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Expert Analysis

‘Obey-the-Law’ Injunctions: Is Time Running Out for the SEC?

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Enforcement actions brought by the U.S. Securities and Exchange Commission are governed by a five-year statute of limitations on civil monetary penalties. As a practical matter, the SEC has been able to enlarge the period it has to bring enforcement actions by, among other things, seeking equitable relief. Courts have generally held such equitable relief not to be subject to the five-year limitations period. In recent years, however, courts have come to view the de facto enlargement of the limitations period for SEC actions critically, and that development has begun to influence the course, and outcome, of some prolonged, complex SEC investigations.

In 2013, in *Gabelli v. SEC*, the Supreme Court unanimously held that the five-year limitations period under 28 U.S.C. §2462 for enforcement proceedings seeking “fine[s], penalt[ies], or forfeiture” begins to run “when a defendant’s allegedly fraudulent conduct occurs”—not, as the SEC argued, when the conduct is “discovered.” 568 U.S. 442, 447-48 (2013). Last year, in *Kokesh v. SEC*, the Supreme Court again unanimously held that §2462’s five-year statute of limitations applies to SEC requests for “disgorgement”—a remedy the SEC has sought under federal courts’ inherent equitable powers, which seeks to force a defendant to turn over, or disgorge, the proceeds of unlawful activity. The Supreme Court held that “SEC disgorgement constitutes a penalty,” and is subject to the five-year statute of limitations for civil penalties, thus rejecting the SEC’s position that disgorgement was a purely equitable remedy not subject to a limitations period. 137 S. Ct. 1635, 1642 (2017).

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In the wake of *Kokesh*, courts have wrestled with an additional important limitations question: whether another form of equitable relief sought by the SEC, the so-called “obey the law” injunction, constitutes a “penalty” subject to the five-year statute of limitations. Such injunctions, which prohibit future violations of the securities laws, are routinely requested by the SEC in enforcement actions, and can have severe professional consequences for defendants subject to them. In a recent decision, Judge Nicholas Garaufis of the U.S. District Court for the Eastern District of New York dismissed an SEC complaint as time-barred, concluding that an obey-the-law injunction “would function at least partly as a penalty, and thus is subject to [the five-year limitations period in] §2462.” *SEC v. Cohen*, 2018 WL 3455403, at *13 (E.D.N.Y. July 12, 2018).

In this article, we begin with a discussion of Judge Garaufis’s decision in *Cohen* and then examine the views of other courts as to whether the SEC may use an obey-the-law injunction to sidestep the five-year limitations period in §2462. Lastly, we consider *Cohen*’s practical implications—how the Commission will likely respond and what defense counsel should anticipate.

‘SEC v. Cohen’

In *Cohen*, the SEC charged Michael Cohen and Vanja Baros, two former London-based employees of subsidiaries of Och-Ziff Capital Management, with violations of the Foreign Corrupt Practices Act and the Investment Advisers Act of 1940. The SEC’s complaint accused Cohen and Baros of orchestrating “a ‘sprawling

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scheme' to bribe various African public officials" in five African countries. The SEC filed suit on Jan. 26, 2017—more than five years after the last allegedly fraudulent transaction took place (and five months before the Supreme Court issued its decision in *Kokesh*). In its complaint, the SEC sought civil penalties, disgorgement and an obey-the-law injunction.

Cohen and Baros moved to dismiss the complaint on several grounds, including the statute of limitations. Cohen and Baros argued that, after *Kokesh*, SEC disgorgement and obey-the-law injunctions were penalties subject to the five-year statute of limitations, and thus the SEC's requests were filed five months too late. 2018 WL 3455403, at *1, 6-8.

As to disgorgement, the Commission made three arguments for why its claims were not time-barred, each of which Judge Garaufis rejected. *First*, the SEC argued that it would be premature to consider a statute-of-limitations defense on a motion to dismiss because §2462 "only applies to remedies," which the SEC asserted would require further discovery. The court disagreed, citing language from §2462 prohibiting courts from even "entertain[ing]" actions that accrued more than five years earlier. Taking this restrictive statutory language into account, Judge Garaufis reasoned that "it would make no sense if the SEC could evade the statute of limitations by alleging untimely misconduct and then demanding discovery in hopes of uncovering misconduct within the limitations period." Id. at *10.

