MAYER BROWN ROWE & MAW

www.mayerbrownrowe.com

23 April 2007

Five Years Is Enough For A Civil Penalty Assessment: No "Discovery Of Violation" Rule For The SEC Under 28 § U.S.C. 2642

By Richard J. Morvillo, Peter H. White and Ryan P. Farley[1]

Reproduced with permission from Securities Regulation & Law Report, Vol. 39, No. 16 (Apr. 23, 2007) pp. 635-638.

Each year, numerous civil enforcement proceedings are commenced by the Securities Exchange Commission ("SEC") in Federal district courts. Often these cases settle quickly without significant pre-trial motions or civil trials. But increasingly, SEC enforcement actions are contested by civil defendants and litigated in Federal courts. This is especially true of SEC civil enforcement proceedings brought against individuals.

The last five years have seen record levels of SEC enforcement activity in terms of the number of enforcement proceedings and the sanctions sought and obtained by the SEC. For example, approximately 500 enforcement actions (including both administrative and judicial) were filed by the SEC in 2000. In 2005, the SEC initiated 947 investigations, 335 civil proceedings and 294 administrative proceedings. More than $3 billion in disgorgement and penalties was ordered in SEC enforcement cases in 2005. With the increasing number of enforcement proceedings also has come a trend in the SEC targeting individuals, including current and former officers and directors of companies, who supposedly were involved in their company's alleged wrongdoing. Indeed, the SEC has repeatedly expressed a desire for individual liability as far up the corporate ladder as possible.

SEC enforcement actions against individuals are sometimes instituted by the SEC at the same time as the enforcement action commenced against the entity currently or formerly associated with the individual defendants. It is not uncommon, however, for an SEC enforcement proceeding against an individual to be filed after the SEC has concluded an action against the company or firm. This is because it is often not until well after the SEC has completed its investigation of the allegedly wrongdoing company, as well as concluded its settlement negotiations with that company, that the SEC finally turns its attention to supposedly wrongdoing individuals responsible for the perceived corporate malfeasance. For a variety of reasons, this process can take many years.

---

[1] Richard J. Morvillo and Peter H. White are partners in the international law firm Mayer Brown Rowe & Maw LLP. Ryan P. Farley is a senior associate in Mayer Brown's New York office. Mr. Morvillo, who divides his time between the Washington, D.C. and New York offices of Mayer Brown, is the Chair of the firm's Securities Enforcement Group. Messrs. Morvillo, White and Farley represent entities and individuals nationwide in administrative and judicial enforcement proceedings, as well as other securities and accounting cases. Vanessa Biondo, an associate in Mayer Brown's New York office, also assisted in the preparation of this article.

It then becomes a question of how long the SEC should have to institute an enforcement proceeding against the allegedly wrongdoing individuals. Obviously, the SEC desires an unlimited amount of time to discover and proceed against purported wrongdoing by individuals. The SEC is constrained, however, by a "catch-all" five-year statute of limitations that applies to all civil claims in which the government seeks a civil penalty assessment, including monetary fines; the relevant statute of limitations may also apply to claims that are deemed penal in nature depending upon the totality of the circumstances, such as where the SEC seeks a permanent injunction against an individual with exclusive reliance on the defendant's past conduct as the basis for the injunction. In order to enlarge its time to bring civil claims seeking penalties against individuals, the SEC has recently argued in actions throughout the country that the limitations period should not begin to run until it discovers the alleged violation. Courts should not endorse the SEC's approach by allowing any form of equitable tolling of the applicable statute of limitations.

Statutes of limitations exist to ensure fairness. They serve to protect individuals from indefinite liability. Because memories fade and witnesses may no longer be available, statutes of limitations that apply to the government are designed to protect parties from inappropriate open-ended penalties.

