Client Update

Eleventh Circuit Holds that SEC Claims for Disgorgement and Declaratory Relief are Subject to Five-Year Limitations Period

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On May 26, 2016, the Eleventh Circuit Court of Appeals ("Eleventh Circuit" or "Court") rejected an attempt by the Securities and Exchange Commission ("SEC") to seek disgorgement and declaratory relief for conduct that occurred more than five years ago. In *SEC v. Graham*,[1] a unanimous panel of the Eleventh Circuit held that the disgorgement and declaratory relief sought by the SEC are subject to the statute of limitations set forth in 28 U.S.C. § 2462, which prevents the government from enforcing "any civil fine, penalty, or forfeiture" after five years from when the claim first accrued.[2] The Court held that declaratory relief is a penalty under § 2462, and that disgorgement is "effectively synonymous" with forfeiture, making both subject to § 2462's five-year statute of limitations. The Court allowed SEC claims for injunctive relief to move forward on the grounds that such relief is equitable and forward-looking in nature. The *Graham* decision provides much-needed clarity on the scope of relief subject to § 2462 and, at least in the Eleventh Circuit, places important limits on the SEC's ability to seek broad remedies in cases involving conduct occurring more than five years ago, including, for example, cases stemming from the financial crisis.

FACTUAL BACKGROUND AND THE ELEVENTH CIRCUIT'S DECISION

The SEC filed a civil enforcement action in the U.S. District Court for the Southern District of Florida in January 2013 alleging that from November 2004 to July 2008, the defendants operated an elaborate Ponzi scheme, using a vast

1 *SEC v. Graham*, No. 14-13562, slip op. (11th Cir. May 26, 2016).

2 The Supreme Court has already held that a violation for purposes of § 2462 accrues when the violative conduct occurs, not when it is discovered. *Gabelli v. SEC*, 133 S. Ct. 1216, 1220 (2013). We discussed *Gabelli* in a previous client update.

web of entities to sell unregistered securities in the guise of real estate investments.[3] The defendants allegedly guaranteed instant equity appreciation and extraordinarily high returns for buying into aging condominium developments that the company planned to refurbish into five-star luxury resorts. In addition to a civil monetary penalty, the SEC sought (i) a declaration that defendants violated the federal securities laws, (ii) a permanent injunction from future violations of the federal securities laws, and (iii) disgorgement of all profits with prejudgment interest.

On cross-motions for summary judgment, the district court, without reaching the merits of the motions, dismissed the SEC's complaint as time-barred. The court held that it lacked subject matter jurisdiction because § 2462 was jurisdictional in nature, and the SEC failed to allege any acts of offering or selling a security by any of the individual defendants in the five years prior to filing its complaint. The district court also held that § 2462 applied to all of the SEC's remedies, not just the civil monetary penalties.[4]

In a well-reasoned opinion, the Eleventh Circuit affirmed the district court's ruling that the five-year statute of limitations in § 2462 applied to preclude the SEC from seeking disgorgement and declaratory relief for conduct alleged in the complaint. In so doing, the Eleventh Circuit declined to decide whether § 2462 is jurisdictional in nature, but instead focused on the plain language of § 2462 to dismiss the SEC's disgorgement and declaratory relief claims as time-barred.

With respect to the injunctive relief, the Eleventh Circuit rejected the district court's holding that the SEC's request for an injunction was "nothing short of a penalty" and therefore covered by § 2462. Citing to its prior decisions in *U.S. v. Banks and Nat'l Parks & Conservation Ass'n v. Tenn. Valley Auth.*, the Eleventh Circuit held that legal precedent foreclosed the argument that § 2462 applied to injunctions, because they are equitable in nature. Although the Court recognized that the term "penalty" is not defined in § 2462, it went on to examine the common definition of "penalty," which it held confirmed that a penalty is backward-looking in time and intended to address "a wrong done in the past." Injunctions, on the other hand, "typically look forward in time," and are therefore not a penalty within the meaning of § 2462. In a lengthy footnote, the

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[3] An "investment contract" qualifies as a security under § 2(a)(1) of the Securities Act of 1933, 15 U.S.C. § 77b(a)(1). For the formative interpretation of an investment contract with remarkably similar facts, *see SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

[4] In *Gabelli*, the Supreme Court unanimously held that § 2462 applies to civil monetary penalties sought by the SEC.

Eleventh Circuit admonished the SEC for seeking what is commonly referred to as an "obey-the-law" injunction, which the Court noted it had "repeatedly" said were unenforceable, citing similar views from the Second Circuit.[5] In a firm warning that a broad obey-the-law injunction would not survive scrutiny, the Court suggested that the SEC could seek injunctive relief provided it was "specific and narrow enough that the parties would be afforded sufficient warning to conform their conduct."

