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Expert Analysis

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AFTER *SEC V. GRAHAM*, HAVE THE COURTS LIMITED THE FOREIGN CORRUPT PRACTICES ACT'S REACH?

Valecia M. McDowell, E. Taylor Stukes and Frank E. Schall of Moore & Van Allen analyze the evolving case law regarding the Securities and Exchange Commission's disgorgement remedy and whether it is subject to a statute of limitations.

The Securities and Exchange Commission relies upon the Foreign Corrupt Practices Act to prosecute individuals and companies for engaging in corrupt conduct around the globe. The SEC, along with the Department of Justice, brings numerous FCPA enforcement actions each year, often resulting in companies paying hundreds of millions of dollars for conduct spanning decades.

Due to the sweeping authority provided to the SEC by the FCPA, those companies have few options to defend against such painful consequences. However, a recent 11th U.S. Circuit Court of Appeals decision casts doubt on the availability of one of the SEC's choice tools it uses to prosecute conduct long past: disgorgement.

Until May of this year, courts have allowed the SEC to seek disgorgement without restraint by a statute of limitations. This analysis addresses the evolving case law regarding whether the SEC's disgorgement remedy is subject to a statute of limitations, and its potential implications on SEC enforcement actions.

Relevant statute of limitations

Because the FCPA does not contain its own statute of limitations, 28 U.S.C.A. § 2462 provides the limitations period for civil violations of the FCPA. Section 2462 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." [1]

The SEC maintains that "[t]he five-year limitations period applies to SEC actions seeking civil penalties, but it does not prevent SEC from seeking equitable remedies, such as an injunction or the disgorgement of ill-gotten gains, for conduct pre-dating the five-year period." [2]

Courts' view of disgorgement

Traditionally, courts have agreed with the SEC's view that Section 2462 does not apply to actions seeking disgorgement. In 1993 the 9th U.S. Circuit Court of Appeals held that a statute of limitations does not govern an SEC action seeking disgorgement. [3]

Likewise, the 1st U.S. Circuit Court of Appeals held in 2008 that "the applicable five-year statute of limitations period [under Section 2462] applies only to penalties sought by the SEC, not its request for injunctive relief or the disgorgement of ill-gotten gains." [4]

***2** In 2010 the District of Columbia U.S. Circuit Court of Appeals explicitly addressed the question of whether disgorgement is "a fine, penalty, or forfeiture" subject to Section 2462 and answered with a definitive "no."

The court reasoned "that disgorgement orders are not penalties, at least so long as the disgorged amount is causally related to the wrongdoing." [5] Accordingly, it held that disgorgement in the action before it was not a "civil penalty" subject to Section 2462.

In a footnote, the court also stated that disgorgement is not a forfeiture under Section 2462. But the court left open the idea that "[i]t could be argued that disgorgement is a kind of forfeiture covered by Section 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."

Until recently, this was the closest the courts came to limiting the SEC's use of disgorgement.

SEC's use of disgorgement

Armed with its position that no statute of limitations can bar its actions seeking disgorgement, the SEC frequently seeks disgorgement of profits in its FCPA enforcement actions for allegations spanning well past five years.

The 9th Circuit recognized the importance of the disgorgement remedy to the SEC by noting "[d]isgorgement plays a central role in the enforcement of the securities laws." [6] The courts use various definitions for the disgorgement remedy, but put simply, it is an award that seeks to deprive a wrongdoer of its ill-gotten profit.

It appears the SEC first sought disgorgement as a remedy for an FCPA violation in 2004. [7] So far in 2016, the agency has secured almost half a billion dollars in disgorgement payments. The great majority of that figure comes from a disgorgement payment of $375 million agreed to by VimpelCom Ltd . [8]

Even more important than the dollar amounts secured in disgorgement actions is the ability of the SEC to use the disgorgement remedy to penalize conduct that occurred far outside the five-year limitations period. For example, in July, LAN Airlines entered into a consent cease-and-desist order with the SEC for conduct that occurred well outside the FCPA's limitations period, resulting in disgorgement of over $6.7 million for conduct that occurred about 10 years earlier. [9]

11th Circuit applies Section 2462

A recent decision may seriously jeopardize the SEC's ability to continue to use disgorgement to avoid the FCPA's statute of limitations. In *SEC v. Graham*, the 11th Circuit recently held that actions seeking disgorgement can be subject to the five-year limitations period under Section 2462. [10] In that case, the SEC brought an enforcement action against five individuals for a scheme that raised $300 million from the sale of condominiums that were "functioning, in reality, as unregistered securities."

