

Corporate Investigations & White Collar Defense

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The SEC's Expanded Powers and Remedies in the SEC-Friendly Forum of Administrative Proceedings

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Before the Dodd-Frank Act, the SEC's authority to impose monetary penalties in administrative cease and desist proceedings was available against only certain "regulated persons," including broker-dealer and investment adviser entities and their associated individuals. As to other, nonregulated entities and individuals, including public companies and their directors and officers, the SEC was required to institute a civil enforcement action seeking monetary penalties in federal district court. The Dodd-Frank Act removed this distinction between regulated and nonregulated persons by authorizing the imposition of monetary penalties against *any person* in the context of administrative cease and desist proceedings. This change may impose a significant risk on unregulated entities and persons.

Administrative cease and desist proceedings are conducted in accordance with the SEC's Rules of Practice. In comparison with federal court enforcement actions, these proceedings provide several procedural advantages to the SEC (and corresponding disadvantages to potential respondents), including lack of formal discovery pursuant to the Federal Rules of Civil Procedure (including the right to depose witnesses and obtain other evidence), and the inapplicability of the Federal Rules of Evidence. Perhaps most significantly, administrative proceedings do not provide for the right to trial by jury but instead are heard before SEC Administrative Law Judges (on a mandated expedited schedule), with appellate review by the SEC itself, before any judicial review.

The SEC's newly expanded enforcement authority creates a strong incentive for the SEC to bring a greater number of cases against public companies, their directors and officers in this more SEC-friendly administrative forum.

The *Gupta* Administrative Proceeding

In March 2011, in the first high-profile attempt to utilize these expanded powers, the SEC instituted administrative and cease and desist proceedings seeking civil penalties against a nonregulated individual, Rajat K. Gupta, for alleged insider trading "tipping" violations. Mr. Gupta, the former Managing Director and Senior Partner of McKinsey & Company, and a former director of Goldman Sachs, was alleged to have disclosed material nonpublic information to Raj Rajaratnam, the founder and Managing General Partner of the hedge fund adviser Galleon Management, LP – who allegedly made numerous advantageous trades based on this information for the benefit of

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Galleon-related funds.

In response to the SEC order instituting the administrative proceeding – instead of filing an answer or other response in that proceeding – Mr. Gupta filed a separate lawsuit against the SEC in federal district court in New York, seeking declaratory and injunctive relief to prevent the SEC from applying the civil monetary provisions of Dodd-Frank or otherwise pursuing its claims against him in the setting of the administrative proceeding. One of the primary claims in the complaint was that the initiation of an administrative proceeding was an attempt to “single out” Mr. Gupta in violation of constitutional guarantees of due process and equal protection, because the SEC had filed all of its other Galleon-related cases against at least 28 other defendants (including Mr. Rajaratnam, who was subsequently convicted) in federal court, where additional procedural protections would apply.

The SEC moved to dismiss Mr. Gupta’s complaint on various grounds, including that the district court lacked jurisdiction to hear the matter and that Mr. Gupta’s claims against the SEC were barred by the doctrine of sovereign immunity. In July 2011, Judge Rakoff issued his ruling denying the SEC’s motion to dismiss, but limiting Mr. Gupta’s complaint to the equal protection claim. Specifically, Judge Rakoff held that Mr. Gupta had stated a plausible claim of unequal or discriminatory treatment, with reference to the standards for selective prosecution, because there was