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CLIENT ALERT

Supreme Court Rejects SEC's Ability to Seek Civil Penalties More than Five Years after an Alleged Fraud

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Earlier this week, the U.S. Supreme Court unanimously rejected the Securities and Exchange Commission's argument that the five-year statute of limitations period in 28 U.S.C. § 2462—the default limitations provision that governs civil penalties—begins to run when the fraud is discovered, not when the underlying violation occurred. *Gabelli v. Securities and Exchange Commission* (Feb. 27, 2013). The Court held that the discovery rule, which tolls the statute of limitations when a defendant's fraud prevents the plaintiff from realizing the injury, does not apply to government enforcement actions for civil penalties.

In *Gabelli*, the SEC filed fraud charges against individual defendants based on allegations of market timing. Although the SEC alleged violations from 1999 through August 2002, it did not file its complaint until April 2008, well after the five-year statute of limitations had lapsed. In an opinion by Chief Justice Roberts, the Court soundly rejected the SEC's request to apply the discovery rule, holding that "the five-year clock begins to tick [] when a defendant's allegedly fraudulent conduct occurs." The Court stressed that the "SEC as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect" and recognized that, as a practical matter, the limitations period should not depend on the speculative nature of when a government agency—"with hundreds of employees, dozens of offices, and several levels of leadership"—knows or should know of a violation.

The Court's *Gabelli* decision may serve as a wake-up call to the SEC to hone and accelerate its investigation and enforcement practices. It may also have the immediate effect of increasing the number of SEC Staff requests for tolling agreements. In addition, the Court's decision will likely cause certain SEC inquiries to end with no enforcement action at all, given their age and investigative pace. Notably, the *Gabelli* decision only addresses civil monetary penalties and does not affect the SEC's other enforcement tools, such as injunctions and other forms of equitable relief.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Thomas A. Hanusik
Partner – Washington, D.C.
Phone: +1.202.624.2530
Email: thanusik@crowell.com