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SEC Enforcement Actions After *Gabelli*

In the aftermath of the U.S. Supreme Court's Gabelli *ruling, the Court's reasoning may impact more SEC enforcement remedies than just civil monetary penalties.*

By John H. Sturc and Colin C. Richard

In *Gabelli v. SEC,*[1] the Supreme Court held that an action by the government seeking a civil money penalty must be commenced within five years of the alleged violation, regardless of the nature of the claim. Some observers, including some SEC staff members, have suggested that the Court's holding has a limited impact on potential enforcement actions and will be confined to civil money penalties, but a closer analysis suggests that the effect may be significantly broader.

The *Gabelli* Decision

In a 9-0 decision explained by an opinion by Chief Justice Roberts, the Court held that the five-year period in 28 U.S.C. § 2462's "catch-all" statute of limitations provision applicable to securities enforcement actions begins to run at the time an alleged violation occurs—not, as argued by the Securities and Exchange Commission (SEC or Commission), at the time it is discovered. It concluded that, in the civil monetary penalty context, an alleged fraud does not toll the operation of the statute.

The Decisions Below: S.D.N.Y. and the Second Circuit

Gabelli arose out of a SEC civil enforcement action filed in April 2008 against petitioners Bruce Alpert and Marc Gabelli, two employees of an investment adviser to a mutual fund, in the U.S. District Court for the Southern District of New York. The SEC alleged that the petitioners permitted one of the mutual fund's investors to engage in market timing in exchange for an investment in a separate hedge fund also managed by the adviser. The market timing and the *quid pro quo* transaction were allegedly not disclosed to the mutual fund's other investors who were prohibited from market timing. The complaint alleged violations of the anti-fraud provisions of the Investment Advisers Act of 1940. They were said to have occurred between 1999 and August 2002, more than five years before the complaint was filed.

The petitioners moved to dismiss, arguing, *inter alia*, that the penalties were barred by 28 U.S.C. § 2462, the "catch-all" statute of limitations applicable to many penalty provisions. It states:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or

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> forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

The District Court agreed with the Petitioners and dismissed the civil penalty claim, but the Second Circuit reversed, accepting the SEC's argument that the common law, equitable "discovery rule" should apply to this provision—that is, that the statute of limitations does not begin until the alleged fraud is, or could have reasonably been, discovered.

U.S. Supreme Court

The Supreme Court reversed. The Court explained that the petitioners' interpretation of the statute "is the most natural reading" of it,[2] emphasized the importance of the policies underlying statutes of limitations,[3] and dismissed the government's argument that the discovery rule should apply. While the Court acknowledged that equitable courts had developed and applied a discovery rule as an exception for defrauded parties who were prevented by a defendant's conduct from knowing of their injury, the Court stated that it had "never applied the discovery rule … [where] the Government [is] bringing an enforcement action for civil penalties."[4] Instead, the Court found that "[t]here are good reasons why the fraud discovery rule has not been extended to Government enforcement actions for civil penalties."[5]

First, the government is "a different kind of plaintiff."[6] The Court wrote that "the discovery rule exists in part to preserve the claims of victims who do not know they are injured … [because m]ost of us do not live in a state of constant investigation."[7] The law does not expect private citizens to continually investigate whether others are concealing frauds committed against them. On the other hand, "a central 'mission' of the Commission is to 'investigat[e] potential violations of the federal securities laws.'"[8] Such investigations are among the SEC's core functions, and the Court highlighted the SEC's examination authority, its investigative powers, and its more recently adopted whistleblower awards and cooperation agreements as extraordinary pre-litigation powers to collect information that distinguish the SEC from "the defrauded victim the discovery rule evolved to protect."[9] The Court reasoned that the SEC should not then also need the discovery rule.

Second, the government is seeking "a different kind of relief."[10] When a private citizen makes use of the discovery rule, it is to further the injured party's ability to gain compensation for the injury. The government instead seeks to punish the defendant by imposing penalties that go beyond compensation and "label defendants wrongdoers."[11]

Third, the Court focused on the difficulties of applying a discovery rule to the Government when many different decision makers may be involved, and different and separate agencies may have overlapping responsibilities.[12] Because determining when a government reasonably should have known of a claim also implicated decisions regarding the allocation of government resources and priorities and could also implicate privileges from disclosure that the government could assert,[13] the Court feared that a discovery rule would be difficult to apply.