Second, the Commission argued that its claims for disgorgement were timely because, between November 2012 and June 2014, Cohen had entered into three agreements to toll any claims "arising out of the investigation," which was defined in the tolling agreements as the SEC's investigation of certain transactions in Libya. Applying general principles of contract interpretation, the court held that the tolling agreements applied "only to the SEC's claims arising from Cohen's alleged dealings in Libya," not any other transactions or countries. The tolling agreements did not contain "the sort of broad, open-ended language that might have evinced the parties' mutual intent to extend the statute of limitations applicable to any claims the SEC might bring." Id.

Third, the SEC argued that its disgorgement claims were timely because those claims accrued only when Cohen and Baros received ill-gotten gains from the allegedly corrupt transactions in question, which the SEC argued continued well into the five-year limitations period. Judge Garaufis rejected this argument, holding that the statute of limitations begins to run from when defendants allegedly engage in misconduct, "not when they receive compensation in connection with that misconduct." Id. at *11 (citing *Gabelli*, 568 U.S. at 448).

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As for the obey-the-law injunction sought by the Commission, Cohen and Baros argued that such an injunction is a "penalty" under *Kokesh* and thus the SEC's suit was untimely for the same reasons disgorgement was outside the five-year statute of limitations. The Commission argued, in essence, that "injunctions by definition *cannot* be penalties" and thus injunctions were not governed by any statute of limitations. Id. at *12 (emphasis in original).

Judge Garaufis held that "the SEC's requested injunction would operate at least partly as a penalty" and thus fell within §2462's limitations period. Id. In *Kokesh*, the Supreme Court reasoned that disgorgement should be treated as a penalty for purposes of the statute of limitations because 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." 137 S. Ct. at 1644. The Supreme Court adopted the following test: Relief requested by the SEC is a penalty unless it is "*solely* remedial" in nature. Id. at 1645 (emphasis added).

Judge Garaufis rejected "[t]he notion that injunctions are categorically exempt from §2462 [as] inconsistent with *Kokesh*." 2018 WL 3455403, at *13. The court held that the obey-the-law injunction requested by the SEC was a penalty under *Kokesh* because (1) it sought to redress alleged "wrongs to the public" (i.e., the investing public), and not simply "wrongs to individuals"; and (2) it would "mark [Cohen and Baros] as lawbreakers and stigmatize them in the eyes of the public," a purpose that Judge Garaufis concluded "cannot be understood as '*solely*' remedial." Id. at *14 (emphasis in original) (quoting *Kokesh*, 137 S. Ct. at 1645). Judge Garaufis did not formulate a categorical rule that "an SEC obey-the-law injunction is always a penalty for purposes of §2462," id., yet the court's reasoning could conceivably be extended to all SEC enforcement actions.

Different Decisions in Other Courts

Cases following the *Kokesh* decision have reached different results. Some courts have concluded that obey-the-law injunctions are not penalties and thus are not subject to §2462's five-year statute of limitations. See *SEC v. Collyard*, 861 F.3d 760, 764 (8th Cir. 2017). Other courts have reached the opposite conclusion, holding that obey-the-law injunctions are penal in nature and therefore always within §2462's ambit. See, e.g., *SEC v. Gentile*, 2017 WL 6371301, at *4 (D.N.J. Dec. 13, 2017), appeal filed, No. 18-1242 (3d Cir. Feb. 22, 2018).

In the *Collyard* case, the Commission sued Paul Crawford for brokering certain securities transactions without being a registered broker under §15(a) of the Securities Exchange Act of 1934. On summary judgment, the district court awarded the SEC with a disgorgement order of $240,000 and entered an obey-the-law injunction permanently enjoining Crawford from violating §15(a). On appeal to the Eighth Circuit, Crawford argued that the SEC's action was time-barred because the SEC filed its suit in December 2011—more than five years after November 2006, the last time Crawford acted as an unregistered broker. *Collyard*, 861 F.3d at 763.

The SEC conceded that, after *Kokesh*, §2462 barred it from seeking disgorgement from Crawford. However, the Commission maintained that the five-year limitations period did not apply to its request for an injunction. A unanimous panel of the Eighth Circuit agreed with the SEC, vacating the disgorgement order but affirming the district court's judgment with respect to the obey-the-law injunction. The Eighth Circuit reasoned that the injunction against Crawford was "not imposed 'for the purpose of punishment' or to 'deter others from offending in like manner.'" Id. at 764 (quoting *Kokesh*, 137 S. Ct. at 1642). Rather, the court found that the injunction "(1) require[d] only obedience with the law, (2) [was] based on evidence of a likelihood to violate that law, and (3) [sought] to protect the public prospectively from Crawford's harmful conduct rather than punish Crawford." Id. The court reasoned that deterrence was "an 'incidental effect' of this injunction, not its primary purpose." Id. at 765.

