No. 11-1274

IN THE

Supreme Court of the United States

MARC J. GABELLI AND BRUCE ALPERT,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

"Except as otherwise provided by Act of Congress," any governmental enforcement action must be "commenced within five years from the date when the claim first accrued." 28 U.S.C. § 2462. The government commenced this enforcement action more than five years after its claims first accrued, and no other statute extends the limitation period. The question presented is whether the district court properly dismissed the government's claims as untimely.

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INTEREST OF *AMICI CURIAE*[1]

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA files *amicus curiae* briefs in cases that raise legal issues of vital concern to the participants in the securities industry, including in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011); *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); and *Merck & Co. v. Reynolds*, 130 S. Ct. 1784 (2010).

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents 300,000 direct

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[1] Pursuant to this Court's Rule 37.3(a), all parties consented in writing to the filing of this brief. Pursuant to this Court's Rule 37.6, *amici curiae* state that this brief was not authored in whole or in part by counsel for any party, and no such counsel or any party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity other than *amici curiae*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief.

members and indirectly represents an underlying membership of more than three million businesses and professional organizations of every size, in every industry sector, and from every geographic region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber also filed amicus briefs in *Janus*, *Morrison*, and *Merck*.

Amici curiae represent businesses for which the efficient and fair application of the securities laws is of great consequence. *Amici* recognize that appropriate exercise of the investigatory and enforcement powers afforded by Congress to the Securities and Exchange Commission ("SEC") plays an important role in the regulation of the nation's financial markets to the benefit of investors and other market participants. It is equally true, however, that belated and misdirected enforcement efforts risk undermining the health and stability of our capital markets and of the financial services industry. *Amici* respectfully submit that pursuit of old and stale claims poses a particularly acute threat of governmental overreaching, as Congress has recognized in establishing statutes of limitations and repose for actions involving alleged violations of the federal securities laws. As explained in more detail below, evenhanded adherence to such provisions will best enhance fairness and efficiency and investor welfare. As a result, this Court should apply the five-year statute of limitations in 28 U.S.C. § 2462 as written, without implication of the "discovery rule" requested by the SEC and erroneously approved by the Second Circuit.

SUMMARY OF THE ARGUMENT

This Court has repeatedly emphasized the importance of adhering to the statutory text and structure of the securities laws in order to provide the financial markets and their participants the predictability they require to function properly. In violation of that principle, the Second Circuit engrafted a "discovery rule" onto the five-year statute of limitations applicable to governmental enforcement actions (28 U.S.C. § 2462), transmuting a bright-line rule into a shifting and uncertain inquiry. The Second Circuit's decision contravenes the statutory scheme and constitutes bad public policy.

I. Under Section 2462, the timeliness of an SEC penalty action turns on the date the claim "accrued" or came into existence, not the date on which the SEC asserts it first discovered the alleged fraud.

A. The plain text of Section 2462 does not contain a discovery rule. Congress created two exceptions to the Section 2462 limitations period, neither of which is the discovery rule the SEC seeks. Congress has also incorporated a discovery rule into other statutes of limitations, but did not do so here.

B. Judicially implying a discovery rule is particularly inappropriate in the securities-law context because it invades the proper province of the Legislature, creating uncertainty that Congress may have deemed unwise and unnecessary. This Court has refused to expand securities-law liability where, as here, Congress has not done so itself.

II. Engrafting a discovery rule onto Section 2462 would degrade, not enhance, enforcement of the securities laws. Indefinite extension of the statute of limitations for SEC enforcement actions would lead to perverse incentives, diminish the SEC's enforce-

ment capabilities, and injure innocent businesses and individuals.

A. A discovery rule would weaken enforcement of the securities laws by encouraging the SEC to devote resources to old and stale cases, rather than focusing on its primary enforcement goals—the cessation of recurring misconduct and the prevention of ongoing investor losses. Further, determining the timeliness of SEC penalty actions under a discovery rule would require a fact-intensive inquiry into the SEC's investigative process that would jeopardize the confidentiality on which the SEC relies to perform its enforcement functions.

B. The five-year period provided by Section 2462 is more than enough time for the SEC to discover a securities-law violation and file a complaint. Indeed, it is as long as or longer than the amount of time provided to victims of securities fraud to file private enforcement actions. Discovery rules are traditionally intended to assist tort victims. They are not intended to assist regulatory agencies with vast investigative resources and powers at their disposal to bring enforcement claims.

C. Finally, a discovery rule would create uncertainty in the financial markets by leaving companies, investors and individuals exposed to unending potential liability for conduct they believed, in good faith, to have been lawful.

For each of these reasons, the Second Circuit's decision should be reversed and the district court's judgment dismissing this action as untimely should be reinstated.

ARGUMENT

It is up to Congress, not the courts, to decide whether to adopt a discovery rule for securities-fraud claims—as, indeed, Congress has explicitly done in *other* securities statutes but *not* in Section 2462. Judicial implication of a discovery rule would leave market participants confronted with the indeterminate potential of an SEC enforcement action for long-ago conduct, as well as unpredictable and unquantifiable penalties that turn on a fact-specific inquiry into the adequacy of the SEC's efforts to "discover" the alleged fraud. The Second Circuit's decision should be reversed.