The paradigmatic case is the SEC commencing an enforcement proceeding against an individual seeking a civil penalty assessment by filing a civil complaint against Mr. Officer or Ms. Director for aiding and abetting a company's violations of the securities laws. When the SEC alleges that such an individual has aided and abetted a violation of the securities laws and seeks a civil penalty assessment, among other claims that are penal in nature, for purposes of the applicable limitations period, courts look to the catch-all limitations period established in 28 U.S.C. § 2462.[2] Section 2462 provides:

> 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.

[2] *See 3M Co. v. Browner*, 17 F.3d 1453, 1461 (D.C. Cir. 1994) ("[§ 2462] is a general statute of limitations, applicable. . . to the entire federal government in all civil penalty cases, unless Congress specifically provides otherwise"); *SEC v. Schiffer*, No. 97 Civ. 5853, 1998 WL 226101, at *3 (S.D.N.Y. May 5, 1998).

Section 2462 does not define the term "accrued." Courts have routinely held, however, that under § 2462, the claim accrues as of the *date of the alleged violation*.[3] A relatively recent decision by the Federal District Court for the Northern District of Illinois addressed the issue of when a claim accrues under § 2462 for purpose of a request for civil monetary penalties in a securities fraud case brought by the SEC.[4] The *Buntrock* decision will no doubt be cited by the SEC in response to every motion to dismiss made by defendants on statute of limitations grounds in the foreseeable future. As shown herein, however, and as virtually every other court that has ever considered this issue has decided, a claim by the government under § 2462 accrues at the date/time of the alleged violation, and not when the SEC learns of the claim.

The *Buntrock* court looked to two cases in reaching its flawed decision. *First*, the court considered an opinion by the D.C. Circuit holding that a claim accrues under § 2462 when the cause of action arises and not when the violation is first discovered by the government.[5] *Second*, the court looked at a Seventh Circuit decision finding that the statute of limitations in a civil fraud action runs from the date of the discovery of the violation.[6] The *Buntrock* court ultimately adopted the Seventh Circuit's "discovery of violation" rule, holding that the statute of limitations for civil penalties accrues when the SEC learns, or at least should have learned, of the securities violation.[7]

In adopting the "discovery of violation" rule, the *Buntrock* court overlooked the D.C. Circuit's in-depth analysis of the statute at issue in *Buntrock*, § 2462, in favor of the Seventh Circuit's decision addressing the issue of when the statute of limitations begins to run in the context of a 10b-5 fraud case brought by a private litigant. Notably, the Seventh Circuit's opinion does not even mention § 2462, nor

---

3 *See New York v. Niagara Mohawk Power Co.*, 263 F. Supp.2d 650, 660 (W.D.N.Y. 2003) ("under §2462, the limitations period begins to run on the date that the violation first occurs"); *see also SEC v. Tandem Mgmt.*, No. 95 Civ. 8411, 2001 WL 1488218, at *6 (S.D.N.Y. Nov. 21, 2001) (indicating that § 2462 would bar claim for civil penalty where activities alleged in the complaint occurred more than five years before complaint was filed); *SEC v. McCaskey*, 56 F. Supp.2d 323, 326 (S.D.N.Y. 1999) (stating that, for action filed on Sept. 1, 1998, "only civil penalty claims based on conduct which is alleged to have occurred on or after Sept. 1, 1993 are timely"); *SEC v. Caserta*, 75 F. Supp.2d 79, 89 (E.D.N.Y. 1999) (noting time bar on civil penalties sought for actions occurring more than five years before the filing of the complaint); *New York v. PVS Chemicals, Inc.*, 50 F. Supp.2d 171, 176 (W.D.N.Y. 1998) (noting that § 2462 provided a defense for Clean Water Act violations occurring more than 5 years prior to date of filing); *Schiffer*, 1998 WL 226101, at *2-3 (acknowledging that civil penalties are not applicable to conduct occurring more than five years prior to the filing of the complaint).

4 *See SEC v. Buntrock*, No. 02 C 2180, 2004 U.S. Dist. LEXIS 9495, at *34-37 (N.D. Ill. May 25, 2004).

5 *See 3M*, 17 F.3d at 1462 (addressing § 2462 in an EPA action for civil penalties).

