NOTE

GABELLI V. SEC: EVALUATING THE DISCOVERY RULE IN FINANCIAL FRAUD CASES

SEAN P. MCGONIGLE†

I. INTRODUCTION

Concerns about the health and legitimacy of the financial industry have been mounting since 2008's economic collapse. These concerns gave rise to a national dialogue about alternative means of regulating financial activity to prevent substantial market collapses. Financial fraud and the importance of adequate enforcement mechanisms have come to dominate many of these conversations.[1] The Supreme Court recently decided a case that will play an important role in the solution to these issues and influence government policing of financial markets. While this case, *Gabelli v. SEC*,[2] provides a legal lens for these debates, the decision also instrumentally affects economics and policy.

The potential for reform is an important topic for the U.S. government and the financial sector in 2014. The middle of 2013 marked five years since the economic collapse of 2008, a period also codified by the statute of limitations for 28 U.S.C. § 2462,[3] the general statute for civil penalties and fines. Section 2462 states:

---

† Sean P. McGonigle is a 2014 graduate of Wake Forest University School of Law and Editor-in-Chief of the *Wake Forest Journal of Law & Policy*, Volume 4. He is grateful for the support of his family, Ryan Elizabeth, and her family, both throughout law school and in writing this Note.

1. Paul Krugman, Op-Ed., *Friends of Fraud*, N.Y. TIMES, Feb. 3, 2013, http://www.nytimes.com/2013/02/04/opinion/krugman-friends-of-fraud.html?_r=1&.html.
2. Gabelli v. SEC, 133 S. Ct. 1216 (2013).
3. 28 U.S.C. § 2462 (2006).

> Except as otherwise provided by Act of Congress, an 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 found within the United States in order that proper service may be made thereon.[4]

Many civil penalties are brought under this statute, and the Court's definition of "accrue" determines whether the government can bring enforcement actions for fraudulent conduct occurring before mid-2008.[5] By defining accrue as the moment when a claim ripens, the Court has declined to apply the discovery rule to § 2462.[6] This means that the Securities and Exchange Commission ("SEC") is barred from pursuing civil penalties for most financial fraud that occurred before 2008.

This Note evaluates the Court's decision in *Gabelli* not to apply the discovery rule to § 2462 and explains why that decision is the best policy in fraud actions for civil penalties brought by the government under § 2462. First, I outline the facts and procedural history of *Gabelli*. Next, I present the Supreme Court's analysis, which focused on § 2462's language and history, the different natures of private plaintiffs and government agencies, and the difficulty courts would have in applying the discovery rule to § 2462. Then I evaluate the Court's reliance on each one of these factors and argue that the Court's decision not to apply the discovery rule to § 2462 is correct. Finally, I examine the public policy benefits of not applying the discovery rule to § 2462. Punishing fraudulent conduct from an era of fiscal irresponsibility is important, but these legal and policy arguments demonstrate the harms of an extended statute of limitations in government-initiated civil punishment cases. Therefore, the Supreme Court is

---

4. *Id.*

5. *See* Mary O'Connor & Patrick O'Brien, *Chinks in the Enforcement Armor: Recent Decisions Erode SEC's Favored Remedies*, 44 SEC. REG. & L. REP. 2118 (2012), *available at* http://www.cdn.akingump.com/images/content/1/9/v4/19378/agshf-oconnor-obrienarticle-srlr-nov.-19-2012.pdf.

6. *Gabelli*, 133 S. Ct. at 1224.

correct to hold that the discovery rule does not apply to § 2462 in such cases of fraud.

II. *GABELLI*'S FACTUAL BACKGROUND

Marc Gabelli was the portfolio manager for Gabelli Global Growth Funds ("GGGF"), and Bruce Alpert remains the Chief Operating Officer of Gabelli Funds, a third-party advisor to GGGF.[7] In September 1999, Gabelli allowed Headstart Advisors, Ltd. ("Headstart") to "market-time" investments within the GGGF.[8] Since mutual funds are typically priced at 4:00 PM Eastern Standard Time ("EST"), investors can attempt to market time investments. "Time-zone arbitrage," a form of market timing, allows investors to take advantage of price movements during the "New York trading day."[9] A foreign market's opening can be influenced by these movements, possibly increasing the value of foreign securities within a mutual fund, even though such a price increase would not be accounted for until the next day. This delay enables investors to purchase funds at an artificially low price and profit the next day when the price is adjusted.[10] GGGF sent letters to potential market timers, reserving the right to refuse purchase

7. SEC v. Gabelli, No. 08 CV. 3868(DAB), 2010 WL 1253603, at *1 (S.D.N.Y. Mar. 17, 2010).

8. *Id.*

9. *Id.*

10. As an example of market timing:

> [A] U.S. mutual fund may hold shares of a Japanese company traded on the Tokyo Stock Exchange ("TSE"). Because of the time-zone difference, the TSE may close at 2:00 a.m. EST. If the U.S. mutual fund uses the TSE closing price for the Japanese company's stock to calculate the mutual fund's [net asset value ("NAV")] at 4:00 p.m. EST, that fund's NAV will be based, at least partially, on market information that is fourteen hours old. Positive market movements during the New York trading day, which will later cause the Japanese market to rise when it opens at 8 p.m. EST, will not be incorporated into the fund's NAV, thereby cause the NAV to be artificially low. On such a day, a trader who buys the U.S. fund at the artificially low or "stale" price can realize a profit the next day by selling the U.S. fund's shares.

