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Graham Decision Adopts Gabelli Rationale to Apply Five-Year Statute of Limitations to Enforcement Actions Seeking Equitable Relief

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The decision of a U.S. District Court for the Southern District of Florida judge to dismiss a case involving an alleged $300 million **Ponzi scheme** on statute of limitations grounds holds significant implications for time limits on the SEC's power to bring enforcement actions.

In *SEC v. Graham*, No. 13-10011, 2014 WL 1891418 (S.D. Fla. May 12, 2014), the court ruled that it lacked subject matter jurisdiction over the SEC's claims against former real estate executives because the five-year statute of limitations in 28 U.S.C. § 2462 had run. Notably, the court drew a distinction between "jurisdictional" statute of limitations and statute of limitations that act as "claim-processing rules." While "claim-processing rules" would allow the court to determine whether the statute of limitations had been tolled or otherwise extended, "jurisdictional" limitations prevent a court from entertaining a matter unless the claim is brought within the statutorily allowable time frame.

The U.S. Supreme Court's decision in *SEC v. Gabelli*, 113 S.Ct.1216 (2013)—which held that the five-year limitations period for civil penalties begins to run when the fraud occurs, not when it is discovered—left open the question whether § 2462 applies to what the SEC commonly refers to as "equitable relief," including injunctions and disgorgement. The statute provides as follows:

Except as otherwise provided by an 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 if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

In *Graham,* the SEC alleged that from 2004 to 2008, five individuals, through entities collectively known as the Cay Clubs Resorts and Marinas, unlawfully offered and sold unregistered securities disguised as real estate investments in condominium projects. According to the SEC, the defendants operated a classic Ponzi scheme whereby they bilked 1,400 investors out of $300 million. The defendants attracted investors by promising a return on their investments in condominium projects through instant equity and astronomical rates of appreciation. Instead, the defendants used the investments to repay previous investors, engaged in self-dealing eventually abandoned the development projects and absconded with the money. The SEC investigated the case for seven

years before it finally brought suit in January 2013.

The defendants moved for summary judgment on the basis that the SEC's claims were time barred. In light of *Gabelli*, the *Graham* court was confronted with the question whether § 2462, which applies to actions "for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise," also governs various forms of equitable relief sought by the SEC.

The SEC argued that the five-year statute of limitations did not apply because it brought suit for equitable relief and statutes of limitation do not apply to the United States when it is acting in its sovereign capacity. The SEC relied on the Eleventh Circuit's decisions in *SEC v. Calvo*, 378 F.3d 1211 (11th Cir. 2004), and *United States v. Banks*, 115 F.3d 916 (11th Cir. 1997), in which the court of appeals held that claims brought on behalf of the United States were not subject to the statute of limitations.

At the outset, the court determined, *sua sponte*, that § 2462 is a "jurisdictional" statute of limitation, given that it directs that a suit "*shall not be entertained* unless commenced within five years." As a result, the court reasoned that if the relief sought by the SEC was barred by the statute of limitations, the court would lack subject matter jurisdiction over the case. Next, the court, relying heavily on *Gabelli* and the social policies underpinning *Gabelli*, as well as the plain language of the statute, ruled that the five-year bar applies to all forms of relief sought by the SEC, not just civil penalties. The court rejected the SEC's argument that no statute of limitations applies to actions seeking equitable relief because the words "declaratory relief," "injunction," and "disgorgement" do not appear in the statute. The court noted that "penalties," "pecuniary or otherwise," formed the basis of all of the SEC's sought-after relief. The SEC's injunctive relief, the court reasoned, is a penalty intended to punish and disgorgement is a form of forfeiture, which is expressly covered by the statute.

The court also agreed with the *Gabelli* court's emphasis on statutes of limitation as "vital to the welfare of society" because they serve the basic policies of "repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." The court concluded that "[t]o hold otherwise would be to open the door to Government plaintiffs' ingenuity in creating new terms for the precise forms of relief expressly covered by the statute in order to avoid its application."

In light of the court's conclusion that § 2462 is a jurisdictional statute, the court pressed the SEC to come forward with evidence that a violative act had occurred during the "red zone." The court rejected the SEC's argument that it needed only to show that a genuine issue of material fact remained in order to survive summary judgment. Because the SEC could not meet its burden to show evidence of an act occurring within the red zone, the court ruled that it lacked subject matter jurisdiction over the case, and the court dismissed the suit in its entirety.

The *Graham* decision is a blow to the SEC's long-held position that "equitable relief" in the form of injunctions and disgorgement is not subject to the five-year statute of limitations. And, it is not the first. About two years ago, during the pendency of *Gabelli* in the Supreme Court, the Fifth Circuit decided, in a *per curiam* opinion, that equitable remedies (injunctive relief and officer and director bars) are subject to the five-year limitations period. *SEC v. Bartek*, 484 F. App'x 949, 2012 WL 3205446 (5th Cir. Aug. 7, 2012). The SEC sought Supreme Court review of the Fifth Circuit's decision about two weeks before *Gabelli* was decided, but withdrew its petition for writ of certiorari shortly after the Supreme Court issued its ruling in *Gabelli*. Whether and to what extent other courts adopt the Fifth Circuit and *Graham* rationales will have a major impact on the timing of SEC enforcement investigations and actions. Moreover, if the Supreme Court adopts

the *Graham* “jurisdictional” view of § 2462, the SEC may not be able to use tolling agreements or other equitable arguments to extend the statute of limitations.

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