LITIGATION | June 10, 2016

Eleventh Circuit Rules Disgorgement Subject to Five-Year Limitations Period, Ruling Against SEC

On May 26, 2016, a three-judge panel of the United States Court of Appeals for the Eleventh Circuit issued *SEC v. Graham*,[1] a significant decision that, at least in the Eleventh Circuit, limits the ability of the Securities and Exchange Commission ("SEC" or "Commission") to obtain disgorgement of ill-gotten gains in civil injunctive actions filed more than five years after the allegedly violative conduct. In so doing, the Eleventh Circuit ruled that 28 U.S.C. § 2462—the federal catch-all five-year statute of limitations—applies to the equitable remedy of disgorgement, because disgorgement is nothing other than "forfeiture," which is expressly covered by Section 2462. *Graham* comes after the Supreme Court's 2013 decision in *Gabelli v. SEC* where the Court declined to consider whether claims for disgorgement were subject to Section 2462 but signaled that it was generally in favor of limiting the government's ability to obtain relief for conduct long in the past, noting that "even wrongdoers are entitled to assume that their sins may be forgotten."[2]

Background

According to the SEC, the wrongdoing in *Graham* occurred between July 2004 and January 30, 2008, when Barry J. Graham, Fred Davis Clark, Jr., Cristal R. Coleman, David W. Schwarz, and Ricky Lynn Stokes (the "defendants") sold condominium units to private investors at seventeen properties from Key Largo to Las Vegas.[3] These sales, the SEC alleged, violated the federal securities laws because the units were the functional equivalent of securities, but were not registered with the Commission. The SEC began investigating the defendants in October 2007, but waited over five years, until January 30, 2013, to institute a civil injunctive action against them in the US District Court for the Southern District of Florida. In its brief on appeal, the Commission suggested that it waited to file its complaint because defendants Clark and Coleman had relocated outside the United States, which prevented the SEC from interviewing them in a timely fashion, and because defendants' records were destroyed after defendants abandoned them at an offsite storage facility.[4]

The SEC's complaint sought declaratory and injunctive relief and disgorgement, including: (1) a declaration that the defendants' conduct violated federal securities laws; (2) a permanent injunction enjoining the defendants from future violations; (3) an order requiring that the defendants disgorge their profits and prejudgment interest; and (4) an order requiring Coleman, Clark, and Stokes to pay civil monetary penalties. Coleman, Clark, Stokes and Schwarz moved for summary judgment on the grounds that their conduct was not governed by the securities laws and the five-year statute of limitations under Section 2462 had expired, barring the SEC's requested forms of relief. Section 2462 is the federal "catch-all" statute of limitations. It provides that, "[e]xcept as otherwise provided by Act of Congress, 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[.]"[5] The SEC has long taken the position, and all Federal Courts of Appeal to have considered the issue before *Graham* have agreed, that Section 2462's limitations period does not apply to civil actions seeking disgorgement, or other equitable relief, because such relief is not intended to "punish" defendants.[6]

The federal district judge in *Graham*, however, extending the Supreme Court's rationale in *Gabelli v. SEC*, where the Court signaled that it was receptive to limiting the government's ability to obtain relief for conduct long in the past, granted defendants' summary judgment motion and held that disgorgement was limited by Section 2462. The district judge explained that "the long-held policies and practices that underpin the Supreme Court's unanimous opinion in *Gabelli*, as well as the text of the statute itself, require the conclusion that § 2462 does reach [disgorgement]."[7] First, the district court held that Section 2462 is a "jurisdictional" statute that precluded a court from hearing a claim for a civil fine, penalty, or forfeiture unless the misconduct at issue occurred within five years of the filing of the complaint. Second, the district court held that Section 2462's five-year statute of limitations applied to all the forms of relief sought by the SEC because: (1) the Supreme Court had recently emphasized in *Gabelli* that it was necessary to establish "a fixed date when exposure to . . . Government enforcement efforts end[]," and (2) the SEC's claims for declaratory and injunctive relief were claims for "penalties" and the Commission's claims for disgorgement were claims for "forfeiture," which are both subject to the limitations of Section 2462.[8] Because the SEC offered no evidence that any of the defendants' wrongful conduct occurred after January 30, 2008, five years before the Commission filed its complaint, the district court held that any alleged wrongdoing by the defendants occurred outside the five-year limitations period and thus, it lacked the power to award any of the relief sought by the SEC.[9] The SEC appealed.