SEC v. Gabelli, 653 F.3d 49, 53 n.2 (2d Cir. 2011). While market timing can cause significant harms such as increased fund costs, changes in investment strategy, and capital gains issues, it is not itself an illegal activity. *Id.* at 53.

orders, and Gabelli Funds rejected some suspected market-timed purchases.[11]

Marc Gabelli and Bruce Alpert were both notified about Headstart's market timing, but nevertheless allowed it to continue within the GGGF.[12] On December 15, 2000, Alpert sent out an internal memo warning that market timing had occurred within the fund, but that efforts were being taken to stop those activities.[13] Around April 1, 2002, Alpert asked Headstart to reduce its market timing, finally prohibiting it by August 7, 2002.[14] New York Attorney General Eliot Spitzer began investigating market timing on September 3, 2003, and Alpert responded by posting a memo to the parent company's website stating that the procedures in place to stop market timing within the fund were not always successful.[15] The SEC claims to have discovered the fraud as early as late 2003, but did not file its complaints in the Southern District of New York until April 24, 2008.[16] These complaints charged Alpert with violating § 10(b) of the Securities Exchange Act of 1934 and § 17(a) of the Securities Act of 1933. They also charged both Alpert and Gabelli with violating § 206(1)–(2) of the Advisers Act.[17] Since none of these statutory provisions have a statute of limitations, § 2462's limit applied to the cause of action.

The district court granted nearly all of the defendants' motions to dismiss. In dismissing the Securities Exchange Act and Securities Act claims against Alpert, the court found that Alpert did not make any misrepresentations and had no duty to disclose Headstart's market-timing activity.[18] While the court did not dismiss the Advisers Act claims against either defendant, it did bar

11. *Gabelli*, 2010 WL 1253603, at *1. Gabelli personally banned some market timers, but also said that the market timing he authorized would be allowed. *Id.* at *2.

12. *Id.* at *2.

13. *Id.* Alpert directed two employees in charge of finding market-timing behavior within the fund to overlook Headstart's accounts in the GGGF. *Id.* Over this period, Headstart's accounts had returns of 185%, 160%, and 73%, compared to a best of negative 24.1% for the other GGGF shareholders. *Gabelli*, 653 F.3d at 54.

14. *Gabelli*, 2010 WL 1253603, at *3.

15. *Id.*

16. *Gabelli*, 653 F.3d at 55. The SEC entered into tolling agreements with the defendants in 2007, extending the statute of limitations for a few months, but those agreements did not affect the culmination of the statute of limitations as argued by the SEC or the defendants. *Gabelli*, 2010 WL 1253603, at *3.

17. *Gabelli*, 653 F.3d at 55 (citing 15 U.S.C. § 78j(b) (2006) (including 17 C.F.R. § 240.10b 5); 15 U.S.C. § 77q(a) (2006); 15 U.S.C. § 80b-6(1)–(2) (2006)).

18. *Gabelli*, 2010 WL 1253603, at *8.

the SEC from seeking civil penalties for the claims because the statute of limitations had expired.[19] Refusing to apply the discovery rule[20] to § 2462, the district court cited precedent from inside and outside the Second Circuit, since the circuit court itself had been silent on the issue.[21] Finally, the court held that injunctive relief was not available to the SEC because the complaint did not adequately allege that Gabelli and Alpert were likely to repeat this behavior.[22] Therefore, disgorgement, or the return of profits, was the SEC's only remaining relief against each defendant.

In the appeal to the Second Circuit, the SEC asked to reinstate the Securities Act and Securities Exchange Act claims against Alpert, as well as to pursue civil penalties and injunctive relief for the Advisers Act claims.[23] Holding that the district court erred in dismissing the Securities Act and Securities Exchange Act claims against Alpert, the Second Circuit found Alpert's testimony misleading; his reckless decisions had materially created a negative economic impact for other brokers.[24] The circuit court also reversed the district court's ruling regarding civil penalties under the Advisers Act claims, finding that the discovery rule did apply for fraud cases under § 2462.[25] According to the Second Circuit, the discovery rule applies in fraud cases because a defendant's deceptive conduct prevents a plaintiff from discovering the fraud.[26] Further, because the discovery rule applied to § 2462, the SEC did not need to show affirmative concealment by the

19. *Id.* at *5–6. The court also held that civil penalties were not available for aiding and abetting violations. *Id.* at *6. The court found that Alpert's activity from 1999 to 2001 occurred more than five years before the complaint was filed on April 24, 2008. *Id.* The complaint placed the end of Headstart's market timing on August 7, 2002, so the Advisers Act claims had run against Alpert by March 7, 2008, and against Gabelli by August 7, 2007. *Id.*

20. The discovery rule states, "a cause of action accrues when the violation was discovered or should have been discovered by Plaintiff, rather than when the violation occurs." *Id.* at *5 (citing SEC v. Alexander, 248 F.R.D. 108, 116 (E.D.N.Y. 2007)).

