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Supreme Court: SEC Must File Enforcement Actions Within Five Years of Alleged Fraud

On Wednesday, February 27th, the Supreme Court ruled that the U.S. Securities and Exchange Commission must file enforcement actions within five years of an alleged fraud, and is not entitled to the same right to a discovery tolling of the statute of limitation as private citizens.

In *Gabelli v. Securities Exchange Commission*, the SEC claimed that a portfolio manager and a chief operating officer violated securities laws by allowing Headstart Advisers Ltd. to make late trades at the expense of other investors. In its 2008 complaint, the SEC alleged that the late trading adversely affected long-term fund investors. According to the complaint, the defendants authorized Headstart to place late trades for almost three years between 1999 and 2002, more than six years prior to the filing of the action.

The operative statute, 28 U.S.C. Section 2462, requires that the government bring any action for civil penalties within five years of the date its claim "first accrued." The defendants argued that any such claim "first accrued" when the alleged fraud took place in 2002 and before. The SEC argued that the claim did not accrued until the agency discovered the fraud in 2003, and that it therefore filed its complaint within the five year limitations period.

Although the statute contains no discovery rule, the Second Circuit found that it implies one, and held that an SEC fraud claim first accrues when the agency discovers or should have discovered alleged misconduct. Reversing the Second Circuit, the unanimous Supreme Court concluded that the SEC filed its claims too late, and was not entitled to a stay or tolling of the limitations period during the one year between the occurrence of the challenged activity and the "discovery" of it by the SEC.

According to Chief Justice Roberts, allowing the government to bring enforcement actions after the time permitted by the plain language of the statute of limitations "would be utterly repugnant." Roberts added, "[i]t would leave defendants exposed to government enforcement action not only for five years after their misdeeds, but for an additional uncertain period into the future. Repose would hinge on speculation about what the government knew, when it knew it, and when it should have known it." The unsympathetic high court further noted that, unlike private citizens, the SEC and other government agencies have powerful investigative tools at their disposal, and are commissioned with finding and rooting out fraud when it occurs.

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