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SEC v. Cohen: Calling Into Question the Future of Obey-the-Law Injunctions

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Last month, in *SEC v. Cohen*, Judge Nicholas Garaufis of the Eastern District of New York dismissed as untimely an FCPA case brought by the SEC, including its request for an injunction ordering the defendants to refrain from any future violations of securities laws, often referred to as an "obey-the-law" injunction.[1] In dismissing the case, Judge Garaufis found that the injunction would serve as a penalty and therefore was subject to the five-year statute of limitations imposed by 28 U.S.C. § 2462, an issue left unanswered last year by the U.S. Supreme Court.

The *Cohen* decision is a significant setback for the SEC and its enforcement program and confirms that § 2462 is a powerful tool for defense counsel to invoke in dealing with SEC investigations and litigation. The decision also signals that the SEC's use of obey-the-law injunctions could face further scrutiny and may be subject to Supreme Court review at some point in the future.

See "How the SEC May Circumvent the Five-Year Statute of Limitations on Disgorgement Under *Kokesh v. SEC*" (Aug. 16, 2017).

"Obey-the-Law" Injunctions

Injunctions are a cornerstone of the SEC's enforcement program. In addition to pursuing civil monetary penalties and disgorgement of ill-gotten gains, as part of an enforcement action the SEC routinely seeks an injunction requiring, in essence, that the defendant obey the law in the future. These injunctions can have significant consequences. The stigma of the injunction alone can damage a defendant's livelihood and lead to the loss of his personal and professional reputation. And a defendant who disobeys the injunction can be prosecuted for civil or criminal contempt.

For years, the SEC took the position that it could pursue disgorgement and injunctions indefinitely given that, on its face, § 2462's five-year statute of limitations only applies to actions enforcing "civil fine[s], penalt[ies], or forfeiture[s]." That changed last year, however, when the Supreme Court, in *Kokesh v. SEC,* unanimously ruled that § 2462 extends to disgorgement claims because they constitute a "penalty."[2] Disgorgement had long been thought to fall outside the statute of limitations because it seeks to take back what a defendant received unlawfully. But the Supreme Court took the view that such repayments are a type of penalty, similar to a civil fine, and thus subject to § 2462's five-year time bar.

Kokesh, however, did not address the question of whether § 2462's five-year statute of limitations period also extends to claims for injunctions, giving rise to an ongoing debate among the courts. Recently, in *SEC v. Cohen*, Judge Garaufis joined the fray.

See "SEC Enforcement After *Kokesh*" (Jun. 21, 2017).

SEC v. Cohen

In January 2017, the SEC filed a complaint in the Eastern District of New York against Michael Cohen and Vanja Baros, two former executives at the hedge fund Och-Ziff Capital Management LLC. The SEC alleged that Cohen and Baros bribed foreign officials in Africa to win hedge fund business in Libya, South Africa, the Democratic Republic of the Congo and the Republic of the Congo. The bribery allegations dated as far back as 2007 and continued to 2012. Based on those allegations, the SEC charged Cohen and Baros with violating the FCPA and the Investment Advisers Act and sought civil penalties, disgorgement and a permanent injunction barring them from violating those laws in the future. Both defendants filed motions to dismiss arguing, among other things, that the SEC's claims were all time-barred. Under *Kokesh*, they argued § 2462's five-year statute of limitations applied to the SEC's claim for an injunction as well as its disgorgement and civil penalty claims.

While the SEC was unaware of any wrongful conduct within the five-year limitations period, it still opposed the defendants' motions on a number of grounds. Not surprisingly, the SEC took the position that *Kokesh* did not apply to its claim for an injunction. The SEC also argued the defendants' motions were premature, because the determination of whether the requested injunction was subject to § 2462's limitations period would depend on facts that the SEC would need to develop in discovery. The SEC argued that the case should survive because discovery might reveal that defendants undertook corrupt acts, or received proceeds from corrupt acts, within

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the limitations period. And the SEC argued that based on certain tolling agreements – where the parties agreed to suspend the limitations period – its claims were not time-barred.

On July 12, 2018, Judge Garaufis rejected all the SEC's arguments, agreed with the defendants that the SEC's claims were time-barred and dismissed the case in its entirety. Notably, the court held that § 2462's limitations period applied to the obey-the-law injunction sought by the SEC because it "would function at least partly to punish Defendants."[3] Interpreting *Kokesh*, the court held that a remedy is subject to § 2462 unless it serves a "solely remedial" purpose and not a "retributive" or "deterrent" one.[4] Because the requested injunction would impose upon Cohen and Baros no duties other than their existing duty to follow the law, Judge Garaufis reasoned that the injunction was sought for a retributive and deterrent purpose – to mark the defendants as lawbreakers and stigmatize them in the eyes of the public.

See "In Further Fallout From FCPA Probe, Former Och-Ziff Executive Is Indicted for Fraud and Obstruction of Justice Arising From Undisclosed Conflicts of Interest" (Jan. 24, 2018).

A Higher Burden for the SEC

The *Cohen* decision has several important implications.

The fact that the court dismissed the SEC's case in its entirety at the pleadings stage is significant. In doing so, the court held that § 2462 is an appropriate basis for a motion to dismiss and rejected the SEC's argument that discovery was required to determine whether the injunction sought was subject to the statute of limitations. "Allowing discovery to proceed with respect to claims that appear to be time-barred on the face of a plaintiff's complaint," the court explained, would be something which "§ 2462 clearly prohibits."[5] By dismissing the entire case, as opposed to allowing the SEC's claim for an injunction to proceed to discovery, the decision spared the defendants from incurring further time and expense litigating the matter.

