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ENFORCEMENT

# BNA Insights: Statute of Limitations for Disgorgement Claims in SEC and CFPB Enforcement Actions

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In a landmark May 26, 2016 decision, the U.S. Court of Appeals for the Eleventh Circuit became the first appellate court to rule that Securities and Exchange Commission (''SEC'') actions for disgorgement are subject to a statute of limitations. In that case, *SEC v. Graham*, No. 14-13562 (11th Cir. March 26, 2016), the court held that disgorgement claims, not just civil monetary penalties, are subject to the five-year limitations period of 28 U.S.C. § 2462. This holding, if adopted by other courts, could significantly decrease the financial exposure faced by targets of SEC enforcement actions. In addition, the decision could provide a defense against disgorgement claims in actions brought by the Consumer Financial Protection Bureau (''CFPB'').

## Supreme Court: *Gabelli v. SEC*

Section 2462 provides that ''[a]n 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.'' The U.S. Supreme Court's 2013 decision in *Gabelli v. SEC* held that § 2462 applies to SEC actions seeking penalties and further held that a claim accrues (and thus the limitations period begins to run) when the conduct giving rise to the claim occurred. (*Gabelli v. SEC*, 133 S.Ct. 1216 (2013). The Court rejected the SEC's argument that the claim should only accrue when the fraud was discovered, not when it occurred.) No discovery rule applies to toll the running of the limitations period. The Court in *Gabelli* tacitly left open the question of whether § 2462 may apply similarly to enforcement actions seeking equitable relief, including disgorgement and various forms of injunctive relief. (*Id.* at n.1 (''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.'').)

## Eleventh Circuit: *SEC v. Graham*

In *Graham*, the SEC argued that, under *Gabelli* and by its own terms, § 2462 does not apply to enforcement actions seeking equitable relief. After the five-year limitations period had already run against the *Graham* defendants, the SEC sought relief in the form of (1) a declaratory judgment that the defendants had violated federal securities laws, (2) a permanent injunction enjoining them from violating those laws in the future, and (3) disgorgement of illegally-obtained profits. (*SEC v. Graham*, No. 14-13562, Opinion at 2-3 (11th Cir. March 26, 2016).) As noted in an earlier article, the district court in *Graham* held that § 2462 restricts the SEC's jurisdiction to seek disgorgement, injunctive relief, or any other remedy that operates in *effect*—regardless of formal title or label—as a ''civil fine, penalty, or forfeiture, pecuniary or otherwise.'' (*See* Benja-

min Neaderland and Jared Cohen, Parties Push to Enforce Statutory Time Limits in SEC Enforcement Actions, Journal of Investment Compliance, Vol. 16 No. 3 2015, pp. 30-32.) The Eleventh Circuit declined to rule on whether the statute of limitations in § 2462 is jurisdictional in nature, or only provides an affirmative defense. (*SEC v. Graham*, No. 14-13562, Opinion at 4, n.1.) Both the SEC and the defendants appealed aspects of the decision.

The Eleventh Circuit concluded that the SEC could enjoin prospective violations after the five-year statute of limitations had run, holding that an injunction preventing future misconduct is *not* subject to § 2462, which is explicitly focused on punishing and redressing past wrongdoing. (*SEC v. Graham*, No. 14-13562, Opinion at 5-9.) But relying on the distinction between ''backward-looking'' legal remedies and ''forward-looking'' equitable relief, the court held that the declaratory judgment sought would operate as a ''penalty'' under § 2462 and thus was subject to its five-year imitation period. (*Id.* at 9-11.) Additionally, relying heavily on a dictionary definition of ''forfeiture,'' the Eleventh Circuit ''agree[d] with the district court that for the purposes of § 2462 forfeiture and disgorgement are effectively synonyms; § 2462's statute of limitations applies to disgorgement.'' (*Id.* at 11-14.)

As the first appellate court to bring disgorgement within the ambit of § 2462's definition of ''forfeiture,'' the Eleventh Circuit's opinion may have a significant impact on future SEC enforcement matters, especially if this view is upheld by other courts. The power of this new precedent is likely to be tested soon, beginning in the D.C. Circuit.