21. *Id.* at *5–6 (citing 3M Co. v. Browner, 17 F.3d 1453, 1463 (D.C. Cir. 1994); SEC v. Alexander, 248 F.R.D. 108, 116 (E.D.N.Y. 2007); SEC v. Jones, 2006 WL 1084276, *6 (S.D.N.Y. Apr. 25, 2006)).

22. *Id.* at *11.

23. SEC v. Gabelli, 653 F.3d 49, 56 (2d Cir. 2011).

24. *Id.* at 57–58.

25. *Id.* at 60.

26. *Id.* at 59 (citing Merck & Co. v. Reynolds, 559 U.S. 633, 644 (2010)).

defendants under equitable tolling.[27] Since the SEC merely alleged that it did not discover the fraud until September 2003 because of the defendants' deceptive conduct, the holding that the discovery rule applied to accrue under § 2462 meant the statute of limitations had not run against Alpert and Gabelli.[28] The defendants then appealed this decision to the Supreme Court.

SEC v. Bartek,[29] a Fifth Circuit case decided between the *Gabelli* Second Circuit decision and appeal to Supreme Court, complicated this issue. In *Bartek*, the defendants were accused of improperly backdating stock options from 2000 to 2003, but the SEC did not file its complaint until 2008.[30] The Fifth Circuit held that the discovery rule did not apply to § 2462 based on a plain reading of the statute, congressional and judicial precedent, and the general meaning of accrue.[31] With two circuit courts split on the interpretation of a federal statute for civil penalties, the Supreme Court's decision in *Gabelli* became even more important.

The Supreme Court held that the five-year statute of limitations under § 2462 did not include a discovery rule.[32] The Court's decision not to apply the discovery rule to § 2462 turned on three main points: § 2462's language and history, the difference between a private plaintiff that was victimized and a government agency enforcing the law, and the difficulty in evaluating when a government agency knew or reasonably should have known when fraudulent conduct occurred. The legal and policy concerns that shape these factors show that the Supreme Court was correct not to apply the discovery rule to cases brought by the government under § 2462.

III. THE SUPREME COURT'S DECISION IN *GABELLI*

The Supreme Court focused on the language and history of § 2462, the difference between a private plaintiff and a

27. *Id.* at 60. Even if a claim already accrues, equitable tolling may delay application of the statute of limitations if the defendant affirmatively concealed his conduct from the plaintiff. *Id.* at 59.

28. *Id.* at 59.

29. SEC v. Bartek, 484 F. App'x 949 (5th Cir. 2012).

30. *Id.* at 950–51.

31. *Id.* at 953 (citing United States v. Lindsay, 346 U.S. 568, 569 (1954) ("[T]he normal meaning of 'accrued' is when a claim comes into existence.")).

32. Gabelli v. SEC, 133 S. Ct. 1216, 1224 (2013).

government agency, and the difficulty in evaluating when a government agency knew or reasonably should have known when fraudulent conduct occurred. In discussing § 2462's language and history, the Court focused on the definition of accrue when the statute was enacted, as well as judicial definitions of accrue throughout history. As the Court moved on to the difference between a private plaintiff and a government plaintiff, the argument dealt with the difference in the nature of the actions. In particular, the Court compared the remedial purpose of an action brought by a private victim to the punitive nature of a government action, and found that the different natures of the private and government actions warranted different applications of the discovery rule to suits based in fraud. Finally, the difficulty courts would have in determining when a government agency knew or reasonably should have known when fraudulent conduct occurred also weighed against applying the discovery rule to § 2462. This determination would be extremely difficult for courts to make given the composition of government agencies, as courts would have to decide when a group of people collectively came to know when fraudulent conduct occurred. Examining these reasons further, the Court was correct in determining that the discovery rule does not apply to fraud cases brought by the government under § 2462.

A. The Language and History of § 2462

In *Gabelli*, the Court did not apply the discovery rule to § 2462 because of its analysis of the statute's language and history. The Court stated that "a right accrues when it comes into existence,"[33] and that "a claim accrues when the plaintiff has a complete and present cause of action."[34] In light of those definitions, the Court found that government enforcement of fraudulent claims ended at a "fixed date" in order to promote repose and certainty.[35] Additionally, the Court noted that this definition was controlling in the 1830s, when the original § 2462 was passed, and is still effective today.[36]

---

33. *Id.* at 1220 (citing United States v. Lindsay, 346 U.S. 568, 569 (1954)).

34. *Id.* (citing Wallace v. Kato, 549 U.S. 384, 388 (2007)).

