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Supreme Court defines time limits for SEC to pursue civil cases

By Dina ElBoghdady February 27 2013

The Securities and Exchange Commission suffered a legal blow Wednesday when the Supreme Court unanimously rejected the agency's position on how much time regulators have to pursue civil penalties.

In Gabelli v. SEC, two officials at the Gabelli Fund argued that the SEC waited too long to bring a civil case accusing them of authorizing an improper trading technique.

The high court agreed, ruling that the SEC must act within five years of a violation taking place. The SEC argued that time runs out five years after the alleged fraud was discovered. Lower courts were split on when the clock starts ticking.

The Supreme Court's decision has significant implications for cases stemming from the 2008 financial crisis, attorneys said. If the court had accepted the SEC's interpretation on timing, it could have potentially revived dead or dying cases.

"Those concerned about possible SEC enforcement proceedings tied to the credit crisis are probably breathing a sigh of relief now or anxiously watching the clock on the five years," said Britt Latham, a lawyer at Bass, Berry & Sims in Nashville.

The impact of the decision will be felt in other parts of the government that pursue civil penalties for anything from housing discrimination to improper discharge of pollution, said Brian Murray, a lawyer at Jones Day in Chicago.

"There are a spate of cases across the country under the Clean Air Act where the government has waited a decade or more to bring a lawsuit," said Murray, who filed an amicus brief in the case on behalf of the Cato Institute.

In Wednesday’s opinion, written by Chief Justice John G. Roberts Jr., the court said cases dating back to the 19th century support the idea that the five-year clock starts when a violation takes place, not when it’s discovered. The discovery rule applies only to victims of fraud who may not immediately realize they were defrauded, the opinion said.

The “government is a different kind of plaintiff,” the court concluded. “The SEC’s very purpose, for example, is to root out fraud,” and it has many tools at its disposal, the court said. A defendant should not be left in limbo for an uncertain period, it said.

Determining when the government discovered or should have discovered a fraud is difficult — agencies are sprawling entities with layers of leadership. Sometimes, different agencies have overlapping responsibilities. “Who is the relevant actor?” the opinion said.

Lewis Liman, who represented Marc Gabelli and Bruce Alpert, said his team was gratified by the decision. Gabelli and Alpert have denied any wrongdoing and said that the trading activity targeted by the SEC was not illegal.

John Nester, an SEC spokesman, said the agency is reviewing the decision. “But we do not expect an immediate impact on our ability to successfully hold violators accountable for their misconduct,” Nester said.

The decision applies to civil penalties only. The SEC can still order violators to pay back ill-gotten gains or refrain from taking part in certain activities. Also, when it is up against a deadline, the alleged violators often agree to waive the five-year limit at the SEC’s request.

“The court also left open whether the SEC can pursue financial penalties after five years when violators have taken steps to conceal their illegal conduct,” Nester said.