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Eleventh Circuit Applies Five-Year Statute of Limitations to Claims for Disgorgement and Declaratory Relief, Creating a Circuit Split

In *SEC* v. *Graham*, No. 14-13562 (11th Cir. May 26, 2016), the Eleventh Circuit held that the five-year statute of limitations applicable to SEC enforcement proceedings under 28 U.S.C. § 2462 applies to disgorgement and declaratory relief claims, but not to injunctive relief claims. The Eleventh Circuit reasoned that the backward-looking remedies of disgorgement and declaratory relief constitute a "civil fine, penalty or forfeiture" within the express meaning of the statute.

This decision addresses an area that has long been unsettled and has not yet reached the U.S. Supreme Court, namely, whether the SEC's ability to obtain equitable, monetary relief in the form of disgorgement is subject to any statutory limitations period. By holding that disgorgement claims are extinguished under the five-year statute of limitations, the Eleventh Circuit has split with the D.C. Circuit, which has reached the opposite conclusion.

Relevant Background

SEC enforcement actions are subject to a five-year statute of limitations, which provides that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." 28 U.S.C. § 2462. Although this statutory limitations period has been in effect in its current form since 1948, its meaning remains subject to controversy in the courts. In 2013, the Supreme Court clarified in *Gabelli* v. *Securities and Exchange Commission*, 133 S. Ct. 1216 (2013), that the statute begins to accrue when the alleged violation occurs, not when the SEC discovers the violation. But *Gabelli* did not address what types of remedies sought by the SEC constitute a "civil fine, penalty or forfeiture, pecuniary or otherwise" within the meaning of the statute.

Procedural Background of *Graham*

On May 12, 2014, the United States District Court for the Southern District of Florida (King, J.) granted defendants' motion to dismiss in *SEC* v. *Graham*, 21 F.Supp.3d 1300 (S.D. Fla. 2014). The SEC had sought various forms of recovery, including a request for a declaratory judgment that the defendants had violated the securities laws, an injunction preventing defendants from violating federal securities law in the future, and disgorgement of profits from the allegedly illegal activities.

Defendants argued that because the SEC had waited more than five years after the alleged violation of the federal securities laws to commence an action, all of the SEC's claims were barred by the statute of limitations set forth in § 2462. In response, the SEC denied that the statute of limitations applied to its claims for injunctive relief, declaratory judgment and disgorgement, relying on the plain language of the statute to support its argument. The SEC also relied on the Eleventh Circuit's decision in *United States* v. *Banks*, 115 F.3d 916 (11th Cir. 1997), which held that "the plain language of § 2462 does not apply to equitable remedies." *Id.* at 919.

The district court rejected the SEC's arguments, relying principally on the Supreme Court's 2013 decision in *Gabelli* v. *SEC*, 133 S. Ct. 1216 (2013), which addressed the question of when the five-year limitations period under § 2462 begins to run. *Gabelli* warned that § 2462 should not be interpreted to expose defendants to claims by the SEC for an indeterminate amount of time where the statute was intended to provide "repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." *Id.* at 1221. The district court therefore held that the statute should be applied broadly to all of the SEC's claims related to the alleged wrongdoing of the *Graham* defendants.

The SEC appealed the district court's holding.

The Eleventh Circuit Ruling in *Graham*

On appeal, the Eleventh Circuit held that claims for injunctive relief are not subject to the limitations period of § 2462, but that claims for declaratory relief and disgorgement are subject to the limitations period.

Addressing the request for injunctive relief, the Eleventh Circuit noted that its own precedent—including *United States* v. *Banks*, which the SEC had cited in the district court—dictated that an injunction was not subject to § 2462. The court also found that a common definition of the word "penalty," which is not defined in § 2462, includes only remedies that look "backward in time" to address a past wrong. Since injunctions are forward-looking and prevent future harm, the Eleventh Circuit reasoned that an injunction could not be a "penalty" within the meaning of § 2462.

With respect to the SEC's claims for declaratory judgment and disgorgement, the Eleventh Circuit applied the same reasoning to reach the opposite result. The Court reasoned that the declaratory judgment sought by the SEC was backward looking, and would label defendants wrongdoers related to a past act; therefore, the declaration would be a "penalty" within the meaning of § 2462. Interestingly, although the Eleventh Circuit found that *Gabelli* was irrelevant to the question of whether an injunction was a penalty under § 2462, it found that *Gabelli* supported its conclusion that declaratory judgments are within the ambit of § 2462 when it said that penalties "go beyond compensation, are intended to punish, and label defendants wrongdoers." *Gabelli*, 133 S. Ct. at 1221.

With respect to the claim for disgorgement, the Eleventh Circuit looked for a common definition of the term "forfeiture" in precedent and secondary sources. It found that forfeiture is "forc[ing] [a person] to turn over money or property because of a crime or wrongdoing." The court therefore concluded that there is "no meaningful difference in the definitions of disgorgement and forfeiture"; therefore, a claim for disgorgement is an "an action, suit or proceeding for . . . forfeiture" subject to the statute of limitations in § 2462.

Analysis

For companies and individuals faced with enforcement actions, the Eleventh Circuit's decision in *Graham* is notable in particular because of its holding with respect to disgorgement. Importantly, the *Graham* decision eliminates in the Eleventh Circuit the SEC's remaining tool for obtaining money from defendants for alleged violations of federal securities laws that pre-date the five-year limitations period. This aspect of *Graham* creates a circuit split with the D.C. Circuit, which in 2009 held that an action for disgorgement is not subject to the five-year statute of limitations in § 2462. *See Zacharias* v. *SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009). The *Zacharias* court's reasoning, however, was based on a finding that disgorgement is not a penalty within the meaning of § 2462; the court did not consider, as the *Graham* court did, whether disgorgement could be "forfeiture" within the meaning of the statute.

It remains to be seen whether the *Graham* decision will affect the SEC's behavior in investigations. Until the circuit split is resolved, the SEC will need to consider its ability to obtain monetary recovery from parties under investigation in older or lengthy matters, and may, as a result, seek to enter tolling agreements in a larger percentage of investigations. This could present a difficult decision for defendants, who will need to weigh the risks of the SEC commencing litigation with preserving timeliness defenses. The *Graham* decision could also affect the forum in which the SEC chooses to file suit, perhaps favoring the D.C. Circuit over the Eleventh Circuit and other forums where this issue has not yet been resolved, in matters where the limitations period may be an issue.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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