35. *Id.* at 1221.

36. *Id.* (citing BLACK'S LAW DICTIONARY 23 (9th ed. 2009) (defining "accrue" as "[t]o come into existence as an enforceable claim or right")).

The Court's reading of the historical definition of accrue was correct. Supreme Court precedent weighed heavily towards defining accrue as when a legal right first exists.[37] Congress gave no indication of parting with this established definition of accrue in § 2462, as the statute, which lists several possible penalties, does not provide different rules for different penalties.[38] Further, during oral arguments, Justice Ginsburg and the defense attorney both raised the point that there are some statutes that use both the term "accrue" and "discovery."[39] Since Congress has used both terms in other instances and has not done so here, that is a strong indication that Congress did not intend for the § 2462 definition of accrue to include discovery. Therefore, the Court would have been incorrect had it strayed from the original meaning of accrue.

In addition to the Court's definition of accrue, the statute's use of "shall" could also have been determinative. Since the statute says that actions "shall not be entertained unless commenced within five years from the date when the claim first accrued,"[40] the language of § 2462 provides no room for discretion about when a claim accrues and instead provides a command that the application of the discovery rule would violate.[41] As discussed below,[42] the use of a discovery rule would require tremendous judicial discretion, which would have been inconsistent with the text of § 2462. The analysis § 2462's text shows that Congress left no room for the application of the discovery rule, and that applying it would have been contrary to the plain meaning of the statute.

Additionally, the structure of § 2462 does not allow for the application of the discovery rule. A commonly used canon of construction is that when Congress "explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not

37. *See* Reading Co. v. Koons, 271 U.S. 58, 64 (1926); *see also* Crown Coat Front Co. v. United States, 386 U.S. 503, 511, 514 (1967); Unexcelled Chem. Corp. v. United States, 345 U.S. 59, 65 (1953).

38. Petitioners' Brief on the Merits at 13–14, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274) (citing *Reading*, 271 U.S. 58 at 63–64).

39. Transcript of Oral Argument at 20, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274).

40. 28 U.S.C. § 2462 (2006).

41. Petitioners' Brief, *supra* note 38, at 17–18 (citing Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach, 523 U.S. 26, 35 (1998) (explaining that the use of the term "shall" "creates an obligation impervious to judicial discretion")).

42. *See infra* Part III.C.

to be implied, in the absence of evidence of a contrary legislative intent."[43] There are only two explicit exceptions in § 2462. The first is that the five-year limit does not apply if the defendant is not in the United States.[44] The second exception to § 2462 is, "[e]xcept as otherwise provided by Act of Congress . . . ."[45] This later exception is very important since it explicitly states that any exception to § 2462 must come from Congress—not from the courts.[46] Since Congress has not provided for a discovery rule exception to § 2462, the Court could not have done so on its own. By listing these explicit exceptions, Congress did not intend for any implied exceptions to apply to § 2462.

The SEC tried to argue that there was a specific exception to the common law definition of accrue in cases of fraud and concealment.[47] There have been some instances where the Court has held that, even without explicit reference in a statute's text, the discovery rule might delay a statute of limitation in fraud cases.[48] However, Justice Scalia was very quick to dispatch of that exception during oral arguments, noting that it had never been applied in a criminal or civil penalty case.[49] The Court adopted Justice Scalia's comments and rejected the SEC's definitional argument in its opinion when it highlighted the difference between a plaintiff that is a private victim and a plaintiff that is a government enforcer.[50]

The legal definitions of accrue and shall, as well as the structure of § 2462, preclude the application of the discovery rule to § 2462. The historical definition of accrue as the moment when a plaintiff can bring an action, combined with the use of shall, which limits judicial discretion, justifies the Court's refusal to apply the discovery rule to § 2462. The use of two exceptions in the statute, and the traditional canon of construction against

43. TRW Inc. v. Andrews, 534 U.S. 19, 28 (2001) (quoting Andrus v. Glover Constr. Co., 446 U.S. 608, 616–17 (1980)).

44. 28 U.S.C. § 2462.

45. *Id.*

46. Petitioners' Brief, *supra* note 38, at 18 (citing Alabama v. Bozeman, 533 U.S. 146, 153 (2001) (quoting Anderson v. Yungkau, 329 U.S. 482, 485 (1947))).

47. Transcript of Oral Argument, *supra* note 39, at 20–21.

48. Brief for the Respondent at 33–34, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274) (citing Exploration Co. v. United States, 247 U.S. 435, 447 (1918)).

49. Transcript of Oral Argument, *supra* note 39, at 22.

50. *See infra* Part III.B.

implied exceptions, also presents barriers to the application of the discovery rule. While there is evidence of an exception to the definition of accrue for some fraud actions, the Supreme Court was correct not to rely on those exceptions in this case, given the nature of the plaintiffs—a private victim as compared to a government enforcer.