I. SECTION 2462 DOES NOT INCLUDE A DISCOVERY RULE.

The discovery rule that the SEC advocates is contrary to the plain text of Section 2462. Judicially rewriting this straightforward statute to include a discovery rule would be improper in any context, but it is especially inappropriate in the securities-law context where this Court has emphasized the importance of clear and predictable limits to liability. As it has done for the past two decades, this Court should adhere to the text of the securities statutes that Congress has enacted, leaving modifications of those laws to Congress.

A. The Statutory Text Precludes Judicial Implication Of A Discovery Rule.

According to Section 2462, the limitations period for the SEC's penalty action began to run no later than 2002, when the underlying conduct ceased and the SEC's claim came into existence—not in 2003, when the SEC asserts that it first discovered the alleged fraud. Thus, the limitations period had ex-

pired when the SEC filed this case in 2008. Accordingly, the district court properly dismissed it as untimely. Pet. App. 34a–39a.

1. The SEC alleges that petitioners' conduct between 1999 and 2002 violated the Investment Advisers Act ("IAA"), 15 U.S.C. § 80b-6, and seeks civil monetary penalties for those alleged violations. Pet. App. 6a–11a. The IAA, like many federal statutes, does not set forth a specific time period within which the government must institute enforcement actions. In such instances, the five-year limitations period set forth in 28 U.S.C. § 2462 controls. *See 3M Co. v. Browner*, 17 F.3d 1453, 1455 (D.C. Cir. 1994); Pet. App. 17a; *see also SEC v. Mohn*, 465 F.3d 647, 653 (6th Cir. 2006) (applying Section 2462 to an SEC enforcement action seeking civil fines); *Johnson v. SEC*, 87 F.3d 484, 485 (D.C. Cir. 1996) (applying Section 2462 to an SEC action for civil penalties); *SEC v. Jones*, 476 F. Supp. 2d 374, 380 (S.D.N.Y. 2007) (applying Section 2462 to an IAA claim).

Section 2462 is a "default" limitations period that states in its entirety:

> 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.

Despite this statutory prohibition on courts hearing cases filed more than five years after accrual, the SEC instituted this action in 2008—more than eight

years after the alleged misconduct began and almost six years after it ended. Pet. App. 9a. The SEC sought to excuse this delay by asserting that the claim did not "accrue" under Section 2462 until the agency first "discovered" the alleged wrongdoing, which (according to the SEC) did not occur "until late 2003." *Ibid.*

The plain text of Section 2462, however, precludes the SEC's interpretation. At the time Section 2462's predecessor was first enacted in 1839, the term "accrue" meant the occurrence of the event giving rise to the cause of action, and did not support application of a discovery rule. *See*, *e.g.*, *Bank of the U.S. v. Daniel*, 37 U.S. (12 Pet.) 32, 56 (1838) (The "cause of action . . . accrued at the time the mistaken payment was made"); *Wilcox v. Plummer*, 29 U.S. (4 Pet.) 172, 181 (1830) (holding that a claim accrues at the moment a violation occurs). That meaning persists today. "In common parlance a right accrues when it comes into existence," not when it is first discovered. *United States v. Lindsay*, 346 U.S. 568, 569 (1954); *see also Black's Law Dictionary* 23 (9th ed. 2009) (defining "accrue" as "[t]o come into existence as an enforceable claim or right").

Section 2462 therefore precludes the discovery rule the SEC seeks because, by its express terms, the limitations period runs from accrual and not discovery. The SEC's enforcement action came into existence no later than 2002, when the events underlying the action ceased—six years before the SEC filed suit. Thus, the SEC's action is untimely.

2. The context of Section 2462 further confirms that the Court should not adopt the discovery rule urged by the SEC. The statute provides two exceptions, neither of which is a discovery rule: First, Sec-

tion 2462 states that the limitations period may be "otherwise provided by Act of Congress." 28 U.S.C. § 2462. It is undisputed, however, that no "Act of Congress" has added a discovery rule to Section 2462 or authorized one for IAA enforcement actions. Second, the five-year limitations period does not apply unless, "within the same period, the offender or the property is found within the United States." *Ibid.* But that exception is not relevant here either. "Where Congress [has] explicitly enumerate[d] certain exceptions," this Court should not imply an additional unenumerated exception. *Andrus v. Glover Constr. Co.*, 446 U.S. 608, 616–17 (1980) (citing *Cont'l Cas. Co. v. United States*, 314 U.S. 527, 533 (1942)).

Moreover, when Congress wishes to incorporate a discovery rule into a statute of limitations period—in the securities-law context or otherwise—it does so explicitly. *See*, *e.g.*, 15 U.S.C. § 77m ("No action shall be maintained . . . unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . ."); *id.* § 77www(a) (one-year discovery rule); *id*. § 78i(f) (same); *id*. § 78r(c) (same); 28 U.S.C. § 1658(b)(1) ("[A] private right of action . . . may be brought not later than . . . 2 years after the discovery of the facts constituting the violation"). Even outside the securities-law context, Congress is explicit about its adoption of a discovery rule for anti-fraud claims. *See*, *e.g.*, Federal Trade Commission Act, 15 U.S.C. § 1679i (fraudulent practices by credit repair organizations); False Claims Act, 31 U.S.C. § 3731(b) (false claims to the government); Federal Food, Drug and Cosmetic Act, 21 U.S.C. § 335b(b)(3) (fraudulent

practices in connection with certain drug applications).

