U.S. Supreme Court Confirms that Statute of Limitations Period for Federal Enforcement Actions Seeking Civil Penalties Begins When Fraud Occurs, Not When It Is Discovered; Application In FCPA Matters Remains Unclear In Light of Recent Southern District of New York Decision

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In *Gabelli v. Securities and Exchange Commission*, No. 11-1274, the United States Supreme Court unanimously concluded that the five-year statute of limitations applicable to actions brought by the Securities and Exchange Commission (SEC) seeking civil penalties begins to run when the alleged fraudulent conduct occurs rather than when it is discovered. In doing so, the Court declined to apply the "discovery rule" that is available in private actions—which delays accrual of certain fraud-based claims until they are discovered—to federal enforcement actions governed by 28 U.S.C. § 2462. The *Gabelli* case, one of the last "market timing" cases brought by the SEC, did not involve the Foreign Corrupt Practices Act (FCPA), but its application in that context will be of particular importance given the prevalence and time-consuming nature of those actions, which often challenge alleged conduct from many years prior. A recent decision in an FCPA case from the Southern District of New York, decided less than three weeks before *Gabelli*, reflects a more expansive view of the statute of limitations. In *SEC v. Straub*, No. 11 Civ. 9645 (RJS)—which interpreted a part of 28 U.S.C. § 2462 that was not at issue in *Gabelli*—the district judge concluded that a defendant must be physically present in the United States in order for the statute of limitations in Section 2462 to run. The *Straub* decision ultimately may be limited to its facts, however, and may be reconsidered by the District Court itself or reviewed by the U.S. Court of Appeals for the Second Circuit. The decision nonetheless demonstrates the SEC's expansive view of its authority to bring FCPA claims more than five years after alleged fraudulent conduct occurs.

Gabelli v. SEC: Case Background

From 1999 until 2002, a portfolio manager of a mutual fund and the chief operating officer of the fund's investment adviser (the "executives") allegedly permitted an investor to engage in "market timing"—a technique of exploiting short-term pricing inefficiencies that is not illegal but that can harm long-term investors—in exchange for the investor's participation in a hedge fund run by the portfolio manager. According to the SEC, neither this *quid pro quo* arrangement nor the investor's market timing was disclosed to the other investors, who were not permitted to engage in market timing.

The SEC brought a civil enforcement action in 2008 against the executives, which sought civil penalties for aiding and abetting violations of the antifraud provisions of the Investment Advisers Act of 1940 (15 U.S.C. §§ 80b-6(1) and (2)). The statute of limitations for such federal enforcement actions seeking civil penalties is five years "from the date when the claim first accrued." *See* 28 U.S.C. § 2462.

The executives moved to dismiss the SEC's claims as untimely because the complaint alleged market timing up until August 2002 but was not filed until April 2008. The district court agreed and dismissed the claims. The Second Circuit reversed, holding that the "discovery rule"—which delays the accrual of a cause of action until a plaintiff has discovered it—was applicable, and therefore that the claims were not clearly time-barred because the SEC alleged that it first discovered the fraud less than five years before it brought suit.

The Supreme Court's Decision

On February 27, 2013, in an opinion authored by Chief Justice Roberts, the Supreme Court reversed the Second Circuit and held that the five-year statute of limitations commenced when the alleged fraudulent conduct occurred rather than when it was discovered. The Court noted that this standard, conduct-based rule for the limitations period was "the most natural reading of the statute" and that there were no "textual, historical, or equitable reasons" to depart from it. Slip op. at 4, 11.

In rejecting the SEC's position that the discovery rule should apply, the Court stated that it had "never applied the discovery rule . . . where the plaintiff [wa]s not a defrauded victim seeking recompense, but [wa]s instead the Government bringing an enforcement action for civil penalties." *Id.* at 6. The Court explained that the discovery rule aims to protect private parties suffering from "self-concealing" injuries who "may be unaware that they have been harmed." *Id.* at 7. The SEC, on the other hand, does not have to rely on apparent injury to learn of a wrong; its very mission is to discover wrongs and root them out, and it "has many legal tools at hand to aid in that pursuit." *Id.* at 8. Moreover, the discovery rule helps ensure that victims are compensated, whereas SEC penalties go beyond compensation and are intended to punish. *Id.* The "SEC as enforcer" is thus "a far cry from the defrauded victim the discovery rule evolved to protect." *Id.*

