

FINANCIAL INSTITUTIONS ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

The Expanded Role of SEC Administrative Proceedings Under Dodd-Frank

June 16, 2011

In October 2009, a shock wave rumbled through worldwide financial institutions when the Securities and Exchange Commission (“SEC”) brought insider trading charges against Raj Rajaratnam, the billionaire co-founder of the Galleon Group hedge funds.¹ Rajaratnam’s seven-week jury trial in a New York federal court earlier this year riveted the financial industry, and ultimately ended in a conviction on all 14 counts.² During the 19 months between the criminal complaint and the jury verdict in Rajaratnam’s case, however, Congress quietly changed the procedural rules for pursuing similar enforcement proceedings in the future.

Under Section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the SEC now has broad powers to impose civil monetary penalties in administrative cease-and-desist proceedings, even against non-regulated entities and individuals.³ The effect is that the SEC can now pursue enforcement proceedings in a faster and more streamlined process with limited discovery. Arguably, the SEC also has a higher likelihood of success or favorable settlement with the home-court advantage of proceedings before administrative law judges employed by the SEC.

However, the scope and enforceability of Section 929P are still to be tested in the courts. While the financial industry was captivated by the Rajaratnam trial, the SEC was also pursuing claims against numerous other individuals that were allegedly involved with the Galleon Group. The SEC tried out the new administrative procedure under Section 929P in its case against alleged tipper Rajat K. Gupta. Gupta challenged the administrative forum in a New York federal court, arguing that his due process rights had been violated and that the procedure established by Section 929P could not be applied to conduct prior to the Dodd-Frank Act’s enactment.⁴

The SEC subsequently filed a motion to dismiss the federal court suit in favor of the SEC administrative proceeding. The Honorable Jed S. Rakoff, who has a reputation for being critical of the SEC, is the judge assigned to Gupta’s case. Judge Rakoff currently has the SEC’s motion to dismiss under advisement. Perhaps tellingly, just over a week before he heard the SEC’s motion to dismiss, Judge Rakoff remarked during a lecture at Fordham University, “[o]ne concern I have about Dodd-Frank is that it puts more adjudication into the hands of the SEC and its administrative judges.”⁵

¹ *United States v. Rajaratnam*, No. 1:09-cr-01184 (S.D.N.Y. filed Oct. 15, 2009).

² Order, *United States v. Rajaratnam*, No. 1:09-cr-01184 (S.D.N.Y. filed May 11, 2011) (Docket No. 272).

³ Dodd-Frank Act, 111th Cong. § 929P (2010).

⁴ Complaint, *Gupta v. SEC*, No. 1:11-cv-01900 (S.D.N.Y. filed Mar. 18, 2009).

⁵ Carlyn Kolker, [Gupta Judge Expresses ‘Concern’ Over Administrative Courts](#), Thomson Reuters News & Insight, Apr. 12, 2011.

Of course, the best way for financial institutions (and their directors and officers) to avoid both court *and* administrative proceedings is to understand and scrupulously comply with applicable laws and regulations. Our attorneys stand ready to advise you in navigating this legal and regulatory framework, and assist you in enforcement proceedings, should they be forthcoming.

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