Importantly, when Congress enacts a discovery rule in the securities-law context, it typically couples the rule with a longer statute of repose in order to place an outer bound on the limitations period. For example, 15 U.S.C. § 77m, which contains the discovery rule described above, also provides that "[i]n no event shall any such action be brought . . . more than three years after" the event triggering liability. *See also id.* § 777www(a) (coupling one-year discovery rule with three-year statute of repose); *id.* § 78i(f) (same); *id.* § 78r(c) (same); 28 U.S.C. § 1658(b)(1), (2) (coupling two-year discovery rule with five-year statute of repose).

In fact, with only one exception, *all* of the causes of action created by the Securities Exchange Act of 1934 ("Exchange Act") originally "include[d] some variation of a 1-year period after discovery combined with a 3-year period of repose." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360 (1991); *see also Merck & Co. v. Reynolds*, 130 S. Ct. 1784, 1790 (2010) (interpreting a later-enacted limitations period that included an express 2-year discovery rule with a 5-year statute of repose).

In contrast to the legislative determination to couple discovery rules with repose periods, the SEC asks this Court to judicially imply a discovery rule that is unaccompanied by a statute of repose, giving the SEC potentially unlimited time to discover a securities fraud—and then five *more* years to bring an enforcement action. Section 2462 "quite clearly does not extend the period in th[e] manner" proposed by the SEC. *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1419 (2012).

"Congress could have very easily provided" for the discovery rule the SEC seeks in Section 2462 or elsewhere, "[b]ut it did not." *Simmonds*, 132 S. Ct. at 1419. Neither the text nor context of the statute give any hint of the discovery rule on which the SEC relies. Because "[t]he text of [Section 2462] simply does not support the [SEC's desired discovery] rule," *ibid.*, this Court need go no further to resolve this case. The SEC's action is untimely.

B. The Structure Of The Securities Laws Further Precludes Judicial Implication Of A Discovery Rule.

In the securities-law context, this Court has expressed particular concerns about judicial modifications to the statutory regime because of the direct and potentially serious consequences of such adjustments on market participants. Although Section 2462 is a statute of general applicability and is not limited to securities-law causes of action, any interpretation of that statute of limitations would govern *all* applications of the statute, including the securities-law application at issue here. *See Clark v. Martinez*, 543 U.S. 371, 380 (2005) ("The lowest common denominator, as it were, must govern"); *Leocal v. Ashcroft*, 543 U.S. 1, 11–12 n.8 (2004) ("[W]e must interpret the statute consistently . . ."). Viewed through the lens of this Court's recent securities-law jurisprudence, the discovery rule is especially inappropriate.

Over the past 20 years, this Court has increasingly recognized the importance of "pa[ying] close attention to the statutory text in defining the scope of" securities statutes. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 169 (1994) (discussing Section 10(b) of the Exchange

Act, the most well-known of the anti-fraud provisions of the securities laws). The Court has expressed particular concern about the deleterious effects of imposing "unclear" "rules for determining . . . liability . . . in an area that demands certainty and predictability," *id*. at 188 (internal quotation marks omitted), something Congress is better suited to provide. And the Court has cautioned that "[t]he decision to extend [a securities-law] cause of action is for Congress, not for us." *Stoneridge Inv. Partners, LLC v. Scientific-Atlantic, Inc.*, 552 U.S. 148, 165 (2008). In this case, the Court should once again decline to expand the potential for liability under the securities laws beyond the plain text enacted by Congress.

1. In *Central Bank*, the Court held that Section 10(b) did not allow for aiding and abetting liability because "the statutory text," which "controls the definition of conduct covered by § 10(b)," "does not itself reach those who aid and abet a § 10(b) violation." 511 U.S. at 175, 177. The Court refused to consider "whether imposing private civil liability on aiders and abettors is good policy," looking only at "whether aiding and abetting is covered by the statute." *Id.* at 177; *see also id.* at 176 ("Congress knew how to impose aiding and abetting liability when it chose to do so"). Any other outcome, the Court cautioned, would have risked "lead[ing] to the undesirable result of decisions 'made on an ad hoc basis, offering little predictive value' to those who provide services to participants in the securities business." *Id.* at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). It also would have created "'shifting and highly fact-oriented'" results that fail to provide "a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions.'" *Ibid.* (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755

(1975)); *see also Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1106 (1991) ("The issues would be hazy, their litigation protracted, and their resolution unreliable. Given a choice, we would reject any theory . . . that raised such prospects"). Thus, to avoid creating uncertainty in the enforcement of the securities laws, the Court concluded that "the statute itself resolve[d] the case." *Cent. Bank*, 511 U.S. at 178.

A decade later, the Court again hewed to the statutory text when it refused to extend Section 10(b) to encompass so-called "'scheme liability,'" which was not provided in the express language of the statute. *Stoneridge*, 552 U.S. at 159. As it did in *Central Bank*, the Court again pointed to "the potential for uncertainty and disruption" that implying such a rule would create—risks that could "raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets." *Id.* at 163–64. Moreover, the Court sought to foreclose further judicial expansion of Section 10(b) by declaring that the PSLRA reflected Congress's decision to "accept[ ] the § 10(b) private cause of action as then defined but . . . extend it no further." *Id.* at 166; *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 327 (2007) ("It is the federal lawmaker's prerogative . . . to allow, disallow, or shape the contours of—including the pleading and proof requirements for—§ 10(b) private actions").