B. The Difference between a Private Victim and a Government Enforcer

The Court in *Gabelli* further cited the different natures of actions brought by a private victim and a government enforcer—like the SEC—as a reason not to apply the discovery rule to § 2462.[51] The discovery rule was meant to preserve the claims of unsuspecting victims, particularly against self-concealing injuries.[52] However, the SEC is not an unsuspecting victim. It is instead supposed to search out fraud with several tools at its disposal.[53] Such tools include demanding information from investors, subpoenaing documents, paying whistleblowers, and offering cooperating agreements for information in exchange for more lenient treatment.[54] Since private victims do not have these same capabilities to detect fraud, the victims benefit from the application of the discovery rule; given these differences, it is a "far cry" to compare a government enforcer like the SEC to a private victim.[55]

The nature of relief sought is also different for a private victim than it is for a government enforcer. While the private plaintiff seeks compensation, the government aims to enforce the laws and punish defendants.[56] The Court has long recognized the importance of effective statutes of limitations for punitive actions,[57] and thus found that a discovery rule under § 2462 could leave defendants exposed to penalties for an uncertain period of

51. Gabelli v. SEC, 133 S. Ct. 1216, 1222 (2013).
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.* at 1223.
57. *Id.* (citing Adams v. Woods, 6 U.S. (2 Cranch) 336, 342 (1805) ("[I]t 'would be utterly repugnant to the genius of our laws' if actions for penalties could 'be brought at any distance of time.'")).

time.[58] Finally, the Court emphasized that the SEC's inability to cite a single case before 2008 that applied the discovery rule to a fraudulent enforcement action strongly indicated that the discovery rule was not meant to apply to § 2462.[59] As mentioned above, one definition of accrue may have allowed for the application of the discovery rule to § 2462, but the Court did not adopt that definition because of the plaintiffs' separate natures.[60] The SEC tried to argue that *Exploration Co. v. United States*[61]—where a government agency sued a defendant in fraud—allowed for the application of the discovery rule to government actors in the same way that it applies to private plaintiffs.[62] However, in that case the government was actually a victim of fraud itself, suing for monetary recovery.[63] Here, the SEC was suing to punish the defendants for allegedly fraudulent conduct, so the government was acting as an enforcer rather than an unsuspecting victim.

Treating the government enforcer in the same manner as a private victim would have put defendants at the mercy of government agencies. During oral arguments, Justice Breyer noted the difference between the current situation's criminal context and that of a private plaintiff seeking restitution.[64] Justice Kagan further highlighted the dangers that a discovery rule in a criminal context would pose, stating that a discovery rule would create "no natural starting point" for a statute of limitations, a real concern given the ability of the government to shift enforcement priorities.[65] The SEC has the ability to promise "bold and unrelenting"[66] enforcement of the laws, and punish defendants

58. *Id.*

59. *Id.* at 1221.

60. *See supra* Part III.A.

61. Exploration Co. v. United States, 247 U.S. 435 (1918).

62. Brief for the Respondent, *supra* note 48, at 41–45.

63. *Gabelli*, 133 S. Ct. at 1222.

64. Transcript of Oral Argument, *supra* note 39, at 35.

65. *Id.* at 38. *See also* Mark Roche et al., *Will the SEC Have Forever to Pursue Securities Violations?* SEC v. Gabelli, 44 SEC. REG. & L. REP. 1415 (2012), *available at* http://www.bakermckenzie.com/files/Publication/f86b9ccc-cfa7-4f33-bf79-961f5483a5e4/Presentation/PublicationAttachment/befed81f-d831-4604-8b4f-9c8b601b3dce/ar_us_secpursueviolations_jul12.pdf.

66. Terence Healy, *Bold and Unrelenting Enforcement: What Employers Should Expect From The New SEC*, FORBES (Oct. 14, 2013, 9:16 AM), http://www.forbes.com/sites/theemploymentbeat/2013/10/14/bold-and-unrelenting-enforcement-what-employers-shouldexpect-from-the-new-sec.

for their actions in ways that private victims cannot.[67] Exposing a defendant to a suit by an enforcer in the same manner in which a defendant is exposed to a private victim would be fundamentally unfair. The repercussions that defendants face in enforcement actions are magnified—with the potential to destroy careers and chill markets[68]—when compared with actions by private victims. These repercussions, combined with the government's enhanced ability to detect fraud, would greatly compromise a defendant's right to certainty and repose if the discovery rule applied in enforcement actions.

In addition to the nature of the plaintiff, the nature of the relief sought by the government differs from that of a private victim. Chief Justice Roberts noted that § 2462's penalties are more than just compensation, as they punish defendants and label them "wrongdoers."[69] Led by Justice Scalia, many of the Justices took that position at oral arguments. Justice Scalia described this type of suit by the SEC as a "prosecution for a civil penalty rather than a criminal [penalty]," and then commented that as a prosecution, the rule of lenity should apply.[70] While the rule of lenity was not specifically addressed in the Court's opinion in *Gabelli*, the Court's reliance on principles of repose and certainty[71] are not far removed from lenity. Should uncertainty regarding the legality or timing of a defendant's conduct arise, principles of fairness suggest that the matter should be resolved in favor of the defendant. Since there is uncertainty as to how the timing of the defendants' conduct falls within § 2462, the punitive nature of relief sought by the government indicates that the uncertainty should be resolved in favor of the defendants.

