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The past is never DEAD

Should the SEC be able to bring suit for as long as it failed to 'discover' alleged misconduct, no matter how ancient?

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A company's general counsel calls her outside counsel, saying that she fears a U.S. Securities and Exchange Commission investigation of her company. An employee committed wrongdoing six years ago, she says, and although the employee apparently took no particular action to cover it up, nobody discovered the wrongdoing until today.

Her outside counsel might tell her not to worry: The statute of limitations for SEC actions is five years, so any SEC action seeking civil penalties is time-barred.

Before the decision by the U.S. Court of Appeals for the Second Circuit in *SEC v. Gabelli*, her outside counsel would have been right.

If the U.S. Supreme Court affirms the Second Circuit's expansive interpretation of the statute of limitations applicable to the SEC, the SEC will be empowered to commence actions seeking civil penalties for as long as it failed to "discover" alleged misconduct, no matter how ancient the misconduct is.

Moreover, while the impact of *Gabelli* on SEC actions is obvious, the statute in question applies to all federal agency actions seeking civil penalties, unless Congress specifically states otherwise. Thus, the potential fallout is far broader.

In *SEC v. Gabelli*, 653 F.3d 49 (2d Cir. 2011), the Second Circuit considered when an action "accrues" under 28 U.S.C. 2462, which states that, except as otherwise provided by Congress, administrative agencies have five years from "the date when the claim first accrued" to commence any action seeking civil fines, penalties, or forfeitures.

In *Gabelli*, the allegedly wrongful acts ended in August 2002. The SEC filed the civil action in April 2008, claiming to have discovered the acts only in late 2003. If the claim accrued in 2002, when the acts took place, the claim was time-barred. However, if the claim accrued when the SEC "discovered" the acts in 2003, the limitations period had not yet expired.

The Second Circuit held that because the allegations sounded in fraud, the discovery rule delays accrual of the cause of action "until the plaintiff has 'discovered' it, or in the exercise of due diligence, should have discovered it." Even though "Section 2642 does not expressly state a discovery rule… for claims that sound in fraud[,] a discovery rule is read into the relevant statute of limitations." Thus, the court determined, the SEC has five years from its discovery of the wrongdoing to initiate the action.

The Second Circuit distinguished the discovery rule, which deals with claims that "by their very nature involve self-concealing conduct," from the well-established fraudulent-concealment doctrine, under which claims are equitably tolled when "the defendant took specific steps to conceal her activities from the plaintiff." But fraudulent concealment is not at issue before the Supreme Court—only the "discovery" rule.

THE DISCOVERY RULE AND THE SEC

The discovery rule sensibly applies in cases brought by private plaintiffs, who are not charged with enforcing laws or performing the investigatory work necessary to do so. Private citizens need not live their lives constantly checking whether any person, anywhere, has caused them harm about which they might not yet know.

But it is another matter to allow the discovery rule to be the default for government action. Administrative agencies have affirmative obligations to provide oversight and regulation. As the SEC describes, its mission "is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." It cannot do so without diligently overseeing and investigating those markets.

The Second Circuit's reading of Section 2642 would give the SEC a free pass. Without a looming limitations period, the SEC could ignore warning signs of wrongdoing, knowing that if it later "discovers" the wrongdoing, it will then have five more years to decide whether to commence an action. Such a rule risks incentivizing the SEC not to investigate a matter until it is good and ready. In the wake of Bernie Madoff, the mortgage-backed securities fraud settlements, insider trading scandals and fallout from the financial crisis of 2007-2008, few would argue that a slower, less watchful SEC should be a national priority.

Allowing the SEC a "discovery" rule also would be acutely unfair to individuals and organizations in the securities industry, for whom there could never be any finality.

Before *Gabelli*, the discovery rule was rarely, if ever, applied to Section 2462. Many circuit courts that have considered the discovery rule in this context have rejected it, including a recent Fifth Circuit decision, which (contrary to *Gabelli*) held that Section 2462 does not include a discovery rule. Although some lower federal courts have inferred a discovery rule when a statute of limitations is silent, the Supreme Court has rejected the general application of an implied discovery rule.

The circuit split alone is enough to raise interest at One First Street. But the federal significance here goes beyond that split. Unless carefully cabined, a Supreme Court decision siding with the SEC could make the discovery rule universally applicable in Section 2462 cases, unleashing an avalanche of unintended consequences.

THE BROADER CONTEXT

Section 2462 is explicit: Unless Congress sets forth a different limitations period, the five-year period applies to any administrative action seeking civil fines, penalties or forfeitures. In many cases Congress has created an exception: Section 2462 does not apply to taxpayers who falsify a tax return, for example, because Internal Revenue Code Section 6501 sets forth a different limitations period.

But in many cases Congress has not specified a different period, and future legislative action on this point is hardly guaranteed. So Section 2462 applies (and will likely continue to apply) to many administrative actions seeking civil penalties in court or in administrative proceedings, making *Gabelli* broadly relevant to the entire federal government.

How broadly? Section 2462 applies to the U.S. Department of Justice in civil actions such as forfeiture actions. It applies to the Environmental Protection Agency in bringing actions under the Toxic Substances Control Act, Clean Air Act, Clean Water Act and Energy Policy and Conservation Act. It applies to the Department of Transportation in bringing actions under the Federal Aviation Act, and to the Federal Trade Commission in bringing certain actions under the Clayton Act and Federal Trade Commission Act. It affects a slew of professionals, because it applies to the IRS Office of Professional Responsibility in bringing disciplinary proceedings against tax professionals, to the Federal Deposit Insurance Corp. in expelling bankers from the industry, and to the Patent and Trademark Office in excluding attorneys from practicing before it.

If the Second Circuit's decision in *Gabelli* is broadly upheld, all of these agencies (and more) would be free to "discover" wrongdoing years after it occurred, and then seek civil penalties. Finality would become illusory across a broad swath of the economy, eviscerating the very purpose of a federal statute of limitations.

The pernicious effects could reach to quite unexpected and unwelcome places. Historically, courts have rejected the "discovery rule" in Federal Election Commission actions for campaign finance violations. But if the Supreme Court broadly upholds *Gabelli*, the FEC would be permitted to "discover" that a politician committed campaign finance fraud any number of years ago, and launch civil actions accordingly. The FEC is structured to be politically balanced—no more than three commissioners from the same political party, and four votes are required for an official action. But if just one commissioner crossed party lines, a future FEC could "discover" wrongdoing relating to Paul Ryan's campaign for the House of Representatives in 1998, or Nancy Pelosi's House campaign in 1987. The potential for abuse is acute.

In 1805, Justice John Marshall wrote that it would be "utterly repugnant to the genius of our laws" to allow the government to have no statute of limitations for a penalty action, when "not even treason can be prosecuted after a lapse of three years." His wisdom should guide the Supreme Court today.

The court should reject the notion of an unwritten "discovery rule" in Section 2462. Congress has dictated that if administrative agencies, which should actively monitor their regulatory terrain, fail to notice wrongdoing for five years, no civil penalties may be assessed. If the Supreme Court does affirm the Second Circuit, it should do so narrowly, confining its ruling to SEC actions involving fraud. Otherwise the court may unwittingly let loose a flood of claims by the federal government that should have been brought—or laid to rest—long ago.

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