The Court's text-focused approach has extended beyond determining the scope of Section 10(b) liability in private actions. For example, the Court has held that SEC enforcement actions require the government to prove scienter. *See Aaron v. SEC*, 446 U.S. 680, 689–95 (1980) (referring to "the plain

meaning" of Section 10(b) as "[t]he most important" determinant of its decision). The Court has also refused to expand the Section 10(b) limitations period by implying an equitable tolling rule that does not appear in the statute's text. *See Lampf*, 501 U.S. at 363. With respect to other securities statutes as well, the Court has carefully followed the text. *See*, *e.g.*, *Gustafson v. Alloyd Co.*, 513 U.S. 561, 567–68 (1995) (interpreting the meaning of the term "prospectus" under then-Section 12(2) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77*l*(2)); *Pinter*, 486 U.S. at 624–25 (interpreting "seller" for purposes of then-Section 12(1) of the Securities Act, 15 U.S.C. § 77*l*(1)).

2. Even though *Central Bank* and *Stoneridge* addressed the Section 10(b) private action, their animating principle of deference to Congress is equally applicable—if not more so—in the SEC enforcement context because Congress has been particularly active in establishing and adjusting the SEC's enforcement authority.

In recent years, Congress has expressly expanded the SEC's authority several times. The Court's decision in *Central Bank*, for example, prompted Congress to consider the proper scope of aiding and abetting liability when it passed the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 ("PSLRA")—which adopted aiding and abetting liability for SEC actions but not for private actions under Section 10(b). *See* 15 U.S.C. § 78t(e). In the Sarbanes-Oxley Act of 2002, Congress expanded the SEC's authority by broadening the financial disclosure obligations of companies and enhancing the penalties for fraud. *See* Pub. L. No. 107-204, sec. 302, 116 Stat. 745, 777 (codified at 15 U.S.C. § 7241). Even more recently, after this Court

held that Section 10(b) of the Exchange Act did not have extraterritorial application, *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2883 (2010), Congress revised the law in an effort to allow the SEC to reach certain extraterritorial securities-law violations. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 929P(b)(2), § 78aa, 124 Stat. 1376, 1865 (2010).

Congress has also commissioned studies of these and other evolving topics regarding securities-law enforcement and design. *See*, *e.g.*, U.S. Gov't Accountability Office, GAO-83-118, *Analysis of SEC's Recommendation to Repeal the Public Utility Holding Company Act* (1983) (evaluating repeal of the Public Utility Holding Company Act of 1935, which Congress decided against); U.S. Gov't Accountability Office, GAO-95-153, *Financial Market Regulation: Benefits and Risks of Merging SEC and CFTC* (1995) (analyzing potential merger between the SEC and the Commodities Future Trading Commission, which never occurred); U.S. Gov't Accountability Office, GAO-11-664, *Securities Fraud Liability of Secondary Actors* (2011) (considering potential impact of creating a statutory private right of action for aiding and abetting securities law violations).

If courts take it upon themselves to expand the SEC's authority without regard for the limits Congress has established, then Congress would be absolved of its responsibility to reevaluate and (when necessary) adjust those limits. If, on the other hand, courts enforce the securities laws Congress has enacted—as this Court has insisted on doing over at least the last twenty years—then the SEC will continue to ask Congress for new and different laws when it believes they are necessary and appropriate. Congress can then balance competing policy and con-

stituent concerns (in a way that courts in a single case cannot do) and decide whether to agree to those requests. In our system of separated powers, this ongoing dialogue among the executive, judicial, and legislative branches is the proper course of proceeding.

3. In this case, the SEC seeks a special exception to the Section 2462 limitations period for enforcement actions that would allow it to pursue civil penalties more than five years after the alleged securities fraud has ceased. But, even though Congress has enacted several statutes clarifying and expanding the SEC's enforcement authority—and has adopted several securities-law statutes of limitations that expressly contain discovery rules (*see supra*, pp. 8–9)—it has never expanded the Section 2462 limitations period to include the discovery rule the SEC seeks. Nor does it typically enact discovery rules in the securities-law context that are unaccompanied by a statute of repose, as the SEC asks the Court to do here. To the contrary, Congress has consistently fashioned limitations periods more restrictive than the rule the SEC is proposing.

Especially in such circumstances, where Congress has pursued a course *other* than the one the SEC proposes, this Court has not endorsed judicially crafted expansions of securities-law liability. For example, the Court rejected an expansive view of secondary liability under Section 10(b), in part because Congress had provided for a more limited form of the liability under a separate provision of the Exchange Act, Section 20(a). *See Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2304 (2011). The Court also declined to extend civil liability under Section 10(b) to "merely negligent conduct," because doing so "would run counter to the fact that

wherever Congress intended to accomplish that result, it said so expressly and subjected such actions to significant procedural restraints not applicable to § 10(b)." *Aaron*, 446 U.S. at 690; *see also Cent. Bank*, 511 U.S. at 184 ("[W]hen Congress wished to create . . . secondary liability, it had little trouble doing so") (internal quotation marks omitted).

