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Third Circuit Reversal a Pyrrhic Win for SEC in Ongoing Statute of Limitations Saga

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In *Securities & Exchange Comm. v. Gentile*, No. 18-1242, 2019 WL 4686251 (3d Cir. Sept. 26, 2019), the United States Court of Appeals for the Third Circuit took up the question of whether Securities and Exchange Commission ("SEC") injunctions constitute penalties subject to a five-year statute of limitations. In vacating a district court decision holding that they do, the Third Circuit held in this case of first impression that injunctions properly tailored to prevent future harm are not penalties. However, the opinion did not reach a determination as to whether the specific relief at issue had been so tailored, remanding that decision to the lower court along with the admonition that relief extending beyond the preventative into the punitive may not issue as an injunction. While the Third Circuit's decision shielded the SEC's injunctive powers from wholesale subjection to a five-year statute of limitations, it charted what qualifies as appropriate injunctive relief and, ultimately, may operate to curtail unduly broad injunctions.

The government's case against Gentile, the owner of an upstate New York broker-dealer, began in 2012 with the Justice Department's filing of a sealed complaint in connection with Gentile's alleged participation in "pump-and-dump" schemes in 2007 and 2008. Gentile initially agreed to cooperate against other participants in the scheme, but the agreement fell through after the government rejected his demand for a non-felony disposition and filed an indictment on March 23, 2016. Gentile moved to dismiss the indictment based on his unknowing entry into certain tolling agreements. The United States District Court for the District of New Jersey agreed and dismissed the case, holding that prosecution was time-barred.

The same day the indictment was filed, the SEC entered the fray by initiating a civil enforcement action that sought two injunctions against Gentile based on the same 2007 and 2008 conduct. The injunctions would have required Gentile to refrain from violating the securities laws and participating in the penny stock industry. Gentile moved to dismiss this action, arguing that the injunctions sought were punitive within the meaning of *Kokesh v. Securities & Exchange Comm.*, 137 S. Ct. 1635 (2017), and, therefore, subject to a five-year statute of limitations.

The district court held that the injunctions would do nothing more than require compliance with existing laws, as required of all citizens, while stigmatizing Gentile in the eyes of the public and restrict Gentile's business based upon alleged violations in the past. As the court explained, "simply alleging that [Gentile] violated securities laws does not lead the Court to conclude that [he] is likely to violate securities laws in the future." Accordingly, the district court dismissed the action, holding that the injunctions constituted penalties because they operated to punish Gentile rather than prevent an adequately demonstrated risk of future harm.

On appeal, the Third Circuit panel reversed, holding that properly issued and framed injunctions are equitable in nature and do not constitute penalties. However, the court held that the injunctions sought against Gentile must serve a preventive purpose and be carefully tailored to proscribe only that conduct necessary to prevent a future harm.

Notably, the Third Circuit did not determine whether the SEC's requested relief was properly framed and instead remanded the matter to the District Court to "decide whether the injunctions sought are permitted under [the SEC's statutory authority]." As such, the Third Circuit's ruling, while generally preserving the SEC's authority to pursue injunctive relief beyond the five-year statute of limitations, concretely circumscribed the contours of the SEC's injunctive powers and left open the possibility that the SEC will nonetheless be barred from securing the particular relief at issue in this case.

In delivering its opinion, the Third Circuit underscored the potential perils of overbroad injunctive relief and, particularly, the serious collateral consequences of industry bans, which it referred to as the "securities industry equivalent of capital punishment." As the district court in this case and others apply *Gentile* moving forward, we can expect to see increased scrutiny of relief fashioned as injunctions, particularly when it entails industry bans, to ensure that it goes no farther than necessary to prevent an adequately demonstrated risk of future harm and thus avoids the imposition of time limits.