6 *See Law v. Medco Research, Inc.*, 113 F.3d 781, 785 (7th Cir. 1997) (addressing statute of limitations in a 10b-5 claim).

7 *See Buntrock*, 2004 U.S. Dist. LEXIS 9495, at *37.

did the case arise in the context of an SEC enforcement proceeding. Instead, the Seventh Circuit used § 13 of the Securities Act of 1933, which imposes a one-year limitations period for suits involving false registration statements, to inform its decision that the statute of limitations in an SEC enforcement proceeding alleging fraud should run from the date of discovery of the wrongdoing. Although not fraud-specific, § 2462's application to SEC enforcement proceedings is undisputed, making it peculiar that the *Buntrock* court would rely upon some random analysis of an inapposite statute rather than squarely contending with an analysis of the exact provision it sought to interpret.

On the other hand, in *Browner*, the D.C. Circuit found no basis for the argument by the Environmental Protection Agency ("EPA") that the limitations period under § 2462 should depend upon the discovery of the violation.[8] The court stated, "nothing in the language of § 2462 even arguably makes the running of the limitations period turn on the degree of difficulty an agency experiences in detecting violations."[9] The D.C. Circuit looked into the statutory and common law histories of the word "accrued" and determined that the phrase "claim accrued" has always meant the date/time at which a cause of action first existed and not the date/time when the violation was first discovered.[10] The D.C. Circuit found this historical interpretation consistent with modern case law.[11] The weight of authority throughout the country clearly favors the D.C. Circuit's opinion in *Browner*, exposing *Buntrock* as a lone, maverick decision.[12] The Second Circuit has yet to address the issue of whether a "discovery of violation" rule applies to claims under § 2642, especially in the context of an SEC enforcement proceeding seeking civil penalties for violations of the securities laws.

Recently, the Federal District Court for the Northern District of Alabama rejected the SEC's argument to apply the "discovery of violation" rule to a claim under § 2462.[13] Relying on *Browner* and its progeny, the *Scrushy* court squarely rejected the position that the SEC advanced—that the *Browner*

---

8 *See 3M*, 17 F.3d at 1461.

9 *Id*.

10 *Id*. at 1462.

11 *See United States v. Core Lab*, 759 F.2d 480, 482 (5th Cir. 1985) (finding that a review of § 2462 cases showed that the date of the underlying violation "has been accepted without question as the date when the claim first accrued, and, therefore, as the date on which the statute began to run").

12 *See FEC v. Williams*, 104 F. 3d 237, 240 (9th Cir. 1996) (finding the D.C. Circuit's reasoning in *3M* persuasive and rejecting the "date of discovery" approach); *U.S. v. Lockheed Martin Energy Sys., Inc.*, 00 CV-39-M, 2004 U.S. Dist. LEXIS 22246, at *60-61 (W.D. Ky. Sept. 29, 2004) (same); *United States v. Murphy Oil USA, Inc.*, 143 F. Supp. 2d 1054, 74-75 (W.D. Wis. 2001) (same); *United States v. Taigen & Sons, Inc.*, 303 F. Supp. 2d 1129, 1143-1144 (D.C. Idaho 2003) (same); *United States v. Pac. N.W. Elec., Inc.*, No. CV-01-019-S-BLW, 2003 U.S. Dist. LEXIS 7990, at *21 (D.C. Idaho March 19, 2003) (same).

13 *SEC v. Scrushy*, 2005 U.S. Dist. LEXIS 30553. No. CV-03-J-615-S (N.D. Ala. Nov. 29, 2005).

ruling has no application in cases in which the government alleges fraud. The *Scrushy* court held that the "start of the statute of limitations is the date of the violations for which the civil penalties are sought, not the discovery of such violations."[14]