Further, the SEC's proposed discovery rule would turn an easy-to-apply five-year limitations period into an undetermined length of time that depends on an unpredictable inquiry into when the SEC "should have" discovered the alleged fraud. *See* Michael J. Kaufman & John M. Wunderlich, *Toward a Just Measure of Repose: The Statute of Limitations for Securities Fraud*, 52 Wm. & Mary L. Rev. 1547, 1609 (2011) ("A bright-line rule removes the uncertainty that plagues [the] 'discovery' standard"). That, in turn, would result in precisely the type of "ad hoc" outcomes based on the conduct of others—here, the government's choice of enforcement priorities and its allocation of resources—that this Court has warned against in the securities-law context. *Cent. Bank*, 511 U.S. at 188; *see also Stoneridge*, 552 U.S. at 163–64; Christopher A. Ford, *Knowledge and Notice in Section 10(b) Limitations Law*, 103 Yale L.J. 1939, 1951 (1994) ("Particularly in the field of securities law . . . limitations periods provide repose not only for the allegedly guilty parties but for potentially large numbers of innocent dependents who rely upon the continued financial health of a defendant").

If Congress wished to enact such an amorphous securities-law limitations period, that would be its "prerogative." *Tellabs*, 551 U.S. at 327. And, if it were to do so, it would almost certainly append a statute of repose as well. *See supra*, p. 9. There is no reason for this Court to adopt an unlimited extension

of the securities-fraud limitations period where Congress has not done so—and does not typically do so—itself.[2]

II. AN IMPLIED DISCOVERY RULE WOULD BE BAD POLICY.

Even if the text and context of Section 2462 afforded this Court sufficient leeway to adopt the discovery rule requested by the SEC, it should not do so because the rule the SEC advocates is potentially harmful and unnecessary. Although such a rule might lead to more enforcement actions, it would also lead to perverse incentives, diminish the SEC's effectiveness, and injure innocent companies and individuals.

A. A Discovery Rule Would Weaken The Enforcement Of The Securities Laws.

The discovery rule the SEC proposes has the potential to degrade efficient enforcement of the securities laws. As this Court has noted, just because a construction of a statute "[e]xtend[s]" the reach of the securities laws, "it does not follow that the objectives

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[2] The SEC's proposed discovery rule would also violate the well-established rule of lenity that applies to punitive statutes, whether civil or criminal. *See*, *e.g.*, *Comm'r v. Acker*, 361 U.S. 87, 91 (1959) ("The law is settled that penal statutes are to be construed strictly") (internal quotation marks omitted); *see also Tiffany v. Nat'l Bank of Mo.*, 85 U.S. (18 Wall.) 409, 410 (1874). In *Acker*, the Court declined to adopt the IRS's interpretation of the Internal Revenue Code to permit the assessment of a tax penalty where it "fail[ed] to find any expressed or necessarily implied provision or language that" supported the interpretation. *Acker*, 361 U.S. at 91. As it should do here, the Court emphasized the longstanding rule that "one is not to be subjected to a penalty unless the words of the statute plainly impose it." *Ibid.* (internal quotation marks omitted).

of the statute are better served." *Cent. Bank*, 511 U.S. at 188 (referring to "the goals of fair dealing and efficiency in the securities markets"). This case provides a compelling example of that principle.

1. In an enforcement action like this one that the SEC brings more than five years after the events in question, the SEC's proposed discovery rule would place a burden on defendants to prove that the SEC was not diligent in uncovering the alleged fraud earlier. That, in turn, would likely require the targets of enforcement actions to conduct discovery into the SEC's activities, leading to mini-trials of the SEC's investigative process, priorities, and resource-allocation decisions, all within the trial on the merits.

As a practical matter, determining when "the SEC," as a whole, discovered a violation would be fact-intensive and difficult. It is the agency's staff that conducts investigations by issuing orders, seeking documents, and subpoenaing witnesses. SEC Div. of Enforcement, *Enforcement Manual* 31 (2012), *available at* http://www.sec.gov/divisions/enforce/enforcementmanual.pdf ("*SEC Enf. Manual*"). Thus, under the SEC's proposed rule, courts and juries would have to decide whether a lone staff attorney's actions—sending out a single subpoena, or interviewing a single witness, for example—suffice to constitute "knowledge" on behalf of the SEC.

Moreover, the need to resolve such questions points to the possibility of routine and otherwise unnecessary discovery into the SEC's investigative and decisional processes. Such discovery could have deleterious effects on federal investigators, not to mention the companies and individuals that are the subject of investigation and anyone who cooperates with

the SEC. As the SEC has explained: "[I]nvestigations are conducted confidentially to protect evidence and reputations." SEC, Investigations by the Securities and Exchange Commission, http://www.sec.gov/answers/investg.htm (last modified Jan. 19, 2012). Disclosure of confidential information that is not relevant to the merits of the claims alleged in the case could also undermine the SEC's ability to secure assistance from whistleblowers, tipsters, and other uninvolved corporations and individuals. Indeed, the SEC cautions that, at least in certain situations, "disclosure . . . of the Commission's cooperation program . . . would adversely affect related ongoing investigations or proceedings." *SEC Enf. Manual* at 136; *see also* Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 63237 at 25–26, 41 (Nov. 3, 2010) (recognizing that disclosure of confidential information could reveal a whistleblower's identity).