67. *See, e.g.*, Dina ElBoghdady, *SEC Developing New Fraud Detection Technology*, WASH. POST (Feb. 15, 2013), http://www.washingtonpost.com/business/economy/sec-developing-new-fraud-detection-technology/2013/02/15/ffb5f686-771c-11e2-aa12-e6cf1d31106b_story.html.

68. Roche et al., *supra* note 65.

69. Gabelli v. SEC, 133 S. Ct. 1216, 1223 (2013) (referencing Meeker v. Lehigh Valley R.R. Co., 236 U.S. 412, 423 (1915) (calling a penalty under § 2462's predecessor "something imposed in a punitive way for an infraction of a public law")).

70. Transcript of Oral Argument, *supra* note 39, at 32–33. The rule of lenity provides that "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." Skilling v. United States, 130 S. Ct. 2896, 2905–06 (2010) (citing Cleveland v. United States, 531 U.S. 12, 25 (2000)).

71. *Gabelli*, 133 S. Ct. at 1223.

Finally, the Court was strongly influenced by the government's inability to cite a single case before 2008 where the discovery rule was applied in a criminal case or for a criminal sanction. The government argued that there were no cases on point because the use of civil penalties to punish fraud is a modern problem, but Justices Scalia, Breyer, and Chief Justice Roberts were skeptical of this justification and wary of the fact that the government never used the discovery rule to seek a civil penalty until 2004.[72] The Court's opinion explicitly references this failure by the government to cite such an application of the discovery rule, despite the discovery rule's longevity.[73] Not only was the nature of relief sought by the government in *Gabelli* enough of a reason not to apply the discovery rule to § 2462, but the lack of historical application of the discovery rule for civil penalty claims was also a compelling reason for the Court not to apply the discovery rule to § 2462.

The Court correctly relied on the differences between a private victim and a government enforcer in fraudulent actions not to apply the discovery rule to § 2462. The different nature of a victim seeking recompense and a government agency seeking to punish conduct warrant two different rules. The nature of the relief sought further justifies not applying the discovery rule to § 2462, as the government's attempt to punish a defendant's conduct through civil penalties resembles a criminal action, while a private plaintiff seeking restitution fits squarely within a civil action. The quasi-criminal nature of a government action warrants the application of the principles of lenity, repose, and certainty, all of which favor the defendants in § 2462 discovery rule situations. The government's inability to demonstrate a historical application of the discovery rule to civil penalties levied by the government cemented the Court's decision to forgo the application of the discovery rule to § 2462.

C. Determining when the Government Knew or Should Have Known

The difficulty courts would have in applying the discovery rule to § 2462, especially against government entities like the SEC,

72. Transcript of Oral Argument, *supra* note 39, at 22–27.
73. *Gabelli*, 133 S. Ct. at 1221.

was another problem addressed by the Court. The opinion noted that courts would need to speculate about "what the Government knew, when it knew it, and when it should have known it."[74] This speculation would be based on an agency's number of employees and offices, responsibilities, and levels of leadership.[75] Further, agency priorities and resources make this determination even more difficult for courts.[76] The Court also raised the concern about the government's ability to raise privileges during litigation, which could hinder discovery and make judicial determinations about government knowledge even more difficult.[77] Finally, when Congress has required such a judicial determination in other statutes, it has done so when the government is itself a victim,[78] it has included an absolute provision for repose,[79] and it has required the government to attempt to identify the official with relevant knowledge.[80]

The Court correctly notes that it can be very difficult for judges to determine when an agency makes a discovery. This is especially true with market-timing activity, since a victim is more inclined to know when it has been wronged than is an investigative agency. There are many reasons that a government agency may not know about fraudulent conduct. It is possible that two people in different parts of an agency had relevant information but did not communicate with each other, or the government may have had evidence of fraudulent conduct without realizing there was a violation.[81] The agency's allocation of resources may also prevent the timely detection of the fraud, as law enforcement priorities could be focused elsewhere, the enforcement program may be insufficient, or the agency may be inadequately staffed.[82]

In these situations, applying the discovery rule to § 2462 would mean that extended periods of time could pass before an agency might actually discover a violation, leaving open the possibilities of faded memories or evidence, and violations of the

74. *Id.* at 1223.
75. *Id.*
76. *Id.* (citing 3M Co. v. Browner, 17 F.3d 1453, 1461 (D.C. Cir. 1994)).
77. *Id.*
78. *Id.* at 1224 (citing 28 U.S.C. §§ 2415, 2416(c) (2006)).
79. *Id.* (citing 21 U.S.C. § 335b(b)(3)(B) (2006)).
80. *Id.* (citing 31 U.S.C. § 3731(b)(2) (2006)).
81. Petitioners' Brief, *supra* note 38, at 46.
82. 3M Co. v. Browner, 17 F.3d 1453, 1461 (D.C. Cir. 1994).