The Eleventh Circuit then applied this same backward-looking/forward-looking framework to determine whether the intent of the other relief sought by the SEC was to punish, rather than to stop ongoing or future harm. In considering declaratory relief, the Eleventh Circuit noted that a "public declaration that the defendants violated the law does little other than label the defendants as wrongdoers." The Court found that declaratory relief therefore fit the definition of a "penalty," and is subject to § 2462. In considering disgorgement, the Eleventh Circuit agreed with the district court that, "for the purposes of § 2462 forfeiture and disgorgement are effectively synonyms." The Court sharply rejected the SEC's attempt to find a distinction between forfeiture and disgorgement by focusing on the technical definitions, instead of the words' ordinary meanings, particularly because § 2462 applies to a wide variety of agency actions and contexts. The Court compared dictionary definitions and found no meaningful difference between the two, noting that even under the definitions advocated by the SEC, "disgorgement is imposed for a wrongdoing and can be considered as a subset of forfeiture."

POTENTIAL IMPACT OF THE DECISION

The Eleventh Circuit's thoughtful analysis of the limits on remedies available to the SEC for conduct occurring more than five years ago could lead those involved in drawn out enforcement investigations to give greater weight to the potential drawbacks of entering into a tolling agreement with the SEC when evaluating tolling requests from the Staff. There can be little doubt that the *Graham* ruling will provide even more motivation for the SEC Staff to seek

[5] "Repeatedly we have said . . . "obey-the-law" injunctions are unenforceable." *Graham*, No. 14-13562, slip op. at 9 n.2. In making this point, the Court endorsed the Second Circuit's important finding in *SEC v. Goble*, 682 F.3d 934, 952 (11th Cir. 2012), that these injunctions violate Rule 65(d) of the Federal Rules of Civil Procedure requiring that an injunction specifically states its terms in the four corners of the injunction. We discussed *Goble* in a previous client update.

tolling earlier and more frequently in matters, notwithstanding prior statements that tolling should not become a common practice.[6]

Another possible impact of the *Graham* decision is on settlement negotiations with the SEC Staff. On occasion, the SEC Staff take the position in cases with older conduct–and in response to defense counsel's statute of limitations arguments–that even if the SEC cannot obtain monetary relief in the form of a penalty, it can always seek purportedly equitable relief in the form of a broad injunction and disgorgement. The *Graham* decision now provides defense counsel with ammunition to challenge the SEC's position with respect to disgorgement. This could have an especially significant impact on older FCPA cases where substantial disgorgement can potentially be attributable to alleged violations occurring more than five years ago. In addition, as for injunctive relief, dicta in the *Graham* decision, citing to prior decisions of the court, suggests that the SEC must more carefully tailor its injunctions to address the conduct at issue.

The Eleventh Circuit's decision also raises a circuit split on the question of whether disgorgement is subject to § 2462's five-year limitations period. In decisions issued prior to the Supreme Court's opinion in *Gabelli*, both the D.C. Circuit and the Ninth Circuit have held that disgorgement was not subject to the five-year statute of limitations.[7] This circuit split increases the likelihood that the Supreme Court may once again be asked to weigh in on the interpretation of § 2642. It remains to be seen whether the SEC will seek review of the *Graham* decision.

Although the Eleventh Circuit's decision in *Graham* conflicts with the D.C. and Ninth Circuits' interpretation of § 2462, the *Graham* decision certainly presents a significant setback for the SEC, particularly as the SEC continues to pursue

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6 In August 2009, then-Director of Enforcement Robert Khuzami announced a change in the SEC's internal policy for seeking tolling agreements, announcing that the approval of the Division Director would be required for all tolling agreements. In announcing the policy change, Khuzami noted that tolling agreements "have become far too common" and they can "impose a significant cost of delay" as well as "undermine our message of prompt accountability for wrongdoing." *See Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement*, Robert Khuzami (August 5, 2009).

7 *Riordan v. SEC*, 627 F.3d 1230 (D.C. Cir. 2011) (holding that disgorgement is not a penalty "at least so long as the disgorged amount is causally related to the wrongdoing."); *SEC v. Rind*, 991 F.2d 1486 (9th Cir. 1993) (holding that disgorgement is an equitable remedy and such remedies are inherently not subject to § 2462). The D.C. Circuit will have the opportunity to revisit the disgorgement issue post-*Gabelli*, and with the benefit of the sound analysis presented by the Eleventh Circuit in the *Graham* decision, when it hears a case currently pending before it where defendants raise similar arguments to those raised in *Graham*. *See Timbervest v. SEC*, No. 15-1416 (D.C. Circuit).

claims based on conduct arising out of the financial crisis and FCPA violations that might have occurred many years before they were discovered. It remains to be seen how the SEC will react to the *Graham* decision and whether other circuit courts will follow the Eleventh Circuit's analysis and further develop the circuit split.

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Please do not hesitate to contact us with any questions.