to include risk disclosures in offering documents to address the potential extinguishment of available remedies and sources of recovery available to investors due to visa backlogs that may exceed five years.
- Regional Centers may wish to consider choice-of-law clauses, dispute-resolution clauses, venue clauses and incorporation options of investment vehicles that may (1) preclude the application of state fraudulent conveyance statutes in excess of the five-year limitation period of § 2462 and/or (2) be less favorable to equitable tolling of § 2462.
- The use of tolling agreements by the SEC during the course of routine investigations of wrongful conduct approaching five years will now increase. Those facing SEC scrutiny will need to consider the limitations on disgorgement in settlement discussions and requests to enter into tolling agreements, especially those of unlimited or significant duration.
- Proposed integrity reforms to EB-5 legislation often have included provisions confirming that the securities laws of the United States apply to EB-5 transactions.

In summary, Regional Centers should continue to address or limit potential exposure to disgorgement remedies given the pending reforms and the "within the United States" language of 28 U.S.C. § 2462. ■