Parties push to enforce statutory time limits on SEC enforcement actions

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Abstract

Purpose – *To alert companies and individuals subject to regulation and investigation by the US Securities and Exchange Commission (SEC) of potential arguments to enforce time limits on enforcement actions that have heretofore commonly been ignored.*

Design/methodology/approach – *Analyzes two cases – one recently decided and one pending – in US Courts of Appeals, explains significance of issues at stake.*

Findings – *The Courts of Appeals for District of Columbia Circuit has recently reviewed, and the Court of Appeals for the 11th Circuit will soon decide whether statutory timing provisions effectively remove SEC power to bring enforcement actions past their deadlines, at least in some circumstances.*

Practical implications – *Depending on the outcomes of the cases, companies and individuals may gain a new procedural defense or two against SEC enforcement actions. They may also expect the SEC to respond by more actively seeking tolling agreements, and/or being more cautious in issuing Wells notices.*

Originality/value – *Guidance based on pending decisions interpreting US securities law, may bring regulatory adjustments to agency practice and procedure.*

Keywords *Dodd-Frank act, Securities and Exchange Commission (SEC), Enforcement, Investigation, Statute of limitations, Wells notice*

Paper type *Research paper*

In two cases recently brought before US Courts of Appeals, defendants have pressed arguments that carry the possibility of placing meaningful new limits on the US Securities and Exchange Commission's (SEC) time horizon for bringing enforcement actions. The SEC has long argued that certain statutory provisions which appear on their face to create binding time limits on SEC actions are either limited in their scope or merely establish internal policy guidelines for the agency, and do not actually circumscribe its jurisdiction to bring actions. But recently, companies and individuals have been pushing back with increased vigor. To the extent the courts are receptive, these efforts, may expand the defenses available to parties subject to SEC enforcement actions when those actions are not undertaken in a timely fashion.

SEC v. *Graham*, now pending in the 11th Circuit[1] is a lawsuit that, involves 28 U.S.C. § 2,462, a generally applicable statute of limitations providing 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." The US Supreme Court's 2013 *Gabelli* decision held that in SEC enforcement actions seeking civil penalties, § 2,462 applies and the claim accrues (thus the limitations period begins to run) when the conduct giving rise to the claim occurred and the fraud was complete[2]. The SEC had argued that the claim should only accrue when the fraud was discovered, not when it occurred. The Court in *Gabelli* left open the question of whether § 2,462 may apply similarly to enforcement actions seeking equitable relief, including disgorgement and various forms of injunctive relief.

The District Court in *Graham* held first that § 2,462 is no mere administrative "claims processing" rule, but rather a "jurisdictional" statute of limitations that removes courts' power to hear actions brought too late. Furthermore, it held that § 2,462 applies to disgorgement, injunctive relief, and any other remedy sought by the SEC that operates in *effect* – regardless of formal title or label – as a "civil fine, penalty, or forfeiture, pecuniary or otherwise[3]".

On appeal to the 11th Circuit, the SEC argued that under *Gabelli*, and by its own terms, § 2,462 does not apply at all to enforcement actions seeking relief that the agency terms "equitable." Mr Graham and *amicus curiae* counter that the equitable relief sought by the SEC is really not in the nature of a compensatory remedy as it is sometimes claimed: in practice, more often, disgorgement operates as a punitive forfeiture and declaratory and injunctive relief operates as a non-pecuniary penalty. Indeed, they cite compelling precedent holding certain SEC injunctive remedies to be punitive in effect for purposes of the general statute of limitations[4]. For example, disgorgement payments frequently go to the US Treasury instead of to compensate victims, and industry bars in particular – a common form of injunctive relief sought by the SEC – clearly do more to punish culpable individuals than to remedy any damage they have caused. While these forms of relief are sometimes warranted and appropriate, one can reasonably question why they should be granted broad exemption from *Gabelli*'s holding that the five-year limitations period in § 2,462 applies to SEC enforcement actions. With regard to industry bars, it would seem hard to take seriously the SEC's claims about their purportedly prospective value (the urgent need to protect investors from potential recurrence of past unlawful behavior) if the SEC has waited more than five years following the previous violation to seek such relief.

If the 11th Circuit is persuaded by these arguments, the SEC may have to bring many more of its actions for equitable relief within five years of a claim's accrual. This will be particularly the case for equitable and injunctive actions that seem to differ from penalties in name only. While *amici* in *Graham* note that the SEC already files roughly 60 per cent of its actions within two years of starting an investigation, and the agency may still seek tolling agreements to allow it to extend the limitations period, the SEC would certainly face heightened pressure to act in a more timely manner.

