June 13, 2016

Eleventh Circuit Applies Five-Year Statute of Limitations to SEC Disgorgement Claims

On May 26, the Eleventh Circuit Court of Appeals unanimously ruled that the five-year statute of limitations applicable to Securities and Exchange Commission claims for fines and suspensions or bars also applies to SEC claims for declaratory relief and disgorgement.[1]

Background

28 U.S.C. § 2462 bars all government entities, including the SEC, from bringing suit to enforce "any civil fine, penalty, or forfeiture" after five years from when the claim first accrued. In *Gabelli v. Securities and Exchange Commission*,[2] a unanimous Supreme Court rejected the SEC's argument that its penalty claim accrued when it discovered the misconduct, and not when the misconduct occurred. The Supreme Court held that such a "discovery rule," used in private actions for damages, does not apply to government actions for penalties. Chief Justice Roberts, writing for the unanimous Court, held that "the five-year clock begins to tick when the fraud is complete [not] when the fraud is discovered." The Court found that the "most natural reading" of 28 U.S.C. § 2462 is that "a claim based on fraud accrues—and the five-year clock begins to tick—when a defendant's allegedly fraudulent conduct occurs." The Court also noted that "we have never applied the discovery rule in this context, where the plaintiff is not a defrauded victim seeking recompense, but is instead the Government bringing an enforcement action for civil penalties."

Significantly, the Supreme Court in the *Gabelli* case expressly did not address whether the five-year statute of limitations applied to claims for injunctions or disgorgement: "The SEC also sought injunctive relief and disgorgement, claims the District Court found timely on the ground that they were not subject to § 2462. Those issues are not before us."[3]

Application of the Statute of Limitations in SEC Actions Seeking Injunctions, Declaratory Relief and Disgorgement

In *Graham*, the Eleventh Circuit determined that "a penalty addresses a wrong done in the past. . . . . Injunctions, by contrast, typically look forward in time. . . . . An injunction therefore is not a penalty within the meaning of § 2462." The Eleventh Circuit concluded, however, that the SEC's request for declaratory relief was subject to the five-year statute of limitations: "A declaration of liability goes beyond compensation and is intended to punish because it serves neither a remedial nor a preventative purpose; it is designed to redress previous infractions rather than to stop any ongoing or future harm."

With respect to claims for disgorgement, the Eleventh Circuit ruled that "for the purposes of § 2462 forfeiture and disgorgement are effectively synonyms; § 2462's statute of limitations

[1] SEC v. Graham, No. 14-13562 (11th Cir. May 26, 2016).

[2] 133 S. Ct. 1216 (2013).

[3] At note 1.

For more information, please contact any of the following members of Katten's **Securities Litigation and Enforcement** and **Financial Services** practices.

Richard D. Marshall
+1.212.940.8765
richard.marshall@kattenlaw.com

Michael J. Diver
+1.312.902.5671
michael.diver@kattenlaw.com

applies to disgorgement. . . . We find no meaningful difference in the definitions of disgorgement and forfeiture." On this basis, the Eleventh Circuit held that "the SEC is time-barred from proceeding with its claims for declaratory relief and disgorgement because, under the plain meaning of 28 U.S.C. § 2462, these remedies are a penalty and a forfeiture, respectively."

Implications of the *Graham* Decision

It is unclear whether the SEC will seek to appeal the *Graham* decision or whether other Courts of Appeals will follow it. It is noteworthy that both the D.C. and Ninth Circuits have previously declined to apply a five-year statute of limitations to SEC claims for disgorgement.[4] It also is noteworthy that the Eleventh Circuit has characterized disgorgement as a forfeiture when other courts have characterized it as an "equitable remedy"[5] designed to deprive wrongdoers of unjust enrichment and to deter others from violating the securities laws. For this reason, Courts have held that disgorgement cannot be used punitively, and thus must be limited to an amount causally connected to the alleged wrongdoing.[6]

If the *Graham* decision is broadly followed, it will create additional time pressure on the SEC to conclude its investigations quickly. Requests for tolling agreements in SEC investigations will likely become more common. It also is likely that if Courts broadly construe disgorgement as akin to a forfeiture, it will become more difficult for the SEC to obtain disgorgement. On the other hand, when the SEC does persuade a court to award disgorgement, characterizing this relief as akin to a forfeiture may make it easier for the SEC to obtain greater relief than was previously viewed as available.

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4 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). See also Zacharias v. SEC, 569 F.3d 458, 471-72 (D.C. Cir. 2009) holding that disgorgement is not a penalty within the meaning of § 2642; the court did not consider, as the Graham court did, whether disgorgement could be "forfeiture" within the meaning of the statute.

5 See, e.g., SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991) ("The disgorgement remedy [the district court judge] approved in this case is, by its very nature, an equitable remedy . . . ." (emphasis added)); First City Fin, 890 F.2d at 1230 ("Disgorgement is an equitable remedy . . . ."); SEC v. Certain Unknown Purchasers of Common Stock of and Call Options for Common Stock of Santa Fe Int'l Corp., 817 F.2d 1018, 1020 (2d Cir. 1987) ("The disgorgement remedy approved by the district court in this case is, by its nature, an equitable remedy." (emphasis added)).

6 E.g., SEC v. First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998); SEC v. Hughes Capital Corp., 124 F.3d 449, 455 (3d Cir. 1997) (quoting First City Fin., 890 F.2d at 1230).