Eleventh Circuit Restricts SEC's Ability to Impose Disgorgement

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On May 26, 2016, the United States Court of Appeals for the Eleventh Circuit held in *S.E.C. v. Graham*, *et. al.* (No. 14-13562), that the five-year statute of limitations in 28 U.S.C. § 2462 (1948) applies to U.S. Securities and Exchange Commission (SEC) claims for disgorgement or declaratory relief. Although *Graham* is not binding outside of the Eleventh Circuit, it represents a significant challenge to the SEC's stated position that disgorgement is not subject to the U.S. Code's general statute of limitations established by § 2462 because it is an equitable remedy. *Graham* is a body blow to the SEC's current view of its enforcement powers, particularly if its reasoning is adopted by other circuit courts or if the U.S. Supreme Court affirms the decision.

Graham is particularly notable because of the importance the SEC places on disgorgement in enforcement proceedings. Disgorgement, which is provided for under the Securities and Exchange Act of 1934, is a tool the SEC frequently relies on in civil dispositions, including those involving alleged violations of the Foreign Corrupt Practices Act (FCPA) to oblige alleged wrongdoers to disgorge their ill-gotten gains. The SEC first ordered disgorgement as part of an FCPA resolution in 2004, and it has since become the primary driver of the SEC's record-setting monetary impositions under the FCPA over the last 10 years. In the last three years alone, the SEC has extracted more than $940 million from companies as part of FCPA-related civil enforcement actions, of which approximately $829 million has been disgorgement, $59 million has been civil fines and $53 million has been prejudgment interest. This imbalance is attributable, at least in part, to the SEC's current view, rejected in *Graham*, that no statute of limitations prevents the Commission from seeking injunctions, declaratory judgments or the disgorgement of ill-gotten gains, regardless of when the conduct occurred, because these remedies are equitable in nature and therefore not subject to the strictures of § 2462.

Although there is judicial precedent supporting the SEC's position, these decisions generally predate the Supreme Court's opinion in *Gabelli v. S.E.C.*, 133 S. Ct. 1216 (2013), a statute of limitations case that rejected the SEC's view of when a limitations period begins. *Gabelli* left open the question of whether claims for so-called equitable relief (including injunctions, declaratory judgments and disgorgement) fall under the statute of limitations. That decision presaged *Graham*, and at this juncture other circuit courts are likely to engage in a re-consideration of how statutes of limitations should apply across the board in SEC cases.

Background in *Graham*

On January 30, 2013, the SEC filed a civil complaint against Barry J. Graham and four other individual defendants for allegedly selling condominiums that functioned as unregistered securities in violation of federal securities law. In its filings, the SEC "requested that the district court: (1) declare that the defendants had violated federal securities laws; (2) permanently enjoin the defendants from violating federal securities laws in the future; (3) direct the defendants to disgorge all profits from their illegal ventures, with prejudgment interest; (4) order the defendants to repatriate any funds held outside the district court's jurisdiction; and (5) require three defendants ... to pay civil money penalties."

In dismissing the SEC's complaint as time-barred, the district court held that the § 2462 statute of limitations -- which bars any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture ... unless commenced within five years from the date when the claim first accrued ..." -- applies to all of the remedies requested by the SEC in the case. In doing so, the district court found that declaratory and injunctive relief each constitute a "penalty" and that disgorgement amounts to "forfeiture" within the meaning of the statute.

On appeal, the Eleventh Circuit rejected the district court's holding on injunctive relief, reasoning that injunctions are equitable relief and, therefore, not subject to the statute of limitations. However, the court largely upheld the district court's rulings on declaratory relief and disgorgement, basing its reasoning not on the distinction between equitable and non-equitable remedies -- which has been the buttress of the SEC's arguments -- but rather on statutory construction of the language of § 2462. The court determined that the statute of limitations applies to a declaratory judgment because it is "backward looking" and thus functions as a penalty, while holding that disgorgement falls within the definition of "forfeiture" based on the ordinary meaning of the terms, reasoning that there is "no meaningful difference in the definitions of disgorgement and forfeiture." In finding disgorgement to be indistinguishable from "forfeiture" under § 2462, the court expressly did not reach the companion issue of whether disgorgement is also a "penalty" within the meaning of statute. The court's analysis of declaratory judgments suggests, however, that had it reached this issue and applied similar reasoning, the court might also have concluded that disgorgement in the context of an enforcement action is also a penalty. A decision on that basis, however, would have more directly confronted precedents, which the court referenced earlier in its opinion, holding that § 2462 "does not apply to equitable remedies."

Graham Creates a Circuit Split

The Eleventh Circuit's decision in *Graham* creates a circuit split with the DC and Ninth Circuits on whether the SEC's use of disgorgement in civil enforcement actions is subject to a statute of limitations.

