

Client Alert

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Eleventh Circuit Limits SEC's Ability to Seek Disgorgement or Declaratory Relief for Conduct Occurring More Than Five Years Before the Suit is Filed

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On May 26, 2016, the United States Court of Appeals for the Eleventh Circuit issued an important decision regarding the applicability of 28 U.S.C. § 2462, the five-year statute of limitations governing SEC enforcement actions seeking “any civil fine, penalty, or forfeiture.” In *SEC v. Graham*, the court expressly distinguished between remedies that are backward-looking and subject to Section 2462, such as declaratory relief and disgorgement, and those that are forward-looking and not subject to Section 2462, such as injunctions.¹ This was the first time any circuit court applied Section 2462’s statute of limitations to declaratory relief and disgorgement. The decision is significant because it means that—at least in the Eleventh Circuit—the SEC can no longer seek disgorgement and declaratory relief going back more than five years.

DISTRICT COURT DISMISSES SEC ACTION WITH PREJUDICE

The SEC commenced a civil action in January 2013 in the Southern District of Florida against defendants who allegedly had violated the federal securities laws between November 2004 and July 2008 by “selling condominiums that were functioning, in reality, as unregistered securities.”² The SEC alleged that defendants had raised more than \$300 million from approximately 1,400 investors around the country but failed to pay out the returns they had guaranteed.

In its complaint, the SEC sought an order from the district court (1) declaring that defendants violated the securities laws, (2) permanently enjoining defendants from violating the securities laws in the future, (3) directing defendants to disgorge all profits from the sales, (4) requiring the repatriation of funds held outside the court’s jurisdiction, and (5) imposing civil penalties. The district court held that Section 2462 applied not only to the SEC’s penalty request but to all other remedies, as well.³ In so deciding, the district court relied largely on *SEC v. Gabelli*, 133 S.Ct. 1216 (2013), in which the Supreme Court held that, under Section 2462, a fraud claim brought by the SEC accrues when the defendant’s allegedly fraudulent conduct occurred, not when it is discovered. The district court dismissed the case with prejudice.

¹ No. 14-13562 (11th Cir. May 26, 2016).

² Slip op., at 3.

³ *SEC v. Graham*, 21 F. Supp. 3d 1300, 1308-11 (S.D. Fla. 2014).

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ELEVENTH CIRCUIT LARGELY AFFIRMS

On appeal, the Eleventh Circuit reversed the district court only with respect to the injunctive relief sought by the SEC, holding that injunctions are forward-looking remedies and not penalties within the meaning of Section 2462.⁴ The court then affirmed the remainder of the district court's order.

The Eleventh Circuit held that declaratory relief is "backward-looking and thus would operate as a penalty under § 2462."⁵ A declaration of liability, the court reasoned, 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."⁶ Although the SEC argued that declaratory relief should be exempt from Section 2462 because the SEC may use findings of past violations to obtain other remedies, the court stated that some of the remedies the SEC could seek (such as penalties) were themselves time-barred under Section 2462, and declaratory relief establishing past securities law violations was not necessary for obtaining injunctive relief (which the court had held was not subject to Section 2462). The court also noted that the SEC still could seek declaratory relief as a predicate for other remedies, so long as it did so before the applicable statute of limitations expired.⁷

The Eleventh Circuit concluded that disgorgement amounted to a forfeiture and, therefore, was subject to Section 2462. The court, quoting *Webster's Dictionary* and the *Oxford English Dictionary*, explained that a forfeiture is "the divesting of the ownership of particular property of a person on account of the breach of a legal duty and without any compensation to him."⁸ Forfeiture, the court explained, "occurs when a person is forced to turn over money or property because of a crime or wrongdoing."⁹ Disgorgement, the court said, quoting *Black's Law Dictionary*, is "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion."¹⁰ The court found "no meaningful difference in the definitions of disgorgement and forfeiture."¹¹

The court also noted that the Supreme Court had used disgorgement and forfeiture interchangeably in one case when the Supreme Court stated, "Forfeitures serve a variety of purposes, but are designed primarily to confiscate property used in violation of the law, and to require disgorgement of the fruits of illegal conduct."¹² The SEC had urged the court to hold that "disgorgement only includes direct proceeds from wrongdoing, whereas forfeiture can include both ill-gotten gains and any additional profit earned on those ill-gotten gains," but the court found that

⁴ *Graham*, slip op., at 5-9.

⁵ *Id.* at 9.

⁶ *Id.* at 10.

⁷ *Id.* at 11.

⁸ *Id.* at 12 (quoting "Forfeiture," *Webster's Third New Int'l Dictionary* (2002)).

⁹ *Id.* at 12.

¹⁰ *Id.* (quoting "Disgorgement," *Black's Law Dictionary* (10th ed. 2014)).

¹¹ *Id.*

¹² *Id.* at 13 (quoting *United States v. Ursery*, 518 U.S. 267, 284 (1996)).

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Congress meant for disgorgement and forfeiture to have their “ordinary meanings” when it adopted Section 2462, not their “technical definitions.”¹³

This decision is significant because it expands on the Supreme Court’s *Gabelli* decision and limits dramatically defendants’ exposure for conduct occurring outside of the five-year statute of limitations period, at least within the Eleventh Circuit. The decision creates a circuit split, as both the D.C. Circuit and the Ninth Circuit have held, pre-*Gabelli*, that disgorgement was not subject to the statute of limitations.¹⁴ Although the ultimate impact of the *Graham* decision remains to be seen, the SEC could become more aggressive in seeking tolling agreements and more selective about the circuits in which it chooses to litigate.

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¹³ *Id.* at 13, 14.

¹⁴ *Riordan v. SEC*, 627 F.3d 1230 (D.C. Cir. 2011); *SEC v. Rind*, 991 F.2d 1486 (9th Cir. 1993). The D.C. Circuit currently has before it another case in which defendants are seeking to prevent the SEC from disgorging funds for conduct occurring outside the limitations period. Time will tell whether the D.C. Circuit will be swayed by the *Gabelli* and *Graham* decisions. See *Timbervest v. SEC*, No. 15-1416.