haynesboone
Setting precedent.

Haynes and Boone's Newsroom

Supreme Court Limits Government's Ability to Seek Civil Penalties on Stale Claims

02/28/2013

Ronald W. Breaux, Jeremy D. Kernodle, Emily Westridge Black

The United States Supreme Court yesterday significantly limited the federal government's ability to bring an action for civil penalties more than five years after the alleged misconduct occurred. In *Gabe v. Securities and Exchange Commission*, the Court held that the five-year limitations period governing most enforcement actions begins to run when the underlying violation occurred – not when the government discovered the violation. Writing for a unanimous Court, Chief Justice John Roberts note that this interpretation was "the most natural reading" of the statute and advanced "the basic polici of all limitations provisions: repose, elimination of stale claims, and certainty about a plaintiff's opportunity for recovery and a defendant's potential liabilities." The ruling will have a significant impa on the SEC and other agencies with civil enforcement power.

The Limitations Period

Many agencies – including the SEC, the Department of Justice, the Federal Trade Commission, the Environmental Protection Agency, the Department of Health and Human Services, and the Social Security Administration – are empowered to seek civil penalties for statutory or regulatory violations Unless another statute provides otherwise, these actions are subject to the "catch-all" federal limitations statute, 28 U.S.C. § 2462, which provides that:

> [A]n 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 if, within the same period, the offender or the property is fou within the United States in order that proper service may be made thereon.

The critical question addressed by *Gabelli* is when does a claim "first accrue?"

The Facts of *Gabelli*

The SEC alleged in *Gabelli* that from 1999 until 2002 the COO and manager of Gabelli Funds had allowed an investor to engage in undisclosed "market timing," and brought suit for civil penalties. However, the SEC did not file its complaint until 2008 – more than five years after the alleged misconduct. The defendants moved to dismiss the complaint, arguing that the Commission's claims were barred by Section 2462. The district court agreed and dismissed the case.

The Second Circuit reversed, adopting the SEC's position that the discovery rule applies to extend th limitations period in cases "that sound in fraud." As the court explained, "[u]nder the discovery rule, statute of limitations for a particular claim does not accrue until that claim is discovered, or could hav been discovered with reasonable diligence, by the plaintiff."

The Supreme Court's Ruling

A unanimous Supreme Court reversed, holding that in all cases, including those involving fraud allegations, claims accrue under Section 2462 when the alleged misconduct occurs. The Court noted that this is "the most natural reading" of Section 2462 and is consistent with the "standard rule" tha claim accrues when the plaintiff has a complete cause of action. In addition, the rationale underlying the discovery rule – preserving the claims of victims "who do not know they are injured and who reasonably do not inquire as to any injury" – is inapplicable in enforcement actions where injury is of irrelevant. A discovery rule, moreover, would leave defendants exposed to punishment for an uncert and lengthy period. The Court found this not only "repugnant to the genius of our laws," but unworkable because it would require courts to determine when "the Government" knew or should h known of a violation.

These are the same arguments that Haynes and Boone made to the Fifth Circuit last year in persuac that court to rule in favor of its client. *See SEC v. Microtune*, 783 F. Supp. 2d 867 (N.D. Tex. 2011), *aff* 484 Fed. Appx. 949 (5th Cir. 2012).

Significant Changes in SEC Practice?

The *Gabelli* decision will impact the SEC's enforcement program in a number of ways. First, the SEC w clearly have to move more quickly on its investigations as it will no longer be able to argue that the discovery rule saves its stale claims. This will probably lead SEC enforcement attorneys to investigat and decide to file or decline cases within five years of the alleged misconduct. We suspect that the S may not pursue a number of cases simply because they involve conduct more than five years old.

Second, this ruling may provide an opportunity for both the Commission and defense counsel to resc some old matters that are either close to or beyond the five-year limitations period through declinations or negotiated resolutions. This may be particularly important in investigations resulting from the financial crisis of 2008, since the five-year limitations period on those actions will run this ye

Finally, we expect that SEC lawyers may request tolling agreements more frequently than in the pas Defense counsel will have to carefully consider how likely the Commission is to file suit if they refuse such agreements. Among other things, counsel should consider whether the SEC has enough information to persuade the Commission to authorize a lawsuit at that time. Haynes and Boone attorneys have extensive experience – from the defense and the government sides – with these an other issues that arise in the course of SEC enforcement actions.

A copy of the *Gabelli* opinion can be found **here**. Copies of the *Microtune* opinions can be found **here** **here**.

If you have any questions, please contact one of the attorneys listed below.

Ronald W. Breaux
214.651.5688
ron.breaux@haynesboone.com

Lawrence A. Gaydos
214.651.5622
larry.gaydos@haynesboone.com

Kit Addleman
214.651.5783
kit.addleman@haynesboo

Jeremy D. Kernodle
212.659.5159
jeremy.kernodle@haynesboone.com

Emily Westridge Blac
214.651.5221
emily.black@haynesboon