The DC Circuit has specifically considered whether the statute of limitations applies to SEC actions ordering disgorgement and held that it does not. *See Riordan v. S.E.C.*, 627 F.3d 1230 (DC Cir. 2010) (holding that disgorgement orders are not penalties and are, therefore, not subject to the statute of limitations) (citing *Zacharias v. S.E.C.*, 569 F.3d 458 (DC Cir. 2009)). However, the court in *Riordan* left open the possibility that disgorgement could be "a kind of forfeiture covered by § 2462, at least where the sanctioned party is disgorging profits not to make the wronged party whole, but to fill the Federal Government's coffers," as is often the case when the SEC orders disgorgement in the FCPA context.

Similarly, the Ninth Circuit has refused to extend the statute of limitations to any enforcement action brought by the SEC, which district courts in that Circuit have interpreted to include actions for disgorgement. See *SEC v. Rind*, 991 F.2d 1486, 1492 (9th Cir. 1993) (prior precedent supports "the conclusion that no statute of limitations should apply to Commission civil enforcement actions"); *SEC v. Funinaga*, Case No. 2:13-CV-1658 (D. Nev. Oct. 03, 2014) ("The court agrees with plaintiff that the 5-year statute of limitations in section 2462 is inapplicable. Actions for disgorgement of profits are equitable in nature.").

Given that § 2462 is not an SEC-specific measure, if other courts interpret *Graham* to suggest that disgorgement is not an equitable remedy for the purposes of invoking the statute of limitations, the case could call into question holdings in 10 circuit courts that have held, with varying degrees of analysis, that disgorgement is an equitable remedy in a variety of additional contexts.[1]

Despite the circuit split on whether § 2462 covers disgorgement, the Eleventh Circuit opinion in *Graham* could be seen as supportive of the Internal Revenue Service's recent internal memorandum finding disgorgement to be primarily punitive and therefore not deductible for tax purposes (for additional detail on this memorandum, see our recent alert, [Disgorgements of Profits in FCPA Cases: Deductions for Tax Purposes]).

Graham's Likely Impact on SEC Enforcement

In the short term, *Graham* will likely put pressure on the SEC to take measures to resolve enforcement actions more quickly. Such an effort by the Commission could mirror recent attempts by the U.S. Department of Justice (DOJ) to accelerate the pace of its own FCPA enforcement. This push by the DOJ has included working with the Federal Bureau of Investigation (FBI) to create three squads devoted to the prosecution of FCPA and money laundering violations, increasing the number of DOJ attorneys devoted to FCPA cases by 50 percent and enacting an FCPA "pilot program" to encourage companies to voluntarily self-disclose FCPA issues (discussed in our [FCPA Spring Review 2016]).

Additionally, individuals and entities currently involved in SEC enforcement proceedings, particularly administrative proceedings or in judicial circuits that have not considered this issue, are quite likely to vigorously challenge any continued efforts by the Commission to pursue disgorgement if the statute of limitations has run.

Graham may also discourage defendants from signing tolling agreements to extend or entirely waive the statute of limitations. Given the importance the SEC places on cooperation as a factor in settlement negotiations, however, it is likely that companies and some individuals will continue to sign such agreements, but this decision should increase the leverage of these entities and individuals, who may now be more aggressive in pushing the SEC to narrowly define the scope of their tolling agreements.

Because of the decision's potentially significant impact on SEC enforcement strategies, the Commission is likely to seek review by the Supreme Court. Though it is always difficult to predict which cases the Supreme Court will agree to hear, the Court may be willing to hear this case in light its recent, unanimous holding in *Gabelli*.

1. *See e.g., S.E.C. v. Contorinis*, 743 F.3d 296 (2d Cir. 2014) *cert. dismissed*, 136 S. Ct. 531, 193 L. Ed. 2d 419 (2015); *S.E.C. v. Teo*, 746 F.3d 90 (3d Cir. 2014) *cert. denied*, 135 S. Ct. 675, 190 L. Ed. 389 (2014); *S.E.C. v. Blatt*, 583 F.2d 1325 (5th Cir. 1978); *S.E.C. v. Blavin*, 760 F.2d 706 (6th Cir. 1985); *S.E.C. v. Lipson*, 278 F.3d 656 (7th Cir. 2002); *S.E.C v. Brown*, 658 F.3d 858 (8th Cir. 2011); *S.E.C. v. First Pac. Bancorp*, 142 F. 3d 1186 (9th Cir. 1998); *S.E.C. v. Maxxon, Inc*. 465 F.3d 1174 (10th Cir. 2006); *S.E.C. v. Monterosso*, 756 F.3d 1326 (11th Cir. 2014); and *S.E.C. v. First City Fin. Corp., Ltd*.,890 F.2d 1215 (DC Cir. 1989).

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