## D.C. Circuit: *Timbervest, LLC v. SEC*

Currently pending in the D.C. Circuit is *Timbervest, LLC v. SEC*, No. 15-1416 (D.C. Cir.), which also presents the question whether disgorgement is a remedy subject to § 2462's five-year limitations period. The D.C. Circuit has previously ruled that under § 2462, SEC ''disgorgement orders are not penalties, at least so long as the disgorged amount is causally related to the wrongdoing,'' *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2011) (citing *Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009).) In *Zacharias*, the court found the challenged disgorgement order to be a sufficiently ''reasonable approximation of the profits causally connected to the violation'' and thus not a ''penalty'' under § 2462—but also observed that ''[i]n theory, a disgorgement order might amount to a penalty if it was not 'causally related to the wrongdoing' at issue.'' (569 F.3d at 472-73.) It did not address the question of whether disgorgement might be considered a ''forfeiture.'' As the court then noted in *Riordan*: ''It could be argued that disgorgement is 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. Our precedents have not expressly considered that point in holding that there is no statute of limitations for SEC disgorgement actions.'' (627 F.3d at 1234 n.1.) In this context of recent D.C. Circuit precedents, the petitioners in *Timbervest* are pressing arguments similar to—and perhaps stronger than—those that prevailed in *Graham*. Notably, they argue that the disgorgement looks more like a penalty when it is *not* causally related to the alleged wrongdoing and would not go to compensate any victims, but only to fill U.S. government coffers. (*Timbervest, LLC v. SEC*, No. 15-1416 (D.C. Cir.), Initial Brief for Petitioners at 17-20.) Further, they point out that the SEC itself recognizes that disgorgement is a penalty ''[w]hen it suits its purposes'': the Commission has successfully argued before a bankruptcy court that disgorgement due to the SEC should be exempt from discharge under the bankruptcy code on the basis that ''such debt is for a *fine, penalty, or forfeiture*.'' (*Id.* at 17-18 (citing *SEC v. Telsey*, 144 B.R. 563, 565 (Bankr. S.D. Fla. 1992)).) This exact formulation, ''fine, penalty or forfeiture,'' matches § 2462's language describing those actions covered by the five-year statute of limitations. Separately, the petitioners also argue that disgorgement is a ''forfeiture'' under § 2462, which the D.C. Circuit has not expressly considered previously. (*Timbervest, LLC v. SEC*, No. 15-1416 (D.C. Cir.), Initial Brief for Petitioners at 19-20; *see supra*.)

In addition to seeking time limits on disgorgement actions, the *Timbervest* petitioners also challenge the SEC's ability to impose associational or industry bars beyond the five-year limitation period of § 2462. (*Id.* at 12-16.) While such bars may seem more in the nature of forward-looking injunctive relief under the Eleventh Circuit's rationale in *Graham*, the D.C. Circuit previously held in *Johnson v. SEC* and other cases that temporary suspensions imposed by the SEC may operate punitively, and thus may constitute penalties within the meaning of § 2462. (*Johnson v. SEC*, 87 F.3d 484, 488 (D.C. Cir. 1996); *see also In re Blizzard*, Initial Decision Release No. 229, 80 S.E.C. Docket 1464 (June 13, 2003), *SEC v. Jones*, 476 F. Supp.2d 374 (S.D.N.Y. Feb. 26, 2007).) In *Johnson*, the court made a point of noting that if such a suspension or debarment of a particular individual were truly necessary to address a ''clear and present danger'' to the public—as the SEC claimed—then waiting more than five years to initiate such proceedings would be ''inexplicable.'' (*Johnson v. SEC*, 87 F.3d at 490 n.9.) Notably, the SEC is now arguing in *Timbervest* that *Johnson* was wrongly decided and should be disregarded, and that suspensions or debarments are purely equitable remedies that are *never* in the nature of penalties. Litigants and potential targets of SEC investigations should watch closely to see how the D.C. Circuit responds to this push for the court to overturn its own precedent upon which other circuit and district courts have depended since it was first decided in 1996. (*See, e.g.*, *Coghlan v. Nat'l Transp. Safety Bd.*, 470 F.3d 1300, 1305-06 (11th Cir. 2006); *SEC v. Mohn*, 465 F.3d 647, 653-54 (6th Cir. 2006); *Arch Mineral Corp. v. Babbitt*, 104 F.3d 660, 669-70 (4th Cir. 1997); *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867, 883-84 (N.D. Tex. 2011), *aff'd sub nom. SEC v. Bartek*, 484 F. App'x 949 (5th Cir. 2012); *SEC v. Brown*, 740 F. Supp. 2d 148, 156-57 (D.D.C. 2010); *SEC v. Berry*, 580 F. Supp. 2d 911, 918-19 (N.D. Cal. 2008); *SEC v. Fisher*, No. 07 C 4483, 2008 WL 2062699, at *8 (N.D. Ill. May 13, 2008); *SEC v. Caserta*, 75 F. Supp. 2d 79, 89 (E.D.N.Y. 1999).)