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***3** The dispositive issue on appeal was whether the remedies sought by the SEC -- injunctive relief, declaratory relief and disgorgement -- were subject to the five-year limitations period under Section 2462. The court quickly found that injunctive relief is not subject to the statute of limitations while declaratory relief is.

The court reasoned that even if Section 2462 applied to equitable relief such as an injunction, to fall within the definition of a "penalty" under Section 2462 the relief sought must be backward looking and punitive in nature.

Based on that definition, the court found that an injunction is not a penalty because it seeks to address future conduct through non-punitive means, while a judicial declaration of a defendant's liability, such as the declaratory judgment, can be a penalty because it is backward looking and punitive.

Considering whether the disgorgement ordered by the District Court constituted a "forfeiture" under Section 2462, the 11th Circuit reviewed the definitions of disgorgement and forfeiture in detail and agreed with the District Court, finding "no meaningful difference in the definitions of disgorgement and forfeiture."

The District Court found that "the disgorgement of all ill-gotten gains realized from the alleged violations of the securities laws -- i.e., requiring the defendants to relinquish money and property -- can truly be regarded as nothing other than a forfeiture (both pecuniary and otherwise), which remedy is expressly covered by Section 2462."

Central to the 11th Circuit's reasoning is the broad definition that the District Court gave to the term forfeiture: "Forfeiture occurs when a person is forced to turn over money or property because of a crime or wrongdoing." That broad definition allowed the court to find that disgorgement, at a minimum, can be a subset of forfeiture.

This line of reasoning led the court to reject the SEC's argument that disgorgement and forfeiture are different remedies based on its reasoning that forfeiture encompasses not only the ill-gotten proceeds from illicit activities, but also any profit on those proceeds, while disgorgement includes just the ill-gotten proceeds.

10th Circuit decision

Even after *Graham*, federal appeals courts continue to disagree on the subject. In August, the 10th Circuit reached a decision completely contrary to *Graham* when it held that disgorgement is not a penalty or a forfeiture under Section 2462. [11]

The 10th Circuit found that disgorgement is not a penalty because "[p]roperly applied, the disgorgement remedy does not inflict punishment"; rather its function is remedial in that it removes from a wrongdoer his ill-gotten gains.

The court also found that disgorgement is not a forfeiture by analyzing the historical meaning of "forfeiture," which the court explained has punitive connotations. Further, the court interpreted "forfeiture" in light of its proximity in Section 2462 to the terms "penalty" and "civil fine," which the court found reinforced the term's punitive connotations.

***4** Concluding that disgorgement is remedial rather than punitive, the court found that disgorgement is not a forfeiture. Finally, the court applied a rule of construction requiring it to construe Section 2462 in favor of avoiding a limitations bar, which further bolstered its ruling that the disgorgement remedy is not subject to the five-year limitations period in Section 2462.

The road ahead

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In addition to the circuit split, the Office of the Chief Counsel of the Internal Revenue Service has recently weighed in on the issue of whether a disgorgement remedy under the FCPA is subject to Section 2462. [12]

In finding that disgorgement was a penalty in the matter before it, and not deductible, the IRS disagreed with the prior circuit court opinions finding that disgorgement is not a penalty. [13]

In light of the evolving and conflicting view of whether disgorgement is subject to the statute of limitations, the U.S. Supreme Court likely will need to provide the definitive interpretation of Section 2462.

The Supreme Court has recently expressed its reluctance to allow the SEC an indefinite period to commence an action. In a 2013 decision, it held that the "discovery rule" does not apply to toll the running of the five-year limitations period under Section 2462.

In that case, Chief Justice John G. Roberts, writing for the court, cited the court's reluctance to interpret statutes of limitations to allow the government an unlimited amount of time to bring enforcement actions.

