

## High court limits SEC's time to seek civil penalties

By: Zoe Tillman – February 27, 2013

---

In seeking civil penalties for fraud, the U.S. Securities and Exchange Commission must bring an enforcement action within five years of the alleged misconduct, a unanimous U.S. Supreme Court ruled on Wednesday. The court rejected the SEC's argument that the clock should start running from the date the fraud was discovered, or at least could have been discovered.

The five-year statute of limitations applies to a variety of enforcement actions across the federal government involving civil penalties, so the ruling is expected to affect how other agencies bring these types of cases as well.

The SEC argued that in fraud cases, what's known as the "discovery rule" should apply because a defendant's deception can sometimes keep a plaintiff from learning about the bad acts. But Chief Justice John Roberts Jr., ruling in *Gabelli v. SEC*, said that the rule didn't apply because the government isn't an ordinary plaintiff.

"The SEC's very purpose, for example, is to root out fraud, and it has many legal tools at hand to aid in that pursuit," he wrote, adding that in these enforcement actions the government is seeking civil penalties to punish wrongdoing and chastise bad actors, while nongovernment plaintiffs are typically seeking compensation for a direct injury.

Lewis Liman of Cleary Gottlieb Steen & Hamilton represented two men sued over alleged fraud by the SEC: Bruce Alpert and Marc Gabelli. In a statement today, Liman said that they were "gratified that the Court has upheld the plain language of the statute and affirmed a bright-line standard for the time the government has to bring a civil penalty action." An SEC spokeswoman said the agency is reviewing the decision. Assistant to the Solicitor General Jeffrey Wall argued for the government.

Eugene Goldman, a partner at McDermott, Will & Emery and former SEC senior counsel, said the ruling would likely force the agency to speed up its time frame for making decisions about whether to bring enforcement actions involving civil penalties. But he added that it also opened the door to litigation over which sanctions the ruling would apply to, beyond straightforward monetary penalties.

The SEC brought a civil enforcement action against Alpert and Gabelli in 2008; Alpert is chief operating officer of Gabelli Funds LLC, which served as an investment adviser to a mutual fund, and Gabelli was the fund's portfolio manager until 2004.

The SEC claimed that they allowed one of the fund's investors, Headstart Advisers Ltd., to do "market timing," a trading strategy that exploits a time delay between when securities are actually traded and when investors get a report on a mutual fund's valuation. The agency claimed that, in exchange, Headstart invested in a hedge fund that

Gabelli ran, and that Alpert and Gabelli did not disclose the arrangement. Such a practice can hurt long-term investors. Alpert and Gabelli denied any wrongdoing.

Albert and Gabelli argued that the SEC action was time-barred. The agency alleged misconduct through August 2002 but didn't file its case in the U.S. District Court for the Southern District of New York until April 2008—more than six years later. The district court judge agreed and dismissed the case. But the U.S. Court of Appeals for the Second Circuit reversed that ruling, siding with the SEC and finding that because the underlying case involved allegations of fraud, the "discovery rule" applied.

Roberts wrote that counting down five years from when the alleged fraud took place was "the most natural reading of the statute." Although the exception that allowed plaintiffs to start the clock from when they discovered or could have discovered the fraud dates back to the 18th century, Roberts said the court had never applied it to a government agency seeking civil penalties.

Unlike individual victims who may only learn about fraud once they've been injured, the court noted that the government actively works to uncover and root out that type of bad behavior. As a result, Roberts said, agencies don't need the extra time cushion. Applying the rule to the government "would leave defendants exposed to Government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future," he wrote.

Hunton & Williams partner Scott Kimpel, a former SEC official, said the ruling was expected, since the justices seemed "hostile" to the government's position during oral arguments. "The view expressed by the court that the government is in a different position than a private litigant seems to make eminent sense from a public policy perspective," he said.

Brian Murray, a partner at Jones Day who wrote an amicus brief in the case for the Cato Institute, said the decision was important because it could affect a variety of enforcement actions where civil penalties are at play, such as under the Clean Air Act or Clean Water Act. "Our clients, rather than having to preserve documents for 10 or 20 or 30 years ... they'll have the certainty of knowing that at five years, they're not at risk anymore," he said.