Supreme Court Adopts Strict Interpretation of the Statute of Limitations for SEC Civil Penalty Enforcement Actions

On February 27, 2013, the United States Supreme Court unanimously adopted a strict interpretation of the five-year period in which the Securities and Exchange Commission ("SEC") may seek to impose a civil penalty on a registered investment adviser. In *Gabelli v. SEC*, No. 11-1274, the Supreme Court made clear that when the government acts in an enforcement capacity seeking civil penalties, it cannot benefit from the more lenient "discovery rule" standard available to private plaintiffs. The *Gabelli* decision has broad implications for enforcement actions brought by the SEC and other federal agencies because the particular five-year statute of limitations at issue applies to a wide variety of civil fines and penalties.

The defendants in *Gabelli* were the portfolio manager of a mutual fund and the Chief Operating Officer of the fund's investment adviser. Between 1999 and 2002, the defendants allegedly allowed a fund investor to engage in "market timing" in the fund and then misrepresented that fact to the fund's board of directors and other investors. The SEC brought a civil suit seeking penalties against the defendants for aiding and abetting fraud in violation of the Investment Advisers Act of 1940. Although the SEC began its investigation in the fall of 2003, it did not file suit until April 2008.

The statutory provision at issue, 28 U.S.C. § 2462, provides that "[e]xcept as otherwise provided by Act of Congress," any action "for the enforcement of any civil fine, penalty, or forfeiture" must be "commenced within five years from the date when the claim first accrued." Based on that provision, the defendants moved to dismiss the SEC's claims for civil penalties on the ground that the statute of limitations had expired. The district court agreed and dismissed the case. The Second Circuit reversed, holding that the so called "discovery rule" – under which a cause of action sounding in fraud does not accrue until the plaintiff discovers the fraud – applied. Thus, the five-year clock did not begin ticking until the SEC had discovered its cause of action.

Reversing the Second Circuit, the Supreme Court held that the "discovery rule" did not apply to SEC enforcement actions seeking civil penalties. In its decision, the Supreme Court reasoned that the case was not a typical civil lawsuit for damages, but rather a government enforcement action intended to punish the defendant. In declining to apply the more lenient "discovery rule," the Court explained that the purpose of the "discovery rule" is to preserve the claims of victim-plaintiffs who, due to the self-concealing nature of the perpetrators' actions, reasonably do not know that they have been harmed. This purpose is not furthered where, the Court explained, "the Government is not only a different kind of plaintiff, it seeks a different kind of relief."

The Court stated, "the SEC's very purpose is to root [fraud] out, and it has many legal tools at hand to aid in that pursuit." Indeed, the Justices expressed concern during oral argument that adopting the more lenient "discovery rule" urged by the government would effectively abolish the statute of limitations in a broad set of cases, some of which were "quasi-criminal."

While on its face the *Gabelli* decision has broad implications for a variety of enforcement actions, there are some notable limitations. At oral argument, both Gabelli and the SEC agreed that the statute's five-year limitation period did not apply to equitable remedies such as disgorgement or injunctive relief, and the Supreme Court did not address actions for these other remedies in its decision. The decision also appears to leave the door open for the government to argue that the five-year period should be suspended where a defendant takes affirmative steps, beyond the actual fraud itself, to conceal the existence of the fraud and prevent the government from bringing a timely claim. The Court did not opine on whether such an argument would be successful, noting that the SEC had abandoned that argument. Significantly, the Court also distinguished cases where the government itself has been injured by the defendant's conduct, and implied that the "discovery rule" may apply in instances where the government stands in a different posture.

The implications of the Supreme Court's *Gabelli* decision will likely be sorted out by lower courts in the coming years. In the meantime, if you have any questions or would like to learn more about the issues raised by the Court's decision, please contact the Ropes & Gray attorney who usually advises you.

For the full text of the Supreme Court's decision in *Gabelli v. SEC*, please click here.