Justice Roberts invoked Justice Thurgood Marshall, who wrote it "'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'" [14]

In the meantime, practitioners advising and defending clients with respect to potential or actual FCPA enforcement actions by the SEC will have to grapple with the applicability of Section 2462 to disgorgement claims. Until the issue is resolved, it is likely the SEC will continue to bring, or may even speed up, enforcement actions seeking disgorgement for actions over five years old.

The extent to which a statute-of-limitations defense is pursued will likely differ based on whether the subject of the SEC's investigation is an individual or a company. Companies may be less likely to pursue this defense, especially if doing so means risking an action in court, because companies will usually place a higher value on cooperating with the SEC and reaching an agreement to reduce reputational harm.

However, attorneys for companies facing FCPA enforcement actions may consider raising a statute-of-limitations defense for disgorgement actions if available in negotiations with the SEC.

The potential implications of *Graham* may affect counsel's strategy even before the SEC opens an investigation. Importantly, the question of whether a company should self-report conduct that occurred over five years ago should take into account a variety of factors. Based on the 11th Circuit's ruling in *Graham*, those factors include whether the statute of limitations may bar the SEC from seeking certain remedies.

***5** The SEC often will request tolling agreements with companies to stay the running of the limitations period. Counsel for companies that may be inclined to agree to such agreements to accommodate the SEC and allow time for an orderly resolution of the SEC allegations should consider the extent to which failing to agree to a tolling agreement could cut off the SEC's rights to certain remedies. This may cause the SEC to shift tactics to avoid disgorgement remedies being subject to the statute of limitations either by increasing the speed of its investigations or developing a "continuing wrong" theory to extend the limitations period in certain cases.

Companies should be on the lookout for tactics that may indicate the SEC is trying to avoid a statute-of-limitations issue. At a minimum, counsel should stay abreast of this rapidly developing area of the law so they can remain in a strong position to advise their clients.

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Footnotes

1 28 U.S.C.A. § 2462.

2 Criminal Div. of the U.S. Dep't of Justice and the Enforcement Div. of the U.S. Sec. & Exch. Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act, 35 (2012), https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.

3 *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993).

4 *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).

5 *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (citing *Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009); *SEC v. Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989)).

6 *Rind*, 991 F.2d at 1491.

7 David C. Weiss, *The Foreign Corrupt Practices Act, SEC Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and Deterrence*, 30 Mich. J. Int'l L. 471, 486 (2009) (internal citations omitted).

8 *SEC v. VimpelCom Ltd.*, No. 16-cv-1266, *final judgment issued* (S.D.N.Y. Feb. 22, 2016).

9 LAN Airlines, Order Instituting Cease-and-Desist Proceeding Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, July 25, 2016.

10 *SEC v. Graham*, 823 F.3d 1357, 1359 (11th Cir. 2016) The 11th Circuit is the same circuit that, while not siding with the defendants, limited the DOJ and SEC's broad definition of an "instrumentality" of a foreign government's department or agency in *United States v. Esquenazi*, 752 F.3d 912 (11th Cir. 2014), adding to the analysis an assessment of whether the entity serves a government function.

11 *SEC v. Kokesh*, No. 15-2087, 2016 WL 4437585, at *15-16 (10th Cir. Aug. 23, 2016).

12 Office of the Chief Counsel, Internal Revenue Service, Memorandum No. 201619008 (May 6, 2016), https://www.irs.gov/pub/irs-wd/201619008.pdf.

13 *Id.* at 10. The key issue for the IRS was whether the disgorgement payment was tax deductible. If it was compensatory, it was deductible; if it was punitive, it was not deductible. The IRS explained that it "think[s] disgorgement can be primarily punitive for tax purposes in some cases, where it serves primarily to prevent wrongdoers from profiting from their illegal conduct and deters subsequent illegal conduct." The IRS determined that the SEC did not design the disgorgement award to compensate the government or other party, and therefore, did not have a compensatory purpose to render the payment deductible. While the IRS did not consider a disgorgement remedy in connection with the statute of limitations, its analysis finding that disgorgement remedies can be punitive supports the rationale that FCPA disgorgement remedies are subject to the statute of limitations because they could be considered a "penalty" subject to Section 2462.

14 *Gabelli v. SEC*, 133 S. Ct. 1216, 1223 (2013) (quoting *Adams v. Woods*, 6 U.S. 336, 342 (1805)).

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