According to the Second Circuit, the statute of limitations starts running when the SEC knew or "should have" known of the misconduct. Pet. App. 17a. Under that rule, a target of an SEC investigation seeking to establish a limitations defense will be entitled to discover how and when the SEC obtained its knowledge, even when those facts have no other relevance to the merits of the litigation. *See Lindsey v. Normet*, 405 U.S. 56, 66 (1972) ("Due process requires that there be an opportunity to present every available defense") (internal quotation marks omitted). A bright-line, five-year limit, on the other hand, eliminates the need for such discovery, permitting the limitations defense to be resolved in an early, dispositive motion.

2. A discovery rule would create other problems for the SEC as well. An action filed five years after a claim has accrued will not likely go to trial for another one to two years. When claims are "allowed to slumber" for that long, often "evidence has been lost, memories have faded, and witnesses have disappeared." *Order of R.R. Telegraphers v. Ry. Express Agency*, 321 U.S. 342, 349 (1944); *see also United States v. Kubrick*, 444 U.S. 111, 117 (1979). This concern is particularly acute in the securities industry, which experiences high employee turnover and cyclical downsizing. Five or more years after an event has occurred, the relevant employees are less likely than employees in other industries to be performing the same job function with the same employer, making the investigation and trial more difficult and costly.

Furthermore, trials conducted so long after the underlying events took place breed disrespect for the legal process, *see* Tyler T. Ochoa & Andrew J. Wistrich, *The Puzzling Purposes of Statutes of Limitation*, 28 Pac. L.J. 453, 481–83 (1997), because they lead to less predictable results and a greater risk of injustice: "As the SEC . . . bring[s] cases that are increasingly distant from the time of the alleged violations, faded memories and the disappearance of evidence may make it harder for the SEC to prove violations (and harder for some innocent defendants to demonstrate their blamelessness)." Arthur B. Laby & W. Hardy Callcott, *Patterns of SEC Enforcement Under the 1990 Remedies Act: Civil Monetary Penalties*, 58 Alb. L. Rev. 5, 52 (1994); *cf. SEC v. Bartek*, No. 11-10594, 2012 WL 3205446 (5th Cir. Aug. 7, 2012) (per curiam) (affirming dismissal of SEC suit as untimely). To extend the limitations period be-

yond five years, as the SEC urges, would make matters even worse.

A longer discovery rule would also detract from the agency's effectiveness. The SEC's primary enforcement mission is remedial in nature—the cessation of ongoing misconduct and the prevention of recurring offenses that lead to investor losses—not punitive. *See SEC Enf. Manual* at 1. Although Congress decided in 1990 to provide the SEC with the ability to seek civil penalties in order to punish and deter violators, those punitive pursuits were intended to be only a supplement to existing punitive, criminal enforcement of the securities laws, and not a substitute for the SEC's primary civil remedial authority. *See* S. Rep. No. 101-337, at 11 (1990) ("The Committee anticipates that the SEC will not seek or impose a civil money penalty in every case"); *see also id.* at 11–12; *Securities Law Enforcement Remedies Act of 1989: Hearings on S. 647 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 101st Cong., 2nd Sess. 44–45 (1990) (statement of Richard C. Breeden, Chairman, Securities and Exchange Commission) ("[W]here the defendant in a Commission action is also the subject of a criminal prosecution, the imposition of a civil money penalty in the Commission's action may not be needed to achieve deterrence").

Having a firm end date for enforcement actions seeking punitive sanctions encourages the SEC to focus its resources on its core remedial mission—pursuing fresh cases that, if urgently investigated, might prevent investor losses. Engrafting a discovery rule onto Section 2462, on the other hand, would induce the SEC to expend more enforcement resources seeking civil penalties in old and stale cases. *See* Laby & Callcott, *supra*, at 51–52.

In addition, the pursuit of older cases would result in delay in the imposition of sanctions, which is "generally thought to reduce the effectiveness of deterrence against other offenses, both by the offender (who sees no immediate sanction for his misconduct) and by others (who see the offender appearing to get away with his misconduct)." Laby & Callcott, *supra*, at 52. Indeed, the incumbent Director of Enforcement, noting his disapproval of agreements to toll the statute of limitations, stated that delay can "impose a significant cost . . . and may undermine our message of prompt accountability for wrongdoing." Robert S. Khuzami, Dir., SEC Div. of Enforcement, My First 100 Days as Director of Enforcement (August 5, 2009), *available at* http://www.sec.gov/news/speech/2009/spch080509kr.htm; *see also ibid.* (announcing the SEC's intention to be "strategic . . . swift, . . . smart . . . [and] successful" by establishing specialized enforcement units, streamlining management and internal processes, analyzing tips and data to focus on those with the greatest potential for wrongdoing, and creating incentives for individuals to cooperate with the enforcement program).

B. A Discovery Rule Is Unnecessary.

The SEC's proposed discovery rule is also unnecessary. Discovery rules have historically been used to help compensate tort victims, who may not be immediately aware of the fraud that has been perpetrated on them. *See*, *e.g.*, *3M Co.*, 17 F.3d at 1460; *see also* Adam Bain & Ugo Colella, *Interpreting Federal Statutes of Limitations*, 37 Creighton L. Rev. 493, 553–60 (2004). "[W]here a plaintiff has been injured by fraud and remains in ignorance of it without any fault or want of diligence or care on his part," the discovery rule suspends the running of the statute of limitations so as to avoid inflicting further injustice

on the tort victim. *TRW Inc. v. Andrews*, 534 U.S. 19, 27 (2001) (internal quotation marks omitted); *see also Merck*, 130 S. Ct. at 1793–94.

