ARNOLD & PORTER LLP

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Supreme Court Holds "Discovery Rule" Does Not Apply to Statute of Limitations for Government Enforcement Penalty Actions

I. Executive Summary

On February 27, 2013, the Supreme Court decided *Gabelli v. Securities and Exchange Commission*,[1] holding that the "discovery rule" does not apply to the general statute of limitations for civil penalties, 28 U.S.C. § 2462 (Section 2462), in the context of an enforcement action by the Securities and Exchange Commission (SEC). In a unanimous decision, the Court rejected the SEC's argument that Section 2462's limitations period did not begin to run until the SEC discovered the alleged fraud.

Although the *Gabelli* decision clarifies when the SEC and other federal agencies must commence an enforcement action for penalties, it leaves unaddressed several questions regarding Section 2462's applicability. *Gabelli* expressly did not decide whether federal enforcement actions can seek to extend the limitations period by alleging equitable tolling theories, such as fraudulent concealment. Nor did *Gabelli* directly address what constitutes a "penalty" subject to Section 2462, as opposed to remedial or equitable relief considered outside of Section 2462's scope.

II. Background

Gabelli arose out of alleged market timing by investors in certain mutual funds. The SEC sued Marc Gabelli, the portfolio manager of the Gabelli Global Growth Fund (GGGF), and Bruce Alpert, the Chief Operating Officer of GGGF's investment advisor. The SEC alleged that the defendants granted an illegal *quid pro quo* to a GCCF investor by allowing it to engage in market timing if it promised to invest in a hedge fund run by Gabelli. Meanwhile, GGGF stated in its prospectus that it prohibited market timing.[2] The SEC alleged violations of the anti-fraud provisions of the Investment Advisers Act, 15 U.S.C. § 80b, and sought civil damages and injunctive relief.

The SEC alleged that the market timing took place between 1999 and 2002, but while the

1 No. 11-1274, 2013 WL 691002 (U.S. Feb. 27, 2013).

2 *See* Compl. at ¶¶ 20-29, *SEC v. Gabelli*, No. 08-civ-3868 (S.D.N.Y. filed Apr. 24, 2008).

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SEC began investigating in 2003, it did not file suit until April 24, 2008.[3] Defendants moved to dismiss the SEC's claim for civil penalties as untimely under Section 2462, which provides in relevant part that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." Specifically, defendants argued that the SEC's claim accrued no later than August 7, 2002, when the market timing at issue ceased. The SEC argued that under the discovery rule, the statute of limitations did not start to run until September 2003, when the SEC started investigating the matter. The district court dismissed the case, holding that the discovery rule did not apply, and that the SEC could not rely upon the fraudulent concealment doctrine to save its complaint because it failed to allege that defendants took "affirmative steps" to conceal their wrongdoing.[4]

The Second Circuit reversed, holding that when a case sounds in fraud "the discovery rule defines when the claim accrues and, correlatively, that the SEC need not plead that the defendants took affirmative steps to conceal their fraud."[5]

The defendants filed a petition for a writ of *certiorari*, which the Court granted on September 25, 2012.

III. The Supreme Court's Holding

The only issue before the Supreme Court was whether the five-year limitations period under Section 2462 accrues (a) at the date that the fraud occurs or (b) at the date that the SEC discovers the fraud.[6] In a unanimous decision written by Chief Justice Roberts, the Court reversed the Second Circuit's decision, offering four reasons why Section 2462's limitations period is not subject to the discovery rule in enforcement actions for civil penalties.

First, the Court reasoned that the discovery rule would be inconsistent with the plain and natural meaning of Section 2462, which says that an action to enforce civil fines, penalties, or forfeiture "shall not be entertained unless commenced within five years from the date when the claim first accrued." The Court contrasted Section 2462 with other federal statutes that expressly apply the discovery rule to the government.

Second, the Court explained that while the discovery rule had been applied to extend the statute of limitations in cases where civil plaintiffs sought remuneration, it was unwarranted in the enforcement context. The Court observed that "[u]nlike 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." The Court noted that the SEC has the powers to issue subpoenas, to compel the production of books and records or trading information, to pay monetary awards to whistleblowers, and to offer cooperation agreements to violators of the securities laws.

