Securities Regulation Daily Wrap Up, TOP STORY—SEC: There is no statute of limitations on disgorgement, (Oct. 3, 2016)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Anne Sherry, J.D.

The SEC rejected an investment adviser's argument that the five-year catch-all statute of limitations in 28 U.S.C. § 2462 barred a disgorgement claim against him. Finding that the adviser violated the Investment Advisers Act by recommending unsuitably risky investments in Madoff feeder funds without due diligence, the Commission determined that civil penalties were time-barred but equitable remedies were still on the table. The SEC ordered $3 million in disgorgement, plus interest, and barred the adviser (*In the Matter of Grossman*, Release No. 33-10227, September 30, 2016).

ALJ decision. In late 2014, an administrative law judge found that the adviser recommended unsuitably risky funds to retiree clients of his firm, Sovereign International Asset Management, Inc., in exchange for kickbacks. He did not disclose the conflict resulting from the kickbacks or do proper due diligence on the investments. In fact, the underlying funds were invested in Madoff feeder funds. The ALJ ordered the adviser to pay a $1.55 million civil penalty and about $3 million in disgorgement plus interest. The adviser appealed, asserting the sanctions were time-barred under § 2462 by way of the Eleventh Circuit's recent decision in *SEC v. Graham*.

Commission's opinion bars legal, but not equitable, relief. The Division of Enforcement lost on the civil penalties issue. Although the Commission recognized that the continuing violations doctrine would have preserved an action for civil penalty as long as a portion of the misconduct occurred within the limitations period, all of the Division's claims accrued outside the limitations period. Key to this finding was the Division's concession at oral argument that the adviser did not receive payments from the feeder funds (filtered through Sovereign) during the limitations period. The evidence also did not establish that the respondent continued to meet the definition of an investment adviser during the limitations period.

The SEC disagreed with the respondent, however, that disgorgement falls within the catch-all limitations provision because it is synonymous with forfeiture. *Graham*'s conflating of the two terms is "in tension not only with the decisions of numerous courts of appeals but also with our interpretation of disgorgement," the Commission wrote. It also conflicted with the Eleventh Circuit's prior precedent that disgorgement is equitable: *Graham* itself recognized that § 2462 does not apply to equitable remedies. The SEC agreed with the Division's take that *Graham*, by relying only on modern dictionary definitions of forfeiture and disgorgement, failed to address the statutory context that demonstrate why Congress distinguished the two concepts.

Mitigating factors. Although the equitable remedy of disgorgement is not subject to a statute of limitations, it does not follow that the passage of time is irrelevant to the inquiry, the Commission noted. The SEC can and should consider the remoteness of the past violations, but in this case, the passage of time had not degraded the evidence relevant to disgorgement. However, the Commission reduced the disgorgement amount by $400,000, the amount the respondent's paid to settle an arbitration by a Sovereign client. His payment of $1.37 million in taxes on the ill-gotten gains would not offset the disgorgement amount, and the SEC left him to seek any such relief from the IRS.

The release is No. 33-10227.

Attorneys: Patrick R. Costello, Securities and Exchange Commission, for the Division of Enforcement. Zachary D. Messa (Johnson Pope Bokor Ruppel & Burns, LLP) for respondent Larry C. Grossman.

Companies: Sovereign International Asset Management, Inc.

MainStory: TopStory Enforcement FraudManipulation HedgeFundsNews InvestmentAdvisers RiskManagement

© 2016 CCH Incorporated and its affiliates and licensors. All rights reserved.