Fourth, the Court cited the long-standing policy interest in ensuring that there are time limits on exposure to liabilities. If the Court were to permit the government's use of the discovery rule here, the Court noted that it effectively would be removing the protections of this statute of limitations.

The Court expressly noted that it was not considering the SEC's prayer for an injunction and disgorgement.[14] Because the SEC abandoned reliance on the fraudulent concealment doctrine or other equitable tolling principles in proceedings below, the Court also specifically noted that those issues "are not before us."[15] But Section 2462 has broad wording and applies to "any action, suit or proceeding for the enforcement of any civil fine, *penalty*, or forfeiture, pecuniary or *otherwise*."[16] Thus, the breadth of application leads to two questions: (1) how does the holding affect other doctrines, such as "fraudulent concealment" or "continuing violations"; and (2) how far does the *Gabelli* reasoning extend beyond monetary penalties to other civil enforcement remedies? These issues are discussed in the following sections.

Other Doctrines That May Delay the Statute of Limitations

Fraudulent Concealment

While *Gabelli* focused on the issue of when a claim accrues, the Court's reasoning has significant implications for the possible application of doctrines of equitable tolling, including fraudulent concealment. Several courts distinguish efforts constituting "fraudulent concealment" from the operation of the fraud itself,[17] noting that tolling under the discovery rule "presupposes that the plaintiff has discovered, or, as required by the discovery rule, should have discovered, that the defendant injured him, and denotes efforts by the defendant—above and beyond the wrongdoing upon which the plaintiff's claim is founded—to prevent the plaintiff from suing in time."[18] Thus, the date when a claim accrues determines when the limitation period beings, while fraudulent concealment could theoretically operate to suspend the running of the limitations period.

In *SEC v. Wyly,* and before the *Gabelli* Supreme Court decision, a district court applied the doctrine of fraudulent concealment in denying the defendants' motions to dismiss. After *Gabelli*, and in response to a renewed motion to dismiss, the SEC has argued that "[t]he two issues are quite distinct. Ruling that a cause of action 'accrues' when the acts creating the cause of action are completed, regardless of when they are discovered, says nothing about whether equity will toll a statute of limitations when a defendant separately engages in affirmative acts of concealment."[19] In evaluating the Commission's position on fraudulent concealment, courts may need to weigh a variety of considerations. In *Gabelli*, the Court noted four reasons not to imply a discovery rule for Section 2462, as discussed above.[20] These considerations may apply to a possible interruption of the limitations period by a claim of fraudulent concealment, although in the *Wyly* case, the SEC contended that the defendants had sought to conceal their acts from the SEC itself.

Other aspects of the Court's reasoning also may be considered in weighing an assertion of fraudulent concealment. The Court's analysis rested on a "natural" and textual reading of Section 2462.[21] Congress has provided only two exceptions to the five-year period set forth in Section 2462: "(1) where the 'offender or the property' is not 'found within the United States in order that proper service may be made thereon'; and (2) '[e]xcept as otherwise provided by an Act of Congress.'"[22] Elsewhere, the Court has held that "[w]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent."[23] And, in concluding its *Gabelli* opinion, the Court wrote "cases in which 'a statute of limitations may be suspended by causes not mentioned in the statute itself … are very limited in character, and are to be admitted with great caution; otherwise, the court would make the law instead of administering it.'"[24] Since Congress considered and adopted exceptions to the limitations period, courts may not wish to adopt an exception that is not contained in the statute.