The Eleventh Circuit's Opinion

Sidestepping the issue of whether Section 2462 was "jurisdictional," the Eleventh Circuit affirmed the district court in part, holding that Section 2462's limitations period applied to the SEC's claims for penalties, declaratory relief and disgorgement.[10] (The Court held that the limitations period did not apply to "forward-looking injunctions.") Of particular note, the Court held that Section 2462 required the SEC to bring claims for disgorgement within five years of the underlying misconduct, because the use of "forfeiture" in Section 2462 is synonymous with "disgorgement." The Court opined that there was "no meaningful difference," between the ordinary definition of forfeiture, which occurs "when a person is forced to turn over money or property because of a crime or wrongdoing," and the definition of "disgorgement" as defined in legal reference dictionaries and Supreme Court opinions.[11] The SEC argued, among other things, that disgorgement referred to something fundamentally different from forfeiture, because "disgorgement only includes direct proceeds from wrongdoing, whereas forfeiture can include both the ill-gotten gains and any additional profit earned on those ill-gotten gains." The Court disagreed, explaining: (1) "under the definitions the SEC puts forth, disgorgement . . . can be considered a subset of forfeiture" and (2) the SEC's interpretation would violate the principle that words in statutes should be given their ordinary meaning absent evidence that Congress meant to adopt a more technical meaning.[12] Since disgorgement was a form of forfeiture, and the plain language of Section 2462 applied to claims seeking forfeiture, the Eleventh Circuit held that the SEC's claims for disgorgement were subject to Section 2462's limitations period.

Graham Creates a Circuit Split

The First and DC Circuits are the only other federal appellate courts to consider whether disgorgement is limited by Section 2462. Both courts, unlike the Eleventh Circuit, have ruled that the equitable remedy of disgorgement is not subject to the limitations of Section 2462. Specifically, in 2008, the First Circuit concluded in *SEC v. Tambone* that "the applicable five-year statute of limitations period [the defendant] invokes applies only to penalties sought by the SEC, not its request for injunctive relief or the disgorgement of ill-gotten gains."[13] The D.C. Circuit likewise held in *Riordan v. SEC* that "[t]he five-year statute of limitations in 28 U.S.C. § 2462 applies to an action for the enforcement of a 'fine, penalty, or forfeiture.' Does that list include disgorgement? This Court has said no."[14] Moreover, numerous district courts that have considered this issue have also held that disgorgement is not limited by Section 2462.[15] The Eleventh Circuit may therefore seem like an outlier, but it also could be viewed as falling within a potential exception to the majority rule noted by the D.C. Circuit in *Riordan*, in which the Court noted that "[i]t 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."[16] Moreover, the D.C. Circuit and First Circuit issued their opinions prior to the United States Supreme Court issuing *Gabelli*.

What Is the Significance of *Graham*

The extent of Graham's impact, starting with whether the Supreme Court elects to grant the petition for *certiorari* that the Commission will likely file, remains to be seen. At the moment, disgorgement is only restricted by Section 2462 in the Eleventh Circuit; the law in the D.C. and First Circuits is still congruent with the SEC's assertion of the inapplicability of the 2462 limitations period to disgorgement. In Fiscal Year 2015, which ran from October 1, 2014 through October 30, 2015, the SEC brought 137 enforcement actions in federal court, only 26 of which were filed in the Eleventh Circuit. *Graham* thus may not materially affect the SEC's enforcement program as some commentators are predicting. However, in light of the Supreme Court's decision in *Gabelli*, in which the Court made clear that there should be a fixed date "when exposure to . . . Government enforcement efforts ends," [17] other appellate courts could adopt the Eleventh Circuit's reasoning. Regardless of the reach of *Graham*'s influence, in light of *Gabelli*, we expect that the SEC will be more mindful of the need to accelerate the pace of its investigations and to file any actions more expeditiously than has at times been its practice.