## Potential Ramifications for CFPB Actions

If the D.C. Circuit in *Timbervest* hews closely to its own *Johnson* precedent and adopts an approach to disgorgement similar to that of the Eleventh Circuit in *Graham*, this would represent a significant shift in the en-

forcement landscape in favor of companies and individuals who are the targets of aging SEC probes. Such a development would likely have reverberations outside the SEC context as well, affecting in particular investigations and enforcement actions brought by the CFPB. Also potentially affected would be investigations and actions for disgorgement or restitution brought by federal bank regulators under 12 U.S.C. § 1818(b)(6)(F) (authorizing appropriate federal banking agency to ''take such other action as the banking agency determines to be appropriate'' against insured depository institutions to ensure compliance with and ''correct or remedy any conditions resulting from any violation'' of § 1818).

Though courts have not yet addressed the issue, § 2462's five-year limitations period likely would apply to CFPB actions just as it does to SEC actions under *Gabelli*. (*See* Matthew T. Martens, Jamie Dycus, and Daniel P. Kearney, ''What Is the Statute of Limitations for a UDAAP Claim Under the Federal Consumer Financial Protection Act?'' BNA's Banking Report, 103 BBR 891, 10/28/2014.) At least one district court has held, interpreting a different statute of limitations, that *Gabelli*'s underlying rationale applies with equal force to civil actions brought by the CFPB. (*Consumer Fin. Prot. Bureau v. ITT Educ. Servs., Inc.*, No. 1:14-CV-00292-SEB, 2015 WL 1013508, at *33 (S.D. Ind. Mar. 6, 2015) (''[W]e decline to read an exception for agency plaintiffs into the one-year statute of limitations imposed by [the Truth in Lending Act]'s civil liability provision.'') (citing *Gabelli*, 133 S.Ct. at 1223)).) It thus stands to reason that if courts hold that SEC actions seeking disgorgement are subject to § 2462, the CFPB would likely be similarly bound. At very least, this would provide a potentially compelling argument for targets of CFPB probes to press in negotiations, and if necessary in litigation, with the Bureau.

## Potential Government Reactions

To the extent that the SEC and CFPB actions seeking monetary penalties and disgorgement are subject to § 2462, these (and perhaps other) agencies would likely look for new strategies and approaches to overcome statute of limitations issues. One possible approach that the government could take, in seeking to retain the ability to obtain disgorgement or other monetary relief based on conduct more than five years old, is to redefine the ''unit'' of a particular offense or violation. On this theory, the government might treat the entire course of a fraudulent scheme—as opposed to a particular misrepresentation or other act launching it—as the relevant ''unit'' of the violation for statute of limitations purposes. (*See* Matthew T. Martens & Troy A. Paredes, *The Scope of the Jury Trial Right in SEC Enforcement Actions*, 71 N.Y.U. Annual Survey of Am. L. 147, 173-74 (2016) (discussing unit of prosecution of securities law violations).) Thus, by pursuing a scheme itself instead of the individual acts that comprise it, the government could (if courts approve) gain years of time to avoid statute of limitations problems in certain cases. In a similar vein, the government might invoke the so-called ''continuing offense'' doctrine to pursue violations involving a course of misconduct over an extended period of time. (*Toussie v. United States*, 397 U.S. 112, 113–14 (1970) (presenting test to determine whether criminal offense is ''continuing'' for statute of limitations purposes); *see also United States v. Harris*, 919 F. Supp. 2d 702 (E.D. Va. 2013) (holding that securities fraud is not a continuing violation).)

In any event, for now, the Eleventh Circuit's *Graham* decision places more pressure on the SEC to conduct its investigations—and close them out or bring actions—promptly. In the event the D.C. Circuit rules against the SEC in *Timbervest*, this pressure will only mount. Time will tell if other courts continue this trend, forcing government agencies to react and press creative new approaches to limitations issues. Companies and individuals should continue to monitor these developments closely.

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