The Continuing Violation Doctrine

On occasion, both the government and other litigants have asserted that a claim based on facts occurring before the limitations period is nevertheless viable because of the continuing violation doctrine under which a plaintiff claims that discrete unlawful acts, some of which are time barred, are a part of a continuing unlawful practice which extended into the limitations period and which may therefore be pursued.[25]

Prior to *Gabelli,* courts have suggested that whether a particular securities law violation is a continuing violation turns on the plain language of the statute or whether the nature of the particular violation is such that Congress must have intended that it be treated as a continuing one.[26] Thus, whether an otherwise stale claim may be saved by this doctrine turns on the elements of the alleged violation and the facts at issue. The United States District Court for the District of Columbia has recently found that the Court of Appeals for the D.C. Circuit had not considered whether the doctrine can be applied to securities claims, and that "[d]istrict courts in the Second and Third Circuits have indicated great skepticism that it does."[27]

On the other hand, one district court judge in the Southern District of New York applied the continuing violation doctrine to an SEC enforcement action.[28] The district court for the Northern District of California though, in discussing the SEC's reliance on *Kelly*, clarifies that "the application of the [continuing violation] doctrine to Section 2462 has been questioned."[29] A district judge in the Eastern District of Virginia concluded that, for purposes of a criminal securities case, each sale made as part of a pattern of a fraudulent distribution was a separate violation and not subject to the continuing violation doctrine.[30] Although the *Gabelli* decision does not bear directly on the continuing violation doctrine, the Court's emphasis on the social values underlying repose and its caution against judicial expansion of limitations periods suggest that courts may become cautious in the application of that doctrine.

Implications of *Gabelli* for Other Enforcement Remedies

The Court in *Gabelli* focused solely on civil monetary penalties; additional remedies initially sought by the SEC—an injunction and disgorgement—were not before the Court.[31] But the SEC has a panoply of other sanctions which it may seek or impose—injunctions, cease and desist orders, censures and limitations on the ability of persons to associate with registered entities, limitations on a person's ability to serve as an officer or director of a public company, and the ability to practice and appear as a professional before the Commission. Recently, several courts have found that, as applied to older cases, these remedies too are punitive and are subject to the five year bar of Section 2462.

Suspensions

Long before the *Gabelli* decision, the United States Court of Appeals for the District of Columbia held that an administrative censure and six-month suspension from acting as a supervisor in a brokerage firm were barred by Section 2462 because they were a "form of punishment imposed by the government for unlawful or proscribed conduct which goes beyond remedying the damage caused to the harmed parties by the defendant's actions."[32] In the wake of the *Johnson* decision, the Commission dismissed two pending Rule 102(e) proceedings initiated more than five years after the alleged violations, albeit without deciding the limitations issue.[33] And, while the authority is split, even before *Gabelli,* several courts have expressed doubt about granting an officer and director bar in an action commenced more than five years after the violation.[34]

Injunctive Relief

Injunctions are expressly intended to be remedial rather than a penalty. But, years after the events, an injunction may be ill-suited to protect investors and but still carry collateral consequences which can have punitive effects. Accordingly, several recent decisions have deemed such requests as also barred by Section 2462.[35]

Conclusion

While some may suggest that the *Gabelli* decision was a setback for the government, in the long run, the result may prove beneficial. One of the SEC's key missions is to protect investors from current and ongoing violations. While Congress has determined that it should also have some expressly punitive sanctions, their principal effect is deterrence of others. As a former SEC Enforcement Director observed, enforcement should be strategic, swift, smart and successful.[36] Those objectives are best achieved by focusing attention and resources on investigations of recent matters that may have an ongoing effect on investors.

