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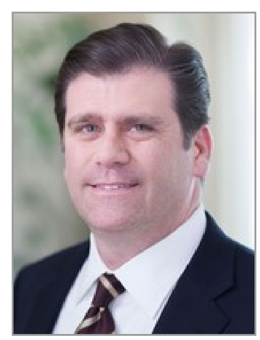
# NJ Case Bolsters The Limitations Defense Against SEC

By **Joseph Dever and Matthew Elkin** January 2, 2018, 1:01 PM EST



Joseph Dever

It's a bit tricky advising clients on how the statute-of-limitations defense works in U.S. Securities and Exchange Commission enforcement cases. SEC civil enforcement actions are subject to the five-year statute of limitations period under 28 U.S.C. § 2462.[1] This provision bars the government from filing claims seeking punitive remedies, but not equitable remedies, for conduct that took place more than five years from the filing date. Last summer, the U.S. Supreme Court ruled in Kokesh v. SEC, 137 S. Ct. 1635 (2017), that SEC disgorgement claims are punitive, not equitable, and are therefore subject to Section 2462's statute of limitations. After Kokesh, the bottom line for clients is that the SEC can file a case against them no matter how old the conduct, but the SEC won't be able to obtain monetary remedies for conduct older than five years. In other words, Section 2462's statute-of-limitations defense is only a partial defense to an SEC enforcement action.

Matthew Elkin

A recent decision from the U.S. District Court for the District of New Jersey, however, has opened the door to the possibility that Section 2462 serves as a complete defense to an SEC enforcement action.

**SEC v. Gentile Extends Section 2462 to Injunctions and Industry Bars**

In SEC v. Gentile, Civ. Action No.: 16-1619 (D.N.J.) (Dec. 13, 2017), Chief Judge Jose Linares dismissed the SEC's complaint in its entirety against defendant Guy Gentile for securities fraud, ruling that Section 2462's five-year statute of limitations period applies in equal force to SEC claims for permanent injunctions and penny stock bars[2] — two remedies that are generally considered to be remedial, not punitive.

The court considered whether the permanent injunction and penny stock bar the SEC was seeking were in fact remedial or punitive. The court concluded that because both remedies were "noncompensatory sanctions," they were penal in nature and, therefore, subject to Section 2462's five-year statute of limitations. Finding that the SEC waited more than five years to file its case, the court granted the defendant's motion to dismiss the SEC's complaint.

The court flatly rejected the SEC's argument that an injunction and an industry bar were equitable remedies because they were necessary to prevent the defendant from committing future violations of the federal securities laws. In doing so, the court found that a permanent "obey-the-law" injunction and a penny stock bar would not compensate victims or injured investors and would not restore the status quo ante. On the other hand, the court recognized that imposing an injunction and penny stock bar would have a significant reputational impact for the defendant or, in the words of the court, would "stigmatize the defendant in the eyes of the public." Therefore, the court found that the injunction and penny stock bar sought by the SEC were punitive, not remedial. The court held:

> [T]here would be no retributive effect from such an order [imposing a permanent injunction and a penny stock bar], nor would such an order restore any "status quo ante." As a matter of fact, Plaintiff [SEC] has not identified a single "victim" or a specific harmed party that these injunctions would be designed to compensate or benefit. Hence, the only person who would be impacted by such an order would be Defendant, and the only purpose for such an order would be to penalize him for his alleged involvement in the [fraudulent stock] schemes.

The court's holding is not a complete outlier. As the court noted in its opinion, there have been a few cases in the past finding that requests by the SEC for injunctions and industry bars were more punitive than remedial. See Johnson v. SEC, 87 F.3d 484, 488 (D.C. Cir. 1996); SEC v. Jones, 476 F. Supp. 2d 374, 381 (S.D.N.Y. 2007). The Gentile decision, however, is significant because it is the most recent decision to address the issue after Kokesh, which Judge Jose Linares found to be "quite instructive" despite the different remedies at issue (disgorgement versus injunction).

**Gentile's Significance for SEC Defense Counsel**

Counsel representing clients in SEC investigations should take notice of the Gentile decision and consider how it might strengthen their defenses or settlement posture with the enforcement staff. For sure, where the age of the conduct is at issue, the staff takes the view that the commission can always file an action seeking, at a minimum, injunctive relief and industry bars because they are remedial remedies not subject to Section 2462. Gentile, however, calls this long-held staff position into doubt.

The Gentile decision could meaningfully influence how defense counsel advise clients about signing tolling agreements requested by the SEC staff. While the tolling agreement preserves the SEC's right to obtain monetary relief, it has generally been viewed as unnecessary to preserve the SEC's right to obtain permanent injunctions and industry bars. Because Section 2462 is not a complete defense to an SEC action, counsel may have been inclined to recommend that clients sign tolling agreements rather than tempt the staff to speed up the pace of its investigations. Gentile may change this strategy because it essentially holds that, without an executed tolling agreement, the SEC is precluded from bringing any action based on conduct that is older than five years.

Furthermore, the Gentile decision could bolster a statute-of-limitations defense raised in counsel's Wells submissions. The decision might serve to recalibrate the "litigation risk" analysis that the staff is required to undertake when recommending that the commission file a contested enforcement case without a settlement. Where the conduct under investigation is older than five years, Gentile provides defense counsel with some ammunition to argue that the litigation risk is now greater for the SEC. In the past, the staff may have assessed the litigation risk for a statute-of-limitations defense as the possibility of losing some, but not all, of the case (i.e., losing the claims for monetary relief, but not injunctive relief). After Gentile, the staff will have to address the question of whether the risk of litigating a statute-of-limitations defense is an "all-or-nothing" risk. In other words, if the conduct is more than five years old, does Section 2462 render the SEC's entire case time-barred and subject to dismissal?

**Conclusion**

We will have to wait and see whether other courts follow Gentile's holding extending Kokesh to SEC claims for permanent injunctions and industry bars. For now, however, Gentile can be cited in Wells meetings and settlement discussions with the SEC staff to help move the needle in defense counsel's favor.

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[1] 28 U.S.C. § 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 ...."

[2] Section 21(d)(6) of the Securities Exchange Act of 1934 allows the court to prohibit securities law violators from participating in future offerings of so-called "penny" stocks. Judicial bars prohibiting participation in penny stock offerings or from serving as an officer or director of a public company are known as "industry bars."



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The U.S. Securities and Exchange Commission recently joined in on a request that the U.S. Supreme Court review a long-simmering issue: Does the Section 2462 five-year statute of limitations apply to SEC disgorgement claims? The lack of clarity poses a substantial risk for litigants on both sides of an SEC enforcement action, say attorneys with Paul Hastings LLP.

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