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A Legal Update from Dechert's White Collar and Securities Litigation Group

Does the Government Have a Perpetual Statute of Limitations?

The United States Supreme Court has just granted a writ of certiorari to decide whether the Securities and Exchange Commission (the “SEC”) has, in essence, a perpetual statute of limitations in cases arising out of alleged fraud. In *Gabelli v. Securities and Exchange Commission*, 11-1274 (cert. granted, Sept. 25, 2012), the Supreme Court will review whether 28 U.S.C. § 2462, the applicable statute of limitations, requires federal agencies to bring penalty actions “sounding in fraud” within five years of the date on which a violation occurred or the date on which the government discovered (or in the exercise of reasonable diligence should have discovered) the violation. The Court’s interpretation of Section 2462 is of great importance because this statute applies to the entire federal government in all civil penalty claims (except where Congress has specifically provided otherwise). If the Court rules in favor of the SEC, the government could delay indefinitely the filing of claims for civil penalties sounding in fraud by simply alleging that it had not discovered the basis for its claim until some time within the five-year limitations period.

The United States Supreme Court has just granted a *writ of certiorari* to decide whether a government agency has, in essence, a perpetual statute of limitations in cases arising out of alleged fraud. In *Gabelli v. Securities and Exchange Commission*, 11-1274 (cert. granted, Sept. 25, 2012), the Court agreed to review whether the statute of limitations, 28 U.S.C. § 2462, that governs federal actions for civil penalties in the absence of a more specific statute requires federal agencies to bring penalty actions “sounding in fraud” within five years of the date on which a violation *occurred* or the date on which the government *discovered* (or in the exercise of reasonable diligence should have discovered) the violation. Section 2462 provides that “except as otherwise provided by Act of Congress,” an action for a civil penalty “shall not be entertained unless commenced within five years from the date when the claim first accrued.” While petitioners have maintained that a claim accrues when the underlying violation occurs, the Securities and Exchange Commission (the “SEC”) has insisted that a claim sounding in fraud accrues when the SEC discovers, or in the exercise of reasonable diligence should have discovered, the violation.

The SEC originally brought claims against Marc Gabelli, a former portfolio manager of Gabelli Global Growth Fund (the “GGGF”), and our client Bruce Alpert, the Chief Operating Officer of Gabelli Funds, LLC, alleging, among other things, that Gabelli and Alpert had aided and abetted a violation by Gabelli Funds of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(1)-(2). According to the SEC, Gabelli Funds had violated Section 206 by allowing one customer to engage in frequent trading in exchange for a small investment in a Gabelli hedge fund without disclosing the trading or investment to the GGGF board of directors. Gabelli Funds had caused the trading at issue to end in August 2002; the complaint was not filed until April 2008. The SEC sought to avoid the bar of Section 2462’s five-year statute of limitations by arguing that it had not discovered the basis for its claim until late 2003 at the earliest, after then-Attorney General Eliot Spitzer publicized a widespread investigation of market timing of mutual funds, including time-zone arbitrage.

The United States District Court for the Southern District of New York granted defendants’ motion to dismiss the SEC’s claim for aiding and abetting a violation of Section 206 insofar as it sought civil penalties on the grounds that the claim was time-barred.[1] In the absence of any Act of Congress providing for a “discovery” rule, the court rejected the SEC’s argument that such a discovery rule should be read into Section 2462.

The SEC appealed to the United States Court of Appeals for the Second Circuit, insisting that a special discovery rule should be read into Section 2462 for claims "sounding in fraud," in part on the theory that all fraud is self-concealing. The Second Circuit agreed, reversed the district court and held that, for purposes of the Section 2462 statute of limitations, a fraud claim first accrues when the SEC discovers it or reasonably should have discovered it.[2] Defendants sought a *writ of certiorari* from the Supreme Court.

Usually the Supreme Court grants a *writ of certiorari* only in cases (1) where the circuit courts of appeal have divided on the issue in question or (2) where the issue in question is of great national importance (or both). Here, there was arguably a split in the circuits at the time the petition was filed, and definitely one by the time the Court considered the petition.[3] In addition, the matter was of great national importance. Section 2462 is a general statute of limitations that applies to the entire federal government in all civil penalty claims, unless Congress specifically provides otherwise.[4] The Second Circuit's holding below could be used not only by the SEC in securities enforcement cases sounding in fraud, but could also be used by other government agencies that pursue civil penalties in cases that arguably sound in fraud. If left standing, this ruling could allow the government to delay indefinitely the filing of claims for civil penalties sounding in fraud by simply alleging that it had not discovered the basis for its claim until some time within the five-year limitations period. Although defendants would still have the opportunity to demonstrate that the government should have discovered the basis for its claim more than five years before filing suit, it is difficult (as in Gabelli) to make such a showing at the motion to dismiss stage of a case. As a result, defendants could be required to engage in lengthy discovery about whether the government should have known about its claim earlier than it alleges. If defendants cannot prevail on this issue at the summary judgment phase, they could be forced to defend themselves against the most serious sorts of claims in circumstances where evidence has been lost and memories have faded with the passage of time.

Dechert LLP represents Petitioner Bruce Alpert in this matter.

Footnotes

[1] *SEC v. Gabelli*, No. 08-CV-3868, 2010 WL 1253603 (S.D.N.Y. Mar. 17, 2010).

[2] *SEC v. Gabelli*, 653 F.3d 49, 59-61 (2d Cir. 2011). The Second Circuit left open the possibility that, at a later stage of the litigation, defendants might be able to establish that the SEC would have discovered the basis of its claim prior to September 2003 if it had been reasonably diligent.

[3] At the time the petition was filed, several courts of appeals had refused to read a discovery rule into Section 2462. For example, the D.C. Circuit held that a claim for civil penalties by the Environmental Protection Agency (the "EPA") accrued "when the factual and legal prerequisites for filing suit [we]re in place," not when the EPA discovered it. *See 3M Co. v. Browner*, 17 F.3d 1453, 1460 (D.C. Cir. 1994) (internal citations and quotation marks omitted). Similarly, the Fifth Circuit held that the Commerce Department could not bring a penalty claim for a violation of the anti-boycott provisions of the Export Administration Act more than five years after the last alleged wrongful act. *See United States v. Core Labs., Inc.,* 759 F.2d 480, 481-82 (5th Cir. 1985); *see also FEC v. Williams*, 104 F.3d 237, 240 (9th Cir. 1996); *United States v. Witherspoon*, 211 F.2d 858, 861-62 (6th Cir. 1954).

[3] (continued) The SEC argued that those cases were distinguishable because they did not involve fraud claims. The SEC further asserted that the one circuit court to consider Section 2462 in the context of a fraud claim had recognized a "special rule for fraud" and held that the SEC was not time-barred from pursuing a fraud claim based on conduct that had occurred more than five years before the SEC filed suit. *See SEC v. Koenig*, 557 F.3d 736, 739 (7th Cir. 2009). Even on the SEC's theory of what would constitute an actual split among the circuits on the issue, such a split developed shortly before the Court considered the petition for certiorari when the Fifth Circuit held, in a case involving claims by the SEC for fraud, that the discovery rule did not apply and that the statute of limitations ran from the date of the alleged violation. *See SEC v. Bartek*, No. 11-10594, 2012 WL 3205446, at *5 (5th Cir. Aug. 7, 2012).

[4] *See 3M Co.,* 17 F.3d at 1461.

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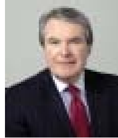
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