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Supreme Court Ruling Means the SEC Must Move Quickly to Seek Civil Penalties Related to the Financial Crisis

Today, the U.S. Supreme Court largely closed the door on the federal government's ability to pursue monetary penalties in civil enforcement actions involving conduct that is more than five years old. The Court's decision in *Gabelli et al. v. SEC*[1] rejected the application of the "discovery rule" to trigger the statute of limitations in civil fraud enforcement actions brought by the government. As a practical matter, the decision should put pressure on the government to wrap up this year many of its investigations related to the financial crisis.

Gabelli v. SEC: The "discovery rule" does not apply when the U.S. government seeks civil penalties.

In 2008, the SEC brought a civil enforcement action against the former portfolio manager of a mutual fund then known as Gabelli Global Growth Fund ("GGGF") and the chief operating officer of Gabelli Funds, LLC, the investment adviser to GGGF. *Gabelli*, 568 U. S. ____ (2013) (slip op. at 2). The SEC alleged that the defendants allowed a select investor (Headstart Advisers, Ltd.) to engage in illegal "market timing" from 1999 until 2002 in violation of fund rules.[2] *Id*. According to the SEC, defendants did not disclose Headstart's market timing or the quid pro quo agreement. *Id*. at 3. The SEC alleged that the aiding and abetting of market timing violates the anti-fraud provisions of the Investment Advisers Act of 1940. The SEC sought civil penalties, which are subject to a five-year statute of limitations that commences when the "claim first accrued." 28 U. S. C. § 2462.

Defendants argued the claim for civil penalties was untimely because the 2008 complaint was filed more than six years after the alleged misconduct in 2002. The District Court agreed and dismissed the SEC's civil penalty claim. *Id*.

The Second Circuit reversed, holding that because the claim sounded in fraud, the discovery rule applied. Under the discovery rule, a claim accrues when the plaintiff knew or should have known of the fraud.

The Supreme Court unanimously reversed, refusing to apply the discovery rule to civil enforcement actions. Noting that "[t]he discovery rule exists in part to preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury," the Court reasoned that the SEC does not need these protections in light of its investigative purpose. *Id*. at 7. "Unlike the private party who has no reason to suspect fraud, the SEC's very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit." *Id*. at 8. Moreover, "[t]his reading sets a fixed date when exposure to the specified Government enforcement efforts ends, advancing the basic policies of all limitations provisions: repose, elimination of stale

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[1] 568 U. S. ____ (2013).
[2] 131 S. Ct. 2296, 2298 n. 1 (2011).

claims, and certainty about a plaintiff 's opportunity for recovery and a defendant's potential liabilities." *Id*. at 5 (internal quotation marks omitted). The Court held that the "standard rule"—that a claim accrues "when the plaintiff has a complete and present cause of action"—applies to the SEC's claims. *Id*. at 5 (internal quotation marks omitted).

Gabelli in Action

The Supreme Court's decision in *Gabelli* will have broad-scale application to civil penalty actions brought by the government in the wake of the financial crisis. Indeed, *Gabelli* means immediately that the SEC is precluded from instituting civil enforcement actions for monetary penalties based on conduct occurring before March 2008 (*i.e*., older than five years). Additionally, the government will be under pressure to bring civil actions this year based upon conduct occurring during the remainder of 2008.

Importantly, however, *Gabelli* did not address whether the government may rely upon a tolling theory (such as fraudulent concealment) to extend the five year statute of limitations. *See Gabelli* at 4 n.2 (noting the SEC abandoned any reliance on tolling in this case).

In addition, *Gabelli* does not apply to U.S. government claims seeking injunctive relief and disgorgement, which the district court found timely on the ground that they were not subject to §2462. *Id*. at 3 n.1. Finally, the Court distinguished causes of action that have statutes of limitations that expressly adopt the "discovery rule" standard. *Id*. at 10-11. Such suits typically occur outside of the enforcement context, such as when the government sues in tort or on a contract (*see* 28 U. S. C. §§2415, 2416(c)), or when the government alleges that it was itself the victim of fraud under the False Claims Act (*see* 31 U. S. C. §3731(b)(2)).

Conclusion

Gabelli limits the ability of the SEC and other U.S. government agencies to seek civil penalties. Although SEC spokesman John Nester said the agency does not expect the ruling to have an immediate impact on its ability to hold violators accountable, it may put pressure on the SEC. That, in turn, could affect the SEC's investigation and prosecution of alleged fraudulent activity, and prompt the agency to act more quickly in cases of suspected fraud, especially those cases involving the 2008 financial crisis.

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