principles of repose and certainty.[83] These consequences would strike a serious blow to the idea that, at some point, it is in the parties' best interest to let "bygones be bygones."[84] Had the discovery rule applied to § 2462, a defendant's best argument would have been to prove that the government failed to act diligently to discover fraudulent conduct.[85]

The Justices went into even more detail about the concerns of applying the discovery rule to § 2462 during oral arguments, which further highlight these difficulties. Justice Sotomayor and Chief Justice Roberts were troubled by the government's suggestion that courts could determine whether an agency diligently discovered fraudulent conduct. Particular concerns arose over the actual repose that applying the discovery rule to § 2462 would offer defendants in this circumstance. A defendant's ability to access government records to determine when the government agency knew of violations during the discovery process troubled Justice Sotomayor.[86] She was particularly concerned about the government's ability to raise privileges and prevent discovery by defendants as to what government agencies knew and when they knew it.[87] Justice Sotomayor's fear was that government agencies could accuse the defendant of wrongdoing, extend the statute of limitations, and prevent the defendant from accessing the material to mount an adequate defense. The SEC's attorney responded that most of the information needed to determine what an agency knew would be in the public domain, which prompted Chief Justice Roberts to ask if the government's knowledge would depend on how many agents would be available to go through public records.[88]

Searching public records for older fraudulent conduct poses significant problems, including burdening the staff by

83. Brief of the Cato Institute as Amicus Curiae in Support of Petitioners at 18–19, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274) (citing Order of R.R. Telegraphers v. Ry. Express Agency, Inc., 321 U.S. 342, 348–49 (1944); Adams v. Woods, 6 U.S. (2 Cranch) 336, 342 (1805)).

84. Petitioners' Brief, *supra* note 38, at 39 (citing *Improvement of Procedures in Claims Settlement and Government Litigation: Hearing on H.R. 13650, H.R. 13651, H.R. 13652, and H.R. 14182 Before the H. Comm. on the Judiciary*, 89th Cong. 6–7 (1966) (statement of John W. Douglas, Assistant Att'y Gen., Civil Division, Dep't of Justice)).

85. Roche et al., *supra* note 65, at 5–6.

86. Transcript of Oral Argument, *supra* note 39, at 29.

87. *Id.* at 28.

88. *Id.* at 29.

shifting resources away from more recent, easier-to-detect conduct; complicating the closing of investigations; and undermining public confidence by policing older conduct.[89] Chief Justice Roberts did not seem to agree with the SEC's argument, commenting, "it seems to me that it's going to be almost impossible for somebody to prove that the government should have known about something," which would not provide defendants with an adequate period of repose.[90] These concerns voiced by Justice Sotomayor and Chief Justice Roberts demonstrate one of the principal reasons the Court chose not to apply the discovery rule to § 2462: asking a court to determine when a government agency knew of fraudulent activity, coupled with the government's ability to claim privileges against defendants' discovery requests, seems "almost impossible."[91] Justice Sotomayor's fears about extending the statute of limitations while preventing defendants from conducting adequate discovery further demonstrates the fundamentally unfair treatment defendants would face if the discovery rule had been applied to § 2462.

In their respective comments during oral arguments, Justices Kennedy, Alito, and Scalia also focused on the difficulty of determining the point of discovery. Justice Kennedy accepted the idea that a private plaintiff had to be diligent to preserve a claim, but was more hesitant when considering a government agency, particularly one overworked and underfunded.[92] Since the SEC's budget is significantly smaller than the market it regulates and its responsibilities have only grown under the Dodd-Frank Act, the SEC could certainly be considered an overworked and underfunded agency.[93] Justice Alito asked if the allocation of resources should play a role in determining if the government knew of a violation, to which the SEC responded that the

89. Brief of Former SEC Commissioners & Officials as Amicus Curiae in Support of Petitioners at 9, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274).

90. Transcript of Oral Argument, *supra* note 39, at 29–30.

91. *Id.*

92. *Id.* at 31.

93. Brief of Occupy the SEC as Amicus Curiae in Support of Respondent at 7–9, Gabelli v. SEC, 133 S. Ct. 1216 (2013) (No. 11-1274). The SEC's budget is $1.32 billion, compared to the $18.93 trillion U.S. financial market. *Id.* at 7 (citing Jason Voss, *Fact File: Annual Budget of the U.S. Securities And Exchange Commission*, SEEKING ALPHA (Apr. 29, 2012), http://www.seekingalpha.com/article/540601-fact-file-annual-budget-of-the-u-s-securities-and-exchange-commission.html).

government would be on constructive notice because of the expertise it has compared to a private plaintiff.[94] Justice Scalia was dismissive of that response, instead noting that the nature of the government action—a de facto prosecution—made the nature of the claim different.[95] Justices Kennedy and Alito highlighted some of the difficult questions courts would have to consider if the discovery rule applied to § 2462, particularly determining if whether an agency was adequately staffed and funded should affect what the government knew and when, while Justice Scalia reemphasized that the different natures of a private action and a government-initiated action warranted different rules.