In this case, however, the discovery rule the SEC seeks would not help compensate tort victims. Victims of securities fraud may bring their fraud claims under a separate statute that already includes a discovery rule. *See Merck*, 130 S. Ct. at 1790. Moreover, SEC enforcement actions like this one that seek civil penalties are not even *intended* to compensate fraud victims. Rather, when the SEC seeks civil penalties under the Securities Remedies and Penny Stock Reform Act of 1990, as it does here, its primary purpose is to punish and deter the malefactors, not to compensate the victims. *See* H.R. Rep. No. 101-616, at 19 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 1386 (explaining the need for increased punishments and deterrence); S. Rep. No. 101-337, at 2 ("The legislation addresses the disturbing levels of financial fraud, stock manipulation and other illegal activity in the U.S. markets by authorizing new civil money penalties to deter unlawful conduct by increasing the financial consequences of securities law violations").

Nor does the SEC require a discovery rule to help it discover fraud, as a tort victim does. Unlike a private tort victim, the SEC is a federal agency with significant resources at its disposal, whose "mission is to . . . investigat[e] potential violations of the securities laws." *SEC Enf. Manual* at 1. The SEC has substantial powers and resources available to it that private litigants do not have. For example:

- The SEC's Division of Enforcement alone has an annual budget of more than $500,000,000 and employs more than 1,350 full-time em-

ployees. SEC, *FY 2013 Congressional Justification* 51 (2012), *available at* http://www.sec.gov/about/secfy13congbudgjust.pdf ("*SEC Cong. Just.*"); *see also* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. Pa. L. Rev. 69, 149–63 (2011) (the SEC "has emerged in recent years as an expansive and powerful enforcement apparatus").

- Its Office of Compliance, Inspections and Examinations, which conducts on-site examinations of securities brokers, investment advisors and markets, and refers potential violations for enforcement action, has an additional 1,000 full-time employees. *See SEC Cong. Just.* at 52.
- The SEC's Division of Corporation Finance also reviews public company filings in order to assure compliance with financial disclosure and reporting laws. *Id.* at 5.
- The agency draws on the surveillance work of the Financial Industry Regulatory Authority and the Public Company Accounting Oversight Board, among others bodies, to detect potential violations of law. *Id.* at 2.
- Unlike most civil litigants, the SEC also has plenary authority to issue compulsory process to investigate possible violations before commencing suit. *See*, *e.g.*, 15 U.S.C. § 78u-1(a)(1).

Drawing on all of these resources, "[d]uring FY 2011, the Commission . . . [f]iled 735 enforcement actions—more than ever filed in a single year in SEC history"—and "obtained more than $2.8 billion in penalties and disgorgement." *SEC Cong. Just.* at 1.

And the SEC matched or exceeded those numbers in FY 2012. *See* Brian Mahoney, *SEC Matches Last Year's Enforcement Peak With 734 Actions*, Law360, Nov. 14, 2012, *available at* http://www.law360.com/articles/394051/sec-matches-last-year-s-enforcement-peak-with-734-actions ("The SEC won approximately $3 billion in penalties and disgorgement from a wide variety of enforcement actions in fiscal year 2012.").

In addition, as a result of the Dodd-Frank Act, the SEC offers substantial bounties and other rewards so that insiders with knowledge of fraud and other violations will report them directly to the agency. *See* Pub. L. No. 111-203, sec. 922, 124 Stat. at 1841-49 (codified at 15 U.S.C. § 78u-6). The SEC has stated that this "Whistleblower Program . . . is providing high-quality information regarding otherwise difficult to detect wrongdoing and permitting investigators to focus resources more efficiently." *SEC Cong. Just.* at 1. In 2011, the agency launched 349 enforcement investigations as a result of tips or complaints from outside sources. *Id.* at 28; *see also* SEC, Welcome to the Office of the Whistleblower, http://www.sec.gov/whistleblower (last visited Nov. 15, 2012); SEC, *Annual Report on the Dodd-Frank Whistleblower Program* 5 (2011), *available at* http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf. As the Director of the SEC's Division of Enforcement remarked, "information from whistleblowers will allow us to build stronger cases and move more quickly, thus increasing the chance of stopping frauds early . . . ." Robert S. Khuzami, Dir., SEC Div. of Enforcement, Speech by SEC Staff: Remarks at Open Meeting—Whistleblower Program (May 25, 2011), *available at* http://www.sec.gov/news/speech/2011/spch052511rk.htm.

In light of those resources and powers, the five-year limitations period provided by Section 2462 is sufficient for the SEC to uncover fraud *and* file an enforcement action. Five years is already as long as or longer than the statute of repose provided for every cause of action under either the Securities Act or the Exchange Act. *See Lampf*, 501 U.S. at 359–61. It equals—and often exceeds—the amount of time that *victims* of securities fraud (who do not have investigative powers) have to file private enforcement actions under Section 10(b). *See Merck*, 130 S. Ct. at 1790 (citing 28 U.S.C. § 1658(b)). And, in an unusual case where the SEC does need more time to file an enforcement action, the agency can (and often does) ask the subject of the investigation to consent to a tolling agreement. *See SEC Enf. Manual* at 39. Or the agency can commence a civil action and use federal civil discovery to obtain the evidence needed to prove its claims. *See*, *e.g.*, *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 112–13 (S.D.N.Y. 1981) (lawsuit to enjoin transfer of allegedly illegal proceeds pending discovery of the identity of the perpetrators).

