D.C. Circuit: Section 4E of the Exchange Act Does Not Bar SEC from Commencing Action More than180 Days After Issuance of Wells Notification

On July 10, 2015, the United States Court of Appeals for the District of Columbia Circuit held that the 180-day requirement set forth in Section 4E of the Securities Exchange Act of 1934 for the Securities and Exchange Commission ("SEC" or the "Commission") to file an enforcement action after the issuance of a Wells notification is not jurisdictional.[1]

I. Factual and Procedural Background

In 2003, Ernest V. Montford, Sr., founder of institutional investment advisor, Montford and Company, Inc. ("Montford Associates" and collectively, "Petitioners"), began recommending that his clients invest with investment manager Stanley Kowalewski. When Kowalewski started his own investment management firm in 2009, Montford and his staff further recommended that their clients transfer their assets to this new firm. Ultimately, nine clients transferred a combined $80 million, and, in 2010 Kowalewski paid Petitioners $210,000.

In March 2011, the SEC issued a Wells notification[2] to Petitioners informing them that the staff was considering recommending that the Commission bring enforcement proceedings relating to these payments. In the fall of 2011—187 days after the issuance of the Wells notification—the SEC instituted an administrative enforcement action against Petitioners related to their failure to disclose the payments from Kowalewski. The order instituting proceedings alleged that Montford Associates' "promotional materials and regulatory filings contained inaccuracies regarding its independence," a violation of the reporting and anti-fraud restrictions imposed by three sections of the Investment Advisers Act and associated rules.[3]

In a proceeding before an Administrative Law Judge ("ALJ"), Petitioners filed a motion to dismiss for lack of jurisdiction. They argued that the order instituting proceedings was untimely under Section 4E of the Exchange Act, which states that: "[n]ot later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action."[4] Petitioners argued that there was no jurisdiction because the SEC brought the enforcement action 187 days after the issuance of the Wells notification, and that, to the extent the Director of the Enforcement Division purported to extend the 180-day deadline, the Director had failed to follow proper procedures.[5]

The ALJ denied the motion to dismiss and concluded that Petitioners had violated Sections 204, 206, and 207 of the Advisers Act and Advisers Act Rule 204-1(a)(2). Montford was barred from the securities industry

[1] *Montford & Co. v. SEC*, No. 14-1126, slip op. (D.C. Cir. July 10, 2015); *see* 15 U.S.C. § 78d-5(a)(1).

[2] *See* 17 C.F.R. § 202.5(c); *see also Enforcement Manual*, SECURITIES AND EXCHANGE COMMISSION DIVISION OF ENFORCEMENT, 19-22 (June 4, 2015), *available at* http://www.sec.gov/divisions/enforce/enforcementmanual.pdf. Rule 5(c) of the SEC's Rules on Informal and Other Procedures permits that: "[u]pon request, the staff, in its discretion, may advise such persons [who the Commission is investigating] of the general nature of the investigation, including the indicated violations as they pertain to them." 17 C.F.R. § 202.5(c).

[3] *See* 15 U.S.C. §§ 80b-4, 80b-6(1)-(2), 80b-7; 17 C.F.R. § 275.204-1(a)(2).

[4] *See* 15 U.S.C. § 78d-5(a)(1).

[5] *See* 15 U.S.C. § 78d-5(a)(2). In complex actions, the Director of the Division of Enforcement "may, after providing notice to the Chairman of the Commission, extend such deadline [described in Subsection (a)(1)] as needed for one additional 180-day period." *Id.*

and ordered to pay a civil penalty of $150,000; Montford Associates was ordered to pay a civil penalty of $500,000; and disgorgement was calculated at $210,000.

Petitioners challenged the ALJ ruling before the full Commission arguing that (i) the action was time-barred pursuant to Section 4E and (ii) the disgorgement was unlawful and the civil penalty was excessive and arbitrary. Upon the Commission's affirmation of the ALJ ruling, Petitioners filed a petition for review with the Court of Appeals for the District of Columbia Circuit.

II. The Circuit Court Decision

The D.C. Circuit denied the petition for review.

The Court began by applying *Chevron* deference and concluding that the SEC had reasonably interpreted the 180-day deadline to be non-jurisdictional.[6] Analyzing the statute under *Chevron*'s first prong, the Court reasoned that Section 4E was ambiguous because Congress did not specify, what, if any, consequences would result if the SEC failed to act within the 180-day time period. Although the language, structure, and purpose of the statute could permit the interpretation that Section 4E has jurisdictional consequences, such characteristics do not "foreclose[] other interpretations" of Section 4E.[7]

Because the statute was ambiguous, the Court turned to the second prong of the *Chevron* analysis and asked whether the SEC's interpretation of statute was reasonable. The Court concluded that it was. Relying on legislative history and case law, the Court accepted the SEC's argument that "congressional enactments that prescribe internal time periods for federal agency action without specifying any consequences for noncompliance do not necessitate dismissal of the action."[8] Moreover, the Court cited to U.S. Supreme Court cases holding: (i) that statutory time limits related to the filing of actions are "presumptively non-jurisdictional";[9] and (ii) that a statute's express deadline and use of the word "shall" does not, alone, "divest the agency of jurisdiction to act after the deadline."[10] In light of this precedent, the SEC's interpretation of Section 4E as a non-jurisdictional statute—that is, one that cannot prevent the SEC from instituting an administrative proceeding merely because the deadline has expired—was reasonable, the Court said.[11]

Separately, the Court rejected Petitioners' argument that the SEC had inappropriately disgorged $210,000. It noted that the Commission possesses flexibility in imposing equitable remedies such as disgorgement. Although Petitioners correctly argued that there must be a causal connection between the securities violation (here, the nondisclosure of payments) and the unjust enrichment (the payments themselves),

[6] *Montford & Co.*, No. 14-1126 at 9-10 (citing *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984)). Under the *Chevron* deference standard, "[w]hen a court reviews an agency's construction of the statute which it administers, it is confronted with two questions," the first of which is "whether congress has directly spoken to the precise question at issue." *Chevron, U.S.A., Inc.*, 467 U.S. at 842-43. If Congress' intent is clear, the analysis goes no further; if, however, Congress' intent is ambiguous, the second prong of the standard asks "whether the agency's [interpretation of the statute] is based on a permissible construction of the statute." *Id.*

[7] *Montford & Co.*, No. 14-1126 at 11.

[8] *Id.* (citations omitted) (internal quotation marks omitted).

[9] *Id.* at 12 (citing *United States v. Kwai Fun Wong*, 135 S. Ct. 1625, 1634-35 (2015)).

[10] *Id.* (citing *Brock v. Pierce Cnty.*, 476 U.S. 253, 266 (1986)).

[11] Because the Court concluded the SEC's interpretation of Section 4E was reasonable and that the statute was non-jurisdictional, it did not address whether the Director of the Division of Enforcement had appropriately extended the 180-day limitation.

the Court accepted the SEC's reasonable conclusion that such a link existed here. Testimony indicated that Kowalewski would not have made payments to Montford if the payments were disclosed because Montford would not have been able to retain clients if clients knew of the arrangement. Consequently, the SEC's disgorgement order was reasonable. Montford's argument that the civil penalties were excessive and arbitrary followed the same logic, and the Court rejected these arguments on similar grounds.

III. Significance

Despite the language of Section 4E stating that the Commission shall take action within 180 days of a Wells notification, one Court of Appeals has now held that the statute is non-jurisdictional and therefore, the 180-day time restriction does not bar the SEC from commencing an action after that time period.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.