The decision in *Collyard* is in line with several pre-*Kokesh* decisions that held that obey-the-law injunctions are not penalties subject to a five-year limitations period. A year before the Supreme Court decided *Kokesh*, for example, the Eleventh Circuit held that injunctions categorically are not penalties within the meaning of §2462 because, unlike penalties (which address a wrong committed in the past), "[i]njunctions … typically look forward in time." *SEC v. Graham*, 823 F.3d 1357, 1361 (11th Cir. 2016). Eschewing a categorical approach, several courts have applied a fact-specific inquiry and have held that SEC obey-the-law injunctions are not penalties subject to §2462. See, e.g., *SEC v. Quinlan*, 373 F. App'x 581, 588 (6th Cir. 2010) (finding an injunction was "remedial rather than punitive" because, among other things, the district court found that the defendant would reoffend in the absence of an injunction).

In *Cohen*, Judge Garaufis acknowledged that his ruling was "in tension with the Eighth Circuit's recent decision in *Collyard*," but found the Eighth Circuit's reasoning unpersuasive, remarking as follows: "To the extent *Collyard* suggests that a remedy is not a §2462 penalty if the remedy's penal effect is only incidental to its remedial effect, the court respectfully finds this suggestion at odds with *Kokesh*." 2018 WL 3455403, at *14. Judge Garaufis's position is supported by the language of the *Kokesh* opinion, in which the Supreme Court held that relief requested by the SEC is a penalty unless it is "*solely* remedial" in nature. Id. (emphasis in original).

Other courts have similarly reached the conclusion that obey-the-law injunctions are penalties subject to a five-year statute of limitations. These courts have generally focused on the collateral consequences and stigmatization inherent in an obey-the-law injunction. *See, e.g.*, *Gentile*, 2017 WL 6371301, at *3 ("[I]n some cases the collateral consequences [of an injunction] can be very grave.").

Conclusion

While the issue continues to be decided by lower courts, practitioners can expect the SEC both to continue arguing that obey-the-law injunctions are not governed by a five-year statute of limitations and, at the same time, to seek broad tolling agreements early in investigations to avoid an outcome like that in *Cohen*. Concerning the SEC's litigation position, the Commission maintains the view that *Kokesh* should not be extended to obey-the-law injunctions, as reflected in the current SEC Enforcement Manual. See §3.1.2 ("[C]ertain claims are not subject to the five-year statute of limitations under §2462, including claims for injunctive relief"). A co-director of the SEC's enforcement division remarked not too long ago that the "*Kokesh* decision *does not* apply to injunctive relief" and that the SEC would not be receptive to such arguments in the context of Wells meetings. Steven Peikin, Co-Director, SEC Division of Enforcement, *Keynote Address at the New York City Bar Association's 7th Annual White Collar Crime Institute* (May 9, 2018).

As to tolling agreements, SEC enforcement attorneys will certainly continue their practice of seeking broad tolling agreements with subjects of investigations, and then re-upping those agreements during lengthy investigations. That appears to have been the intention of the enforcement staff in the investigation underlying the charges in *Cohen*, but due to an apparent expansion over time in the scope of the investigation, the district court found the tolling agreements not to be as broad as the SEC contended. Following *Cohen*, defense counsel should expect SEC enforcement staff to insist on tolling agreement provisions that contain "broad, open-ended language that … evince[s] the parties' mutual intent to extend the statute of limitations applicable to any claims the SEC might bring." *Cohen*, 2018 WL 3455403, at *10.

Lastly, defense counsel should be sure to follow the development of the law in appellate courts. While it is not yet clear whether the SEC will appeal the decision in *Cohen*, a government appeal of an adverse ruling in *Gentile* is fully briefed and awaiting a decision by the Third Circuit. *SEC v. Gentile*, No. 18-1242 (3d Cir. Feb. 22, 2018). The split in the lower courts may reach the Supreme Court in the not too distant future. Until the Supreme Court decides the issue, the legal landscape will remain uncertain.