Akin Gump
Strauss Hauer & Feld LLP

Litigation Alert

Supreme Court to Decide Potential Landmark Case on Application of Statute of Limitations to SEC Civil Penalties

October 3, 2012

On September 25, in *Gabelli, et al. v. Securities and Exchange Commission*, No. 11-1274, the U.S. Supreme Court announced that it had agreed to determine whether the "discovery rule," the concept that a statute of limitations is tolled until the underlying harm is discovered, applies to Securities and Exchange Commission (SEC) enforcement actions seeking civil penalties. The Court agreed to hear the appeal of two executives at Gabelli Funds LLC, against whom the SEC brought an enforcement action under the Investment Advisers Act, alleging that the executives committed fraud between 1999 and 2002 by permitting a customer to engage in exclusive market-timing in a Gabelli-managed mutual fund in exchange for investments in other Gabelli funds. The Second Circuit ruled that the SEC's action was not time-barred under 28 U.S.C. § 2462, which requires an action for civil penalties to be commenced within five years of the date when the claim "first accrued." Relying largely on the Court's recent decision in *Merck & Co. v. Reynolds*, 130 S. Ct. 1784, 1793-94 (2010), which applied the discovery rule to determine the timeliness of private securities fraud actions under 28 U.S.C. § 1658(b)(1), the Second Circuit found that because the SEC's claim under the Investment Advisers Act "sounds in fraud," the claim necessarily involves self-concealing conduct and implicates the discovery rule. Thus, under the Second Circuit's ruling, the five-year statute of limitations as to civil penalties did not begin to run until the SEC discovered or should have discovered the fraud.

The Court's decision is likely to decide this discovery rule question that has divided the courts of appeals. The Second Circuit's decision in *Gabelli* is consistent with several other Circuit court decisions—*e.g., SEC v. Tambone*, 550 F.3d 106, 108 (1st Cir. 2008); *SEC v. Diversified Corp. Consulting Group*, 378 F.3d 1219 (11^{th} Cir. 2004); *SEC v. Rind*, 991 F.2d 1486, 1490-91 (9th Cir. 1993). However, the Fifth Circuit's recent decision in *SEC v. Bartek*, No. 11-10594 (5th Cir. Aug. 7, 2012), called these decisions into question by ruling that the plain language of § 2462, which does not reference the discovery rule, precludes application of such tolling. The Fifth Circuit rejected the SEC's argument (accepted in *Gabelli*) that the discovery rule automatically applies to all fraud-based claims, and distinguished *Merck* because the relevant statute at issue there—28 U.S.C. § 1658(b)(1)—specifically sets out a discovery rule. Defining "accrued" as the date of the violation, the Fifth Circuit found that the discovery rule did not apply to extend the SEC's time to seek civil penalties, including an injunction and an officer and director bar against two executives. Thus, the Court's decision will likely resolve this recent Circuit split as to the application of the discovery rule.

Of course, whichever way the Court decides, the SEC may still invoke the separate, but harder to prove, concept of fraudulent concealment to toll the statute of limitations. But addressing application of the discovery rule to § 2462 will have important consequences by clarifying whether the SEC may reach beyond the five-year limitations period and seek penalties for much older conduct by simply alleging a violation of one of the multiple antifraud provisions of the securities laws. Especially as the five-year anniversary of various key events of the financial crisis looms in 2013, this decision is likely to have a major impact on the SEC's upcoming enforcement actions.

www.twitter.com/akin_gump

CONTACT INFORMATION

If you have any questions concerning this alert, please contact—

Patricia Millett
pmillet@akingump.com
202.887.4450
Washington, D.C.

Patrick O'Brien
pobrien@akingump.com
214.969.4727
Dallas

Mary O'Connor
moconnor@akingump.com
214.969.2818
Dallas