Oral arguments in *Gabelli* further demonstrate the Justices' concerns that were raised in the Court's opinion. Defendants in government-initiated fraud actions would have an extremely difficult time proving what the government knew and when it knew it if the discovery rule applied to § 2462, both because of the composition of government agencies and the government's ability to shield information from defendants by claiming various privileges. Such difficulties would significantly disadvantage a defendant in litigation. Therefore, the Court was correct not to apply the discovery rule to § 2462.

IV. PUBLIC POLICY CONSIDERATIONS

The Court's ruling in *Gabelli* reaffirms certain public policy considerations. The first consideration is society's preference for certainty and repose. Chief Justice John Marshall reflected cultural concerns about limitless penalty actions when he said that it "would be utterly repugnant to the genius of our laws" if penalty actions could be brought "at any distance of time" and "individual[s] would remain forever liable to a pecuniary forfeiture."[96] Decisions like *Gabelli* highlight the importance of policies such as repose and certainty, which are advanced in statutes of limitations to "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses

94. Transcript of Oral Argument, *supra* note 39, at 31–32.
95. *Id.* at 32; *see supra* Part III.B.
96. Adams v. Woods, 6 U.S. (2 Cranch) 336, 342 (1805).

have disappeared."[97] These principles are all the more important in penalty actions by providing "security and stability to human affairs."[98] The Supreme Court has said that defendants are to benefit from these policies, as "even wrongdoers are entitled to assume that their sins may be forgotten."[99] Even if a defendant's conduct was wrongful, when a statute provides a statute of limitations, that defendant is entitled to benefit from the principles of repose and certainty embedded in the limitation.

The second policy consideration reaffirmed by *Gabelli* is the importance of the public's trust in the enforcement system. The SEC's job is to enforce the law fairly, impartially, and expeditiously in a manner consistent with the principles of repose and certainty.[100] Since the principles of repose and certainty are part of the public interest, enforcement that is contrary to those principles would erode the public's confidence in the SEC and its ability to enforce the law.[101] Enforcement of penalty actions under a discovery rule theory would undermine the principles of repose and certainty, so it is in the public's best interest that § 2462 does not contain a discovery rule.

Some might argue that the public welfare is better promoted by the application of the discovery rule to § 2462 to extend statutes of limitations based on the difficulty of detecting fraudulent conduct.[102] However, a discovery rule would allow an agency to "target a disfavored company or individual at any time, review decades of past conduct for potential regulatory violations, and bring stale claims long after the relevant events have passed."[103] Such an indefinite risk of exposure would "chill innocent and valuable activities."[104] Further, while congressional response to market failures can certainly include increased federal regulation, those regulations are rarely repealed.[105] When those regulations are cast broadly—as the discovery rule would cast §

97. Order of R.R. Telegraphers v. Ry. Express Agency, Inc., 321 U.S. 342, 348–49 (1944).

98. Wood v. Carpenter, 101 U.S. 135, 139 (1879).

99. Wilson v. Garcia, 471 U.S. 261, 271 (1985).

100. Brief of Former SEC Commissioners, *supra* note 89, at 11–12.

101. *Id.* at 12.

102. Brief of Occupy the SEC, *supra* note 93, at 6–7.

103. Brief of the Cato Institute, *supra* note 83, at 18.

104. *Id.* at 19.

105. *Id.*

2462—they expose defendants to an increased liability in punitive actions that Congress did not originally intend.[106] The indefiniteness and breadth of such a rule would only damage the public's trust in the enforcement system. *Gabelli*, therefore, legitimizes the enforcement system by providing a definitive limitation on civil penalty actions under § 2462.

V. CONCLUSION

Punishing financial fraud is an important and necessary job for government agencies like the SEC. Given recent economic crises, it is important to target fraudulent conduct in order to provide certainty, stability, and confidence in the marketplace. However, government regulation of financial fraud must still abide by fundamental principles of fairness. In the case of *Gabelli*, these fundamental principles of fairness are shaped by the statutory language and history of § 2462, the different natures of private plaintiffs and government enforcers, and the difficulty courts would face in applying the discovery rule against a government agency. Government agencies can be powerful actors, with a multitude of privileged tools in their arsenals that help detect and punish fraudulent conduct. Private actors' use of the discovery rule to prolong claims of financial fraud does not compromise a defendant's rights to repose and certainty in the way that a government agency's use of the discovery rule would. In *Gabelli*, the Supreme Court not only acknowledged this danger to defendants, but also recognized the tremendous burden that such a rule would place on the judicial system. Cognizant of these concerns, the Supreme Court made the difficult but correct decision to curtail the government's ability to punish financial fraud. In order for the economic system to be legitimate, the methods of enforcement must be legitimate as well.

106. *Id.* at 20–21.