The Court also recognized the practical challenges that would result from adopting the discovery rule in these circumstances. The rule "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." *Id.* at 9. And the Court emphasized that there are a variety of challenges associated with determining when the Government, as opposed to an individual, knew or reasonably should have known of a fraud. *See id.*

Implications

The Court's decision in *Gabelli* should bring a degree of stability and predictability to businesses and individuals subject to governmental enforcement actions seeking civil penalties. As a practical matter, however, there are several ways for the SEC to extend this five-year period: for example, it can pursue a statutory exception from the five-year requirement or seek tolling agreements from those it is investigating. Moreover, SEC claims for injunctive relief and disgorgement are not covered by the *Gabelli* opinion, *id.* at 3 n.1, and many courts have held that such claims are not governed by the five-year limitations period in Section 2462.

A noteworthy decision on February 8, 2013, from the Southern District of New York (SDNY), *SEC v. Straub* (No. 11 Civ. 9645), illustrates another reason why the seemingly rigid five-year limitations period in Section 2462 may in practice be much more flexible. In *Straub*, Judge Richard J. Sullivan held that a defendant must be physically present in the United States in order for the statute of limitations in 28 U.S.C. § 2462 to run. For cases brought under the FCPA, this ruling may expand the SEC's ability to bring claims beyond the five-year period, as FCPA cases often involve defendants who are not physically present in the United States. Although *Straub* hinged on language that was not at issue in *Gabelli,* its result conflicts with sweeping dicta in *Gabelli* concerning "the importance of time limits on penalty actions" and the "utter[] repugnan[ce]" that would result "if actions for penalties could be brought at any distance of time." Slip op. at 9 (internal quotation marks omitted). The impact that the dicta in *Gabelli* will have on the persuasiveness and influence of the *Straub* opinion remains to be seen, as does the ultimate result in *Straub*: the defendants already had moved for an interlocutory appeal to the Second Circuit, but they now may seek reconsideration of the *Straub* decision in light of the conflicting dicta from *Gabelli*.

Straub demonstrates that the law concerning the FCPA continues to evolve through significant decisions in the lower courts. In addition to the statute of limitations issue, *Straub* also contains useful analysis concerning the appropriateness of exercising personal jurisdiction over defendants with limited ties to the United States. Judge Sullivan held that the SEC had met its burden of showing that the exercise of personal jurisdiction over the defendants was consistent with constitutional due process. In so doing, he ruled that the allegations concerning conduct that was designed to violate U.S. securities regulations—including signing false SEC filings and misleading representations to auditors—were sufficient even though the anti-bribery claims were based solely on allegations involving Macedonia.

Less than two weeks later, another district judge in the SDNY reached a contrary result regarding a similar issue in another FCPA case. In *SEC v. Sharef* (No. 11 Civ. 9073), Judge Shira A. Scheindlin granted the motion to dismiss of a Siemens executive who allegedly facilitated bribes to Argentine officials, ruling that the court lacked personal jurisdiction over him. First, the court found that his actions were too attenuated from the resulting harm to establish the necessary minimum contacts to the United States—although he allegedly urged another executive to pay bribes, the bribes were made only after confirming with several "higher ups." Second, the court concluded that it would not have been reasonable to exercise personal jurisdiction over him because of, among other things, his advanced age, the burden on him to journey to the United States to defend the suit, and the previous adjudications that had been brought against the company (in the United States) and the executive individually (in Germany). The defendant in *Sharef* also raised a statute of limitations defense, which Judge Scheindlin did not address in view of the dismissal on jurisdictional grounds. Although *Straub* and *Sharef* show that the SEC's jurisdictional reach over individuals in FCPA actions is unsettled and worth litigating, in the end, the decisions turn on general constitutional law rather than FCPA-specific principles.

The Supreme Court's opinion in *Gabelli v. SEC* is available **here**, and the decisions in *SEC v. Straub* and *SEC v. Sharef* are available **here** and **here**, respectively.

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