In another recent case in the District Court for the Southern District of New York, the SEC likewise invoked the "discovery of violation" rule in opposition to the defendants' argument on a motion to dismiss that the SEC's claims were time-barred under § 2462.[15] Similar arguments as those made in *Scrushy* were made by the SEC in that case, including that the *Browner* decision does not apply in cases involving fraud and, therefore, the limitations period does not begin to run until the SEC discovers the alleged violation. In denying the defendants' motion to dismiss on timeliness grounds, Judge Richard C. Casey noted that the Second Circuit has not yet adopted *Browner* or ruled on the applicability of the discovery rule to actions governed by § 2462. 2006 WL 1084276 (S.D.N.Y. Apr. 25, 2006). Judge Casey did, however, find *Browner* to be instructive. *Id.* Ultimately, Judge Casey allowed the action to proceed because he believed *Browner* "did recognize the possibility of the fraudulent concealment doctrine to toll the statute of limitations." *Id.* (citing *Browner*, 17 F.3d at 1461, n. 15).

After taking extensive discovery in the *Jones* case, defendant Daidone (with defendant Jones joining) renewed his application to dismiss the matter on timeliness grounds. In his summary judgment opinion, Judge Casey revisited the statute of limitations analysis proffered by the defendants at the motion to dismiss stage, agreeing that § 2642 applied to the SEC's claims. Further agreeing that the action would be time-barred unless resurrected by proof from the SEC of fraudulent concealment of the alleged underlying fraud that would toll the limitations period, Judge Casey combed the record supplied by the parties and held that the SEC failed to meet its burden of demonstrating the Defendants' alleged deception was unknowable and hence self-concealing. __ F.Supp.2d__, 2007 WL 632730, at *8 (S.D.N.Y. Feb. 16, 2007). Judge Casey's ruling is important because the SEC was not able effectively to import the discovery rule into the § 2462 analysis merely by claiming, in pure conclusory fashion, that the alleged underlying fraud or deception was self-concealing. Instead, if the fraudulent concealment doctrine actually applies to securities fraud claims under § 2642, a point that *Browner* leaves unsettled, the SEC will not get the benefit of tolling the limitations period under the fraudulent concealment doctrine

---

[14] *Id.* at *6.

[15] *See SEC v. Jones, et al.*, 05 CV 7044 (RCC). Messrs. Morvillo, White and Farley, along with Michael O. Ware and Vanessa Biondo, counsel and associate, respectively, in the New York office of Mayer Brown, represented Lewis Daidone, one of the individual defendants in that matter.

unless the SEC can offer proof that the alleged fraud or deception was unknowable by or concealed to the SEC.[16]

In yet another relatively recent Federal district court case, in ruling upon the defendant's motion for partial summary judgment, Judge Julie E. Carnes of Northern District of Georgia analyzed whether some or all of the five claims alleged by the SEC against the defendant were barred by § 2642.[17] *See S.E.C. v. Miller*, 2006 U.S. Dist. LEXIS 56413 (N.D.Ga. July 31, 2006). Judge Carnes specifically addressed the issue of whether the discovery rule applies to claims brought by the SEC with § 2642 providing the limitations period. Noting the existence of the *Buntrock* decision, Judge Carnes accepted the *Buntrock* decision as persuasive and applied the discovery rule, or the discovery of violation rule, to the claims brought by the SEC against Miller. In her decision, Judge Carnes rationalized applying the discovery rule to claims brought by the SEC governed by § 2642 because the discovery rule is often applied in the Eleventh Circuit to private rights securities fraud class actions. Judge Carnes, in a somewhat confusing fashion, then framed the issue in terms of when the SEC had inquiry or actual notice of a violation – *i.e.*, when the SEC had actual or constructive knowledge of the facts that form the basis of the cause of action. Ultimately, Judge Carnes denied the summary judgment motion in part holding that there remained a dispute of material fact as to when the SEC was on inquiry notice.[18]

The debate with the SEC about whether a "discovery of injury" overlay to § 2642 should exist for civil penalty claims made by the SEC for certain claims of securities fraud will likely continue until the Federal courts of appeals weigh in.[19] Until such time, unless the SEC speeds up its act significantly, we are likely to hear the *Buntrock* refrain time-and-time again. We are also likely to see the SEC make other

---

[16] Judge Casey further ruled that § 2642 blocked the SEC's claims against the Defendants seeking a civil penalty, disgorgement and a permanent injunction.