In *Montford* v. *SEC*, a recent case appealed to the DC Circuit[5], the potential time-limiting provision at issue was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The statute provides that "[n]ot later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action[6]".

This statute would seem on its face to set a firm deadline, 180 days after issuing a Wells notice, by which the SEC must decide whether or not to commence an action – notwithstanding that the statute leaves room for the Commission and the Division of Enforcement to take steps to extend the deadline. And yet, leading up to the *Montford* case, the few district courts to consider the provision concluded that it did not prevent the SEC from bringing actions past the 180-day deadline, regardless of whether any extensions were properly obtained[7].

In the recent DC Circuit case, the SEC brought charges against Montford in an administrative proceeding on the 187th day after issuing its Wells notice. An administrative law judge ruled that the claim was not time-barred by the 180-day limitation in Dodd-Frank. The Commission itself turned down Montford's appeal of the administrative ruling, and held that "this provision is intended to operate as an internal timing directive, designed to compel our staff to complete investigations, examinations, and inspections in a timely manner and not as a statute of limitations[8]". Montford has now sought review of the Commission's ruling in federal court, where the SEC argued that the Commission should be granted deference in its interpretation of the Dodd-Frank provision (section 4E), even

though the statute appears unambiguous in what it proscribes, if not in the remedy for a violation.

On July 10, 2015 the DC Circuit accepted that argument, ruling against Montford and holding that "the Commission's interpretation of Section 4E, as not imposing a jurisdictional bar, is reasonable and entitled to deference[9]". In reaching that conclusion, the court noted that "time limitations for filings in statutes are presumptively non-jurisdictional[10]". In this case, from the court's perspective, there was simply not enough evidence to overcome that presumption and show that the Dodd-Frank provision explicitly curbed the Commission's authority.

Though the DC Circuit sided with the SEC in *Montford* it is not yet clear whether the defendants will seek either en banc or Supreme Court review of the DC Circuit's conclusion, and the 11th Circuit's decision is still pending in *Graham*, a case with the potential to focus greater attention on the timelines of SEC investigations and enforcement decisions. Future legal challenges of this nature should be watched closely, as any measure of success could change the status quo. If the courts begin to accept the defendants' arguments in these types of cases, others subject to SEC investigation and enforcement may gain a new weapon in their defensive arsenals.

Notes

1. *SEC* v. *Graham*, No. 14-13562 (11th Cir.).
2. *Gabelli* v. *SEC*, 133 S.Ct. 1216 (2013).
3. *SEC* v. *Graham*, Case No. 13-10011-CIV-KING, 2014 WL 1891418 (S.D. Fla. May 12, 2014).
4. *See, e.g.*, *Johnson* v. *SEC*, 87 F.3d 484 (D.C. Cir. 1996), *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. February 26, 2007).
5. *Montford and Co., Inc.* v. *SEC*, No. 14-1126 (D.C. Cir.).
6. 15 U.S.C. § 78d-5. As enacted, the provision modified § 4E of the Securities Exchange Act of 1934, adding a new section entitled: "Deadline for Completing Enforcement Investigations and Compliance Examinations and Inspections."
7. *SEC* v. *The NIR Group, LLC and Corey Ribotsky*, CV 11-4723, 2013 WL 5288962, at *1, *5 (E.D.N.Y. March 24, 2013) ("Because the statute does not explicitly provide for dismissal of an enforcement action for failure to comply [. . .] I find that no such remedy exists [. . .]. [E]xpiration of the 180-day deadline imposed by [§ 4E of the Exchange Act] does not create a jurisdictional bar to SEC enforcement actions."); *SEC* v. *Levin*, No. 12-21917-CIV, 2013 WL 594736, at *13 (S.D. Fla. Feb. 14, 2013) ("[A]n internal agency deadline of the type found in Section 4E does not create a statute of limitations.").
8. Opinion of the Commission, *In the Matter of Montford and Co., Inc., et al.*, Investment Advisers Act of 1940 Release No. 3829, May 2, 2014.
9. *Montford and Co., Inc. v. SEC*, No. 14-1126 at 9 D.C. Cir. July 10, 2015.
10. *Id.* at 12 (citing *United States v. Kwai Fun Wong*, 135 S. Ct. 1625, 1634-35 (2015).

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