Notes

1. 568 U.S. ___ (Feb. 27, 2013).
2. *Gabelli v. SEC*, 568 U.S. _, 4 (2013).
3. *Id.* at 7-10.
4. *Id.* at 2.
5. *Id*. at 7.
6. *Id*. at 8.
7. *Id*. at 7.
8. *Id*. at 8.
9. *Id*.
10. *Id*.
11. *Id.* at 2.
12. *Id.* at 9-10.
13. *Id.* at 10.
14. The District Court dismissed the injunctive relief claim because the SEC "ha[d] not plausibly alleged that Defendants are reasonable likely to engage in future violations.'" *SEC v. Gabelli*, No. 08 Civ. 3868 (DAB), 2010 WL 1253603, at *11 (S.D.N.Y. Mar. 17, 2010). The Second Circuit notes that then, "[b]elieving that disgorgement would not provide significant relief, the SEC moved to voluntarily dismiss the remaining [disgorgement] claim without prejudice to the SEC's refiling this claim if, but only if, the SEC were successful in this appeal. The District Court granted the motion over the defendants' objections and entered judgment accordingly." *Gabelli*, 653 F.3d at 56.
15. *Gabelli*, 568 U.S. at 4, n.2 (2013).
16. 28 U.S.C. § 2462 (emphasis added).
17. *See, e.g.*, *Gabelli*, 653 F.3d at 59 ("As an initial matter, we note that Gabelli's latter argument reflects the all-too-common mistake by which the discovery rule is 'sometimes confused with the concept of fraudulent concealment of a cause of action,' *see Pearl v. City of Long Beach*, 296 F.3d 76, 80 (2d Cir. 2002), and we take this opportunity to once again clarify that these two doctrines are distinct."); *SEC v. Wyly*, 788 F. Supp. 2d 92, 104, n.78 (S.D.N.Y. Mar. 31, 2011) ("Equitable estoppel in the limitations setting is sometimes called fraudulent concealment, *but must not be confused with efforts by a defendant in a fraud case to conceal the fraud* ").
18. *Wyly*, 788 F. Supp. 2d 92, at 104, n.78.
19. "Plaintiff Securities and Exchange Commission's Memorandum of Law in Opposition to Defendants' Consolidated Motion for Partial Summary Judgment," *SEC v. Wyly*, Case 1:10-cv-05760-SAS, 3 (Apr. 4, 2013).
20. *Gabelli*, 568 U.S. at 7-9; *see also supra*, pp.2–3.
21. *See id.* at 4.
22. "Defendants' Joint Motion for Partial Dismissal of the SEC's Amended Complaint," *SEC v. Jackson*, Case 4:12-cv-00563, 10 (Feb. 22, 2013).
23. *TRW Inc. v. Andrews*, 534 U.S. 19, 28 (2001).
24. *Gabelli*, 568 U.S. at 11 (quoting *Amy v. Watertown (No. 2),* 130 U.S. 320, 234 (1889)).
25. *See National Railroad Passenger Corporation v. Morgan*, 536 U.S. 101, 117-118 (2002).
26. *United States v. Harris*, 2013 WL 325610 (E.D. Va. Jan. 29, 2013), citing *Toussie v. United States,* 397 U.S. 112 (1970) (holding that the statute of limitations for failure to register for the draft began to run on the date when registration was first required and was not extended by a continued failure to register over several years) and *United States v. Smith,* 373 F.3d 561 (4th Cir. 2004) (embezzlement scheme may be a continuing offense).
27. *SEC v. Brown*, 740 F. Supp. 2d 148, 158–59 (D.C. 2010).
28. *See, e.g.*, *SEC v. Kelly*, 663 F. Supp. 2d 276, 287–88 (S.D.N.Y. 2009) (holding that a continuous accounting scheme to inflate revenue can fit within the continuing violation doctrine).
29. *SEC v. Leslie*, Case No. C 07-3444 (N.D.CA July 29, 2010).
30. *Harris*, 2013 WL 325610.
31. *See supra*, n.14.
32. *Johnson v. SEC,* 87 F.3d 484, 488 (D.C. Cir. 1994).
33. *See In Re Stayner,* 67 SEC Docket 282, 1998 WL 42127 (1998); *In Re Dana*, 64 SEC Docket 720, 1997 WL 197555 (1997).

34. *SEC v. DiBella,* 409 F. Supp. 122, 128 (D. Conn. 2004) (director and officer bar is a penalty); *SEC v. Brown, supra* (whether bar is a penalty depends on the facts); *Brown*, 740 F. Supp. 2d at 159 (deferring decision on application of Section 2462 until a factual record is developed); *cf., e.g., SEC v. Schiffer,* 1998 US Dist. LEXIS 6339, *8 (SDNY, 1998) (director and officer bar may be an equitable remedy).

35. *See, e.g., SEC v. Bartek,* 484 F. App'x 949, 956–57 (5th Cir. 2012), *aff'g. SEC v. Microtune, Inc.,* 783 F. Supp. 2d 867, 886 (N.D.Tex. 2011); *SEC v. Jones,* 476 F. Supp. 2d 374, 383–85 (S.D.N.Y. 2007).

36. "Testimony Concerning Strengthening the SEC's Vital Enforcement Responsibilities," Robert Khuzami, U.S. Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance, and Investment (May 7, 2009).

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