[17] Although the court did not so hold, Judge Carnes also noted in a footnote that the Eleventh Circuit has issued two cases that arguably suggest that no statute of limitations applies to a claim for civil penalties brought by the SEC under 15 U.S.C. § 77t(d). *See Miller*, 2006 U.S. Dist. LEXIS 56413, at *25 n. 9.

[18] Surprisingly, Judge Carnes' decision makes no mention of *Trawinski v. United Techs., Carrier Corp.*, 313 F.3d 1295, 1298 (11th Cir. 2002), an Eleventh Circuit decision discussed below, which does not support, and indeed arguably prohibits, the application of the discovery rule to certain claims by the government against defendants seeking a civil penalty when the statute itself does not include a specific limitations period. The *Trawinski* decision was apparently not mentioned in defendant Miller's briefs and was relegated to the 61st footnote of the SEC's submission.

[19] The Eleventh Circuit has adopted the holding of *Browner*. In *Trawinski*, another case involving environmental regulations violations, the Eleventh Circuit held that the "discovery rule, which might be applicable to statutes of limitations in state tort actions, has no place in a proceeding to enforce a civil penalty under a federal statute. In the Eleventh Circuit, the statute of limitations begins with the violation itself--it is upon violation, and not discovery of harm, that the claim is complete and the clock is ticking." *Trawinski*, 313 F.3d at 1298. As noted above, the Ninth Circuit has similarly embraced the D.C. Circuit's analysis, albeit again not in the context of a securities fraud action brought by the SEC. *See FEC v. Williams*, 104 F. 3d 237, 240 (9th Cir. 1996).

arguments to enlarge the five-year period, including arguing that some form of the "continuing violation" doctrine applies.[20]

In so doing, however, the SEC will ignore "another Supreme Court maxim, older still, a maxim specifically relating to actions for penalties …: 'In a country where not even treason can be prosecuted, after a lapse of three years, it could scarcely be supposed, that an individual would remain forever liable to a pecuniary forfeiture.'"[21] As the *Browner* court aptly stated, "[a]n agency's failure to detect violations, *for whatever reasons*, does not avoid the problems of faded memories, lost witnesses and discarded documents …."[22]

* * * *

For more information about Mayer, Brown, Rowe & Maw LLP, please visit *www.mayerbrownrowe.com*.

---

[20] The continuing violation doctrine "requires that the continuing violation be occasioned by continual unlawful acts, not continual ill effects from a single violation." *State v. Niagara Mohawk Power Co.*, 263 F. Supp. 2d 650, 660 (W.D.N.Y. 2003). New York Federal courts, however, have found that it is not at all certain that the continuing violation doctrine applies in securities fraud litigation. *See, e.g.*, *Pro Bono Invs., Inc. v. Gerry*, No. 03 Civ. 4347, 2005 WL 2429787, at *8 (S.D.N.Y. Sept. 30, 2005); *De La Fuente v. DCI Telecomms., Inc.*, 206 F.R.D. 369, 385-86 (S.D.N.Y. 2002); *SEC v. Schiffer*, CV-5853, 1998 WL 226101, at *3 (S.D.N.Y. May 5, 1998).

[21] *Browner*, 17 F.3d at 1457 (citing *Adams v. Woods*, 6 U.S. (2 Cranch) 336, 341, 2 L.Ed. 297 (1805)); *see also United States v. Maillard*, 26 F. Cas. 1140, 1143 (S.D.N.Y. 1871) (No. 15709) ("Ignorance does not prevent the running of the statute or the accruing of the forfeiture").

[22] *Browner*, 17 F.3d at 1461 (emphasis added).

Reproduced with permission from Securities Regulation & Law Report, Vol. 39, No. 16 (Apr. 23, 2007) pp. 635-638. Copyright 2007 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com