In *SEC v. Cohen*, Court Continues Trend of Limiting SEC Enforcement Powers

July 19, 2018

Securities Litigation and Enforcement

Last week, in *SEC v. Cohen*, a federal district court dismissed an SEC enforcement action, in its entirety, on statute-of-limitations grounds.[1] Most notably, citing the Supreme Court's 2017 *Kokesh* decision, the court held that the injunction sought by the SEC in the case "would function at least partly to punish Defendants and is therefore a penalty"[2] for purposes of the five-year statute of limitations applicable to all federal government actions seeking a civil fine, penalty, or forfeiture.[3] This decision is part of an eight-year trend of rulings in the Supreme Court and the lower courts curtailing the SEC's enforcement powers in numerous ways, including invalidating the appointment of the agency's administrative law judges,[4] extending the coverage of the statute of limitations to SEC enforcement actions,[5] narrowing the scope of the anti-fraud provisions of the federal securities laws,[6] and limiting the extraterritorial reach of these provisions.[7]

As we explained last year, prior to *Kokesh*, the SEC had long taken the position that it could pursue disgorgement claims and other equitable remedies indefinitely. In *Kokesh*, the Supreme Court rejected that approach as to disgorgement, reasoning that disgorgement is a penalty because it addresses a wrong to the public, and that the remedy's purposes include punishment and deterrence rather than merely compensation for a loss. The Court concluded that

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[1] Memorandum & Order Granting Motion to Dismiss, 1:17-CV-00430 (E.D.N.Y. July 12, 2018), ECF No. 68.
[2] 137 S. Ct. 1635 (2017).
[3] 28 U.S.C. § 2462 (2018).
[4] *Lucia v. SEC*, 138 S. Ct. 2044 (2018).
[5] *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) (holding the general five-year statute of limitations applies to claims for disgorgement); *Gabelli v. SEC*, 568 U.S. 442 (2013) (holding the general five-year statute of limitations for federal government civil penalty actions begins to run when a fraud occurs, rather than when the government discovers it).
[6] *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011) (holding that a defendant only "makes" a statement for purposes of a private action under Rule 10b–5(b) of the Securities Exchange Act of 1934 if the defendant "is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."). The Supreme Court also recently granted a cert. petition in *Lorenzo v. SEC*, where it will consider, among other things, whether to reduce the scope of "scheme liability" under Rule 10b-5. 872 F.3d 578 (D.C. Cir. 2017), *cert. granted*, No. 17-1077, 2018 WL 646998 (U.S. June 18, 2018).
[7] *See Morrison v. Nat'l Australia Bank*, 561 U.S. 247 (2010).

disgorgement is punitive instead of remedial because it does not simply restore the money to victims but rather "leaves the defendant worse off."[8]

In *Cohen*, Judge Nicholas Garaufis, of the Eastern District of New York, applied *Kokesh* to the SEC's claim for an "obey the law" injunction as well as its disgorgement and penalty claims. Judge Garaufis held that the requested injunction fell within the ambit of *Kokesh's* reasoning because the SEC was seeking the injunction to benefit the public, and because the injunction would label the defendants as wrongdoers, a form of punishment. Although the court stated that it was limiting its decision to the specific injunction sought in that case,[9] the court's reasoning would appear to extend to all obey-the-law injunctions sought by the SEC. On this issue, the *Cohen* decision is consistent with prior decisions in the Northern District of Texas[10] and the Southern District of New York,[11] but in conflict with a decision last year by the Eighth Circuit.[12]

While the decision to apply *Kokesh* to injunctive relief will garner the most attention, the other aspects of the *Cohen* decision are also notable. The SEC asked the court to deny the defendants' motion to dismiss on limitations grounds as premature given that § 2462 applies only to remedies, arguing that the determination of whether the requested injunction was punitive in nature would depend on facts that the SEC would develop in discovery and present at trial. The court rejected the SEC's argument and held that it was appropriate to consider whether the remedy sought would be subject to the statute of limitations on a motion to dismiss.[13] Judge Garaufis reasoned that "[a]llowing discovery to proceed with respect to claims that appear to be time-barred . . . would constitute 'entertain[ing]' those claims, which § 2462 clearly prohibits."[14]

The *Cohen* court also held that a tolling agreement between the SEC and the defendants should be construed narrowly to apply only to the specific investigation referenced in the agreement and not to subsequent investigations that arose out of that original investigation.[15] This holding reinforces the importance of reviewing and tailoring the language of all tolling agreements with the SEC.

Moreover, in *Cohen*, the court rejected the SEC's argument that "its 'disgorgement claims' accrued only when (and apparently each time) Defendants received ill-gotten gains as a result of the allegedly corrupt transactions."[16] The court explained that "the statute of limitations runs from when Defendants allegedly engaged in misconduct, not when they received compensation

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[8] 137 S. Ct. at 1644.
[9] *Cohen*, Mem. & Order Granting Mot. to Dismiss at 31, ECF No. 68.
[10] *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867, 885-86 (N.D. Tex. 2011) (holding that injunctive relief and officer-and-director bars are subject to § 2462).
[11] *SEC v. Jones*, 476 F. Supp. 2d 374, 385 (S.D.N.Y. 2007) (holding that an obey-the-law injunction was subject to § 2462 because it "would carry with it the sting of punishment").
[12] *SEC v. Collyard*, 861 F.3d 760, 764 (8th Cir. 2017) (holding that an obey-the-law injunction is issued to protect the public, and not deterrent in nature, and thus, is not a penalty and subject to the 5-year statute of limitations of § 2462).
[13] *Cohen*, Mem. & Order Granting Mot. to Dismiss at 19, ECF No. 68.
[14] *Id*. at 18.
[15] *Id.* at 22-23.
[16] *Id.* at 23-24.

in connection with that misconduct."[17] The court's rejection of the SEC's accrual argument helpfully sharpens the date on which the statute of limitations begins to run on SEC enforcement actions.

Although *Cohen* and other recent decisions have limited the SEC's enforcement authority in a number of areas, the agency's investigatory and enforcement powers remain broad. In addition, the SEC may attempt to adapt to these rulings by, among other tactics, pursuing broadly worded tolling agreements and conduct-based injunctions that place limitations on future activity, as well as by focusing on early detection and whistleblowing incentives in an effort to bring enforcement actions long before the expiration of the five-year statute of limitations. These decisions indicate a growing trend that provides companies and individuals with more tools to defend against SEC enforcement actions and more effectively limit broad ranging investigations.

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[17] *Id.* at 24 (citing *Gabelli*, 568 U.S. at 448; *SEC v. Straub*, No. 11-CV-9645, 2016 WL 5793398, at *19 (S.D.N.Y. Sept. 30, 2016)). The court also noted that if the SEC's argument was correct, the SEC would have needed to plausibly allege the defendant's receipt of ill-gotten gains in its complaint—which the SEC failed to do in *Cohen*.