Another important aspect of the decision is the court's denial of the SEC's attempt to extend the limitations clock. The court rejected the idea that the SEC could avoid dismissal by alleging the possibility of discovery yielding evidence of further illegal transactions within the limitations period. It would "make no sense," the court held, to permit the SEC to "evade the statute of limitations by alleging untimely misconduct and then demanding discovery in hopes of uncovering misconduct within the limitations period."[6] The court's ruling, therefore, puts a higher burden on the SEC to credibly plead timely claims – the SEC will not be able to file a complaint with stale claims and count on bootstrapping discovery into timely ones.

Likewise, the court rejected the SEC's theory that the case should proceed because discovery might turn up instances where defendants received ill-gotten funds during the limitations period. For one thing, the court found, the SEC had failed to allege any receipt of funds in the complaint to begin with. The court, moreover, concluded that "the statute of limitations runs from when Defendants allegedly engaged in misconduct, not when they received compensation in connection with that misconduct."[7]

The decision also confirms that SEC tolling agreements should be construed narrowly to apply only to the specific investigation referenced in the agreement. The tolling agreements at issue related to the SEC's investigation into Cohen's alleged misconduct in Libya. But, according to the SEC, those agreements rendered any conduct alleged in the complaint that occurred after April 2010 timely – including conduct in South Africa, the Democratic Republic of the Congo and the Republic of the Congo. The agreements, the court found, by their terms only applied to the investigation of the conduct in Libya, and not to any related spin-off investigations. Thus, the Libyan conduct, which took place before April 2010, as well as all the other alleged conduct, was time-barred.

See "Dirty Dealings in Africa Result in SEC and DOJ Settlements for Och-Ziff and Two Executives" (Oct. 26, 2016).

An Extension of Kokesh

The most significant aspect of the *Cohen* decision is that it extends the Supreme Court's rationale in *Kokesh* to SEC obey-the-law injunctions, adding to the debate among courts about the applicability of § 2462 to injunctive relief. Some courts have permitted injunctions as a remedy for conduct occurring outside of the five-year limitations period, reasoning that they do not constitute a penalty.[8] The Sixth, Eighth and Eleventh Circuits, in particular, have approved obey-the-law injunctions similar to the one the district court rejected in *Cohen*.[9]

Other courts, including the Fifth Circuit and the District of New Jersey, have held that § 2462's statute of limitations applies to injunctions because they function as penalties. [10] In *SEC v. Bartek*, for example, the Fifth Circuit held that "the severity and permanent nature of" a director-and-officer bar – which prohibits defendants from serving as a director or

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officer of a public company – constituted a penalty.[11] Judge Kavanaugh of the D.C. Circuit has also taken that position, noting that "in light of the Supreme Court's analysis in *Kokesh*, expulsion or suspension of a securities broker is a penalty," because it provides no relief to the victims.[12] *Cohen* extends similar reasoning to obey-the-law injunctions, reasoning that, while they may be less obviously punitive than expulsions or director-and-officer bars, obey-the-law injunctions have some punitive function in marking defendants as law breakers.

As a result of this debate, there continues to be uncertainty about whether § 2462 applies to SEC injunctions. However, the *Cohen* case appears to be part of a trend of rulings scrutinizing the SEC's routine practice of seeking injunctions and thus the decision provides another tool that companies and individuals can use to defend against SEC investigations and enforcement actions.

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[1] *SEC v. Cohen*, No. 17-cv-00430-NGG-LB, 2018 WL 3455403 (E.D.N.Y. July 12, 2018).
[2] *Kokesh v. SEC*, 137 S. Ct. 1635, 1639 (2017).
[3] *Cohen,* 2018 WL 3455403, at *7.
[4] *Id.* at *13.
[5] *Id.* at *9.
[6] *Id.*
[7] *Id.*
[8] *SEC v. Quinlan*, 373 F. App'x. 581, 586-88 (6th Cir. 2010); *SEC v. Collyard*, 861 F.3d 760, 764 (8th Cir. 2017); *SEC v. Graham*, 823 F.3d 1357, 1360-61 (11th Cir. 2016); *SEC v. Mapp*, No. 4:16-CV-00246, 2017 WL 5177960, at *6 (E.D. Tex. Nov. 8, 2017); *SEC v. Ahmed*, 308 F. Supp. 3d 628 (D. Conn. 2018); *SEC v. Wey*, 246 F. Supp. 3d 894, 935 (S.D.N.Y. 2017).
[9] *Quinlan*, 373 Fed. App'x. at 586-88; *Collyard*, 861 F.3d at 764; *Graham*, 823 F.3d at 1360-61.
[10] *SEC v. Bartek*, 484 Fed. App'x. 949, 956 (5th Cir. 2012); *SEC v. Gentile*, No. 16-1619 (JLL), 2017 WL 6371301, at *2-4 (D.N.J. Dec. 13, 2017).
[11] *Bartek*, 484 F. App'x at 957.
[12] *Saad v. SEC*, 873 F.3d 297, 304-05 (D.C. Cir. 2017) (Kavanaugh, J., concurring).

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