Supreme Court Limits SEC Disgorgement Remedy to Five Years

On June 5, the Supreme Court ruled that a five-year statute of limitations applies to disgorgement remedies that may be imposed by the SEC. The unanimous decision settles a previous Circuit split and overturns longstanding SEC practice, as it treats disgorgement as a penalty subject to the relevant statute of limitations,[1] rather than as a matter of restitution, which generally is not.

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The ruling's obvious impact is that the SEC can no longer require defendants to pay so-called "ill-gotten gains" received outside the five-year limitations period or interest on those gains. In addition, the result may motivate the SEC to pass on cases where the misconduct only comes to the Staff's attention close in time to the end of the statute of limitations period, and where both disgorgement and penalties would be based primarily on conduct outside of that period. However, factors remain that limit the decision's benefit to the asset management industry:

- A large percentage of the SEC's cases are easily investigated and filed within the five-year period, and the remedy of disgorgement typically is a more significant component of sanctions in asset management cases, as opposed to issuer cases, for example, since fee and expense overages typically are readily discernable and easily calculated.

- The SEC may embrace more aggressive theories to obtain higher disgorgement and penalty amounts for misconduct within the five-year statute of limitations, in order to "make up" for the unavailability of amounts based on conduct falling outside the five-year period.

- The decision is expected to continue the SEC's post-credit crisis focus on bringing cases quickly, increasing the already significant pressure on parties under investigation to expedite document productions, witness testimony, the Wells process and settlement as the limitations period comes into focus.

- The SEC is expected to continue to demand that parties under investigation sign tolling agreements that extend the five-year limitations period and with that extension the availability of disgorgement and penalties, presenting parties under investigation with typically complex decisions relating to refusal to sign.

Whether or not the decision's benefits to asset managers are ultimately limited by these factors, at the least it may assist asset managers undergoing SEC exams, where the SEC's unclear authority to require restitution for fee and expense errors for prior periods historically has caused concern.

1 The decision follows a unanimous 2013 Supreme Court decision that also ruled against the SEC's ability to impose penalties for conduct outside the five-year limitations period.

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