The SEC has not shown that any broad category of cases is escaping detection or punishment as a result of Section 2462's five-year statute of limitations. Indeed, the SEC's statistics show that the "average number [of] months between the opening of an investigation and the filing of the first enforcement action arising out of that investigation" is only 20 months—*less than 2 years*. *SEC Cong. Just.* at 28.

In short, the discovery rule the SEC urges this Court to adopt is unnecessary for accomplishing the SEC's securities enforcement goals and unhelpful for compensating the victims of securities fraud.

C. A Discovery Rule Would Be Harmful To Businesses And Investors.

Finally, the SEC's proposed discovery rule would create a cloud of potential liability over every participant in the financial markets. Without a firm endpoint to the limitations period, businesses, investors and individuals would never be certain when their potential exposure to securities liability has passed.

The SEC often looks back at once-widespread market practices and decides that, in retrospect, they were problematic. As a result, many businesses and investors have been caught up in enforcement "sweeps" launched years after the fact.

This case, involving alleged "market timing" of mutual funds, is one example. Petitioners were among dozens of mutual fund advisers who were alleged to have permitted market timing, a common practice that had been the subject of public comment and known to the SEC for years before this action was commenced. *See* Mark T. Roche, et al., *Will the SEC Have Forever to Pursue Securities Violations?*: SEC v. Gabelli, 44 Sec. Reg. & L. Rep. 1415, at 2 n.3 (July 23, 2012) (quoting the government's stipulation in *SEC v. O'Meally*, No. 06-cv-06483 (S.D.N.Y. 2011), that "[b]eginning in the mid 1990s, the SEC knew about the practice of market timing in mutual funds, and the decision was to let the marketplace regulate itself"). It was not until then-New York Attorney General Eliot Spitzer began lawsuits alleging illegal market timing that the SEC decided to launch its own industry-wide enforcement actions. *See id.* at 2.

Other, similar examples include the practice of dating stock options as of a date other than the date they were granted. This practice was once so common and overt that it was identified by an associate

professor of finance in an academic study based on publicly reported data. *See* Erik Lie, *On the Timing of CEO Stock Option Awards*, 51 Mgmt. Sci. 802, 803 (2005); *see also* Randall A. Heron & Erik Lie, *Does Backdating Explain the Stock Price Pattern Around Executive Stock Option Grants?*, 83 J. Fin. Econ. 271, 274 (2007). After the results of that analysis were reported in *The Wall Street Journal* in 2006,[3] however, the SEC launched dozens of investigations, most of them concerning conduct that ended in 2002 when regulatory changes made the practice infeasible. Many of those who were swept up in the ensuing government litigation had acted in good faith, yet endured years of uncertainty. *See*, *e.g.*, *SEC v. Shanahan*, 646 F.3d 536, 544–45 (8th Cir. 2011) (finding that director who backdated options acted in good faith based on advice from lawyers, accountants and corporate officers).

This is not to say that the SEC cannot or should not reevaluate the propriety of widespread market practices, or try to prove that they are unlawful. Rather, the point is that the agency should do so in a timely fashion in keeping with its statutory priorities and not dwell on long-cold cases. The longer the SEC waits to condemn conduct deemed acceptable when it occurred, the greater the risk that its actions will be arbitrary (or perceived as such) and disrupt long-settled expectations. *See*, *e.g.*, *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) (vacating an SEC censure be-

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[3] Charles Forelle & James Bandler, *The Perfect Payday: Some CEOs Reap Millions by Landing Stock Options When They Are Most Valuable. Luck—or Something Else?*, Wall St. J., March 18, 2006, at A1, *available at* http://online.wsj.com/article/SB114265075068802118.html (referring to Lie's research).

cause the agency knew about the practice in question before it occurred and did not condemn it, and therefore the defendant did not have reasonable notice that his conduct was improper).

Under the SEC's proposed discovery rule, companies and individuals who believe that their conduct is lawful—and the entirely innocent persons and entities that transact with them—will never be free from unknown and undiscovered SEC claims. Such uncertainty would raise the cost of business transactions, making due diligence more difficult and inexact, and burdening successor corporations whom the government may seek to hold liable for the conduct of predecessors.

* * *

The discovery rule the SEC proposes would not only contravene the text of Section 2462 and the structure of the federal securities laws, it would make for bad policy—undermining the stability and predictability on which the securities markets and their participants depend, and diminishing the effectiveness of the SEC's enforcement efforts. If the SEC needs more than five years after a fraud takes place to bring a securities fraud enforcement action, then it should seek congressional authority for additional time. In our tripartite system, that is the body with the power to *change* the law. Under extant law, this action is time-barred. The Second Circuit's decision should therefore be reversed, and the district court's judgment of dismissal reinstated.

CONCLUSION

For the foregoing reasons, the decision of the Second Circuit should be reversed.

Respectfully submitted.

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