Third, the Court opined that the policy interests underlying limitation periods—including finality and repose, elimination of stale claims, and certainty about one's potential liabilities—were particularly strong in enforcement actions given the type of relief sought, in that the remedies sought in a civil penalty action "go beyond compensation, are intended to punish, and label defendants as wrongdoers."

Finally, the Court reasoned that applying a discovery rule to government penalty actions would enmesh lower courts in complex factual questions of when the government—whose "agencies often have hundreds of employees, dozens of offices, [and] several levels of leadership"—knew of the alleged misconduct.

IV. Implications

The *Gabelli* holding is not limited to SEC actions brought under the Investment Advisors Act; Section 2462 also applies when the SEC seeks penalties under the Securities Act or the Securities Exchange Act. Nor is *Gabelli* limited

3 During oral argument before the Supreme Court, the SEC explained that the timing of the filing of its complaint was due to settlement negotiations that resulted in a settlement with the fund, but not with the individual defendants. H'rg. Tr. at 37:18-25, *SEC v. Gabelli*, No. 11-1274 (U.S. Jan. 8, 2013).

4 *SEC v. Gabelli*, No. 08-civ-3868, 2010 WL 1253603, at *5 (S.D.N.Y. Mar. 17, 2010) (citing *3M Co. v. Browner*, 17 F.3d 1453, 1463 (D.C. Cir. 1994) and *SEC v. Jones*, 2006 WL 1084276, *6 (S.D.N.Y. Apr. 25, 2006)).

5 *SEC v. Gabelli*, 653 F.3d 49, 60 (2d Cir. 2011).

6 The application of fraudulent concealment or other equitable tolling principles was not at issue; the SEC abandoned reliance on such doctrines in its briefing to the Court. *See Gabelli*, 2013 WL 691002 at *4 n.2.

to SEC enforcement actions. Section 2462 is a statute of limitations with general applicability, and it therefore governs civil penalties sought by federal agencies under a wide range of statutes, such as consumer protection, environmental, and financial regulatory statutes. The *Gabelli* Court itself underscored that Section 2462 "is not specific to the Investment Advisers Act, or even to securities law; it governs many penalty provisions throughout the U.S. Code." Accordingly, *Gabelli* is important to businesses and individuals operating in a broad range of industries that face exposure to penalty actions brought by the government.

Yet *Gabelli*'s scope may be limited in several important respects. *First*, the Court suggested that the government might rely on the discovery rule when seeking remuneration for its own loss.

Second, Gabelli does not foreclose the SEC's ability to rely on other tolling doctrines. *Gabelli* does not address whether the fraudulent concealment doctrine, which tolls the "applicable limitations period when the defendant takes steps beyond the challenged conduct itself to conceal that conduct from the plaintiff," would apply to Section 2462's limitations period. Therefore, while the Court's reasoning may provide arguments against applying equitable tolling principles to at least certain civil penalty actions under Section 2462, *Gabelli* does not preclude the SEC or other enforcement agencies from invoking fraudulent concealment or other equitable tolling principles, or from arguing a continuing course of conduct.

Finally, Gabelli does not address the applicability of Section 2462 to claims for injunctive relief or disgorgement of ill-gotten monetary gains—actions in which the government seeks relief it characterizes as remedial or equitable, instead of punitive. Lower courts have noted that "the great weight of the case law" supports the proposition that "equitable remedies are exempted from section 2462's limitations period."[7] Although *Gabelli* did not address the applicability of Section 2462 to remedial or equitable relief, it did suggest that relief "which go[es] beyond compensation, [is] intended to punish, and label[s] defendants wrongdoers" would be considered "penalties" within the meaning of Section 2462. Nevertheless, the precise line between "equitable" and "remedial" relief, as opposed to "punitive" sanctions, remains an open question.

7 *See SEC v. Kelly*, 663 F.Supp.2d 276, 286-87 (S.D.N.Y. 2009).

Christopher S. Rhee and other Arnold & Porter attorneys represented amici curiae DRI – The Voice of the Defense Bar in Gabelli.

We hope that you have found this Advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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