Special thanks to Shearman & Sterling LLP Associates Suzanne Forster and Brian Calandra for their contributions to this client publication.

---

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

2 133 S. Ct. 1216, 1221 (2013) (internal quotations and citations omitted) In *Gabelli*, the Supreme Court held that the fraud discovery rule is not applicable to government enforcement actions for civil penalties. *Id.* at 1224.

3 *SEC v. Graham*, 21 F. Supp. 3d 1300, 1303 (S.D. Fla. 2014), aff'd in part, rev'd in part and remanded sub nom. *Sec. & Exch. Comm'n v. Graham*, No. 14-13562, 2016 WL 3033605 (11th Cir. May 26, 2016)

4 *See* Brief of the SEC, Appellant at 14, *S.E.C. v. Graham*, No. 14-13562 (11th Cir. Nov. 26, 2014).

5 28 U.S.C.A. § 2462 (2016).

6 *See, e.g.*, *SEC v. Tambone*, 550 F.3d 106, 148 (1st Cir. 2008), reh'g en banc granted, opinion withdrawn, 573 F.3d 54 (1st Cir. 2009), and opinion reinstated in part on reh'g, 597 F.3d 436 (1st Cir. 2010); *Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009); *see also SEC v. Quinlan*, 373 F. App'x 581, 587 (6th Cir. 2010) (equitable remedies are not subject to Section 2462); *Sierra Club v. Otter Tail Power Co.*, 615

F.3d 1008, 1018 (8th Cir.2010) (same); *United States v. Telluride Co.*, 146 F.3d 1241, 1246 (10th Cir. 1998) (same); *SEC. v. Rind*, 991 F.2d 1486, 1490 (9th Cir. 1993) (equitable remedies are not subject any statute of limitations).

7 *Graham*, 21 F. Supp. 3d at 1309.

8 *Id.* at 1308.

9 *Id.* at 1312.

10 In a footnote, the panel stated that "We need not decide for purposes of this appeal whether § 2462's time bar is jurisdictional such that a time-barred § 2462 claim should be dismissed for lack of subject matter jurisdiction." *Graham*, No. 14-13562, *slip op.* at 4 n.1.

11 *Id.* at 12.

12 *Id.* at 13-14.

13 *Tambone*, 550 F.3d at 148.

14 *Riordan v. SEC*, 627F.3d 1230, 1234 (D.C.Cir. 2010)

15 *See, e.g.*, *SEC v. Lorin*, 869 F. Supp. 1117, 1122 (S.D.N.Y. 1994).

16 *Id.* at 1234, n.1.

17 *Gabelli*, 133 S. Ct. at 1221.

SHEARMAN & STERLING LLP

CONTACTS

Claudius O. Sokenu
New York
+1.212.848.4838
claudius.sokenu@shearman.com

Stephen Fishbein
New York
+1.212.848.4424
sfishbein@shearman.com

Adam S. Hakki
New York
+1.212.848.4924
ahakki@shearman.com

Mark D. Lanpher
Washington, DC
+1.202.508.8120
mark.lanpher@shearman.com

Christopher L. LaVigne
New York
+1.212.848.4432
christopher.lavigne@shearman.com

John A. Nathanson
New York
+1.212.848.8611
john.nathanson@shearman.com

Patrick D. Robbins
San Francisco
+1.415.616.1210
probbins@shearman.com

Philip Urofsky
Washington, DC
+1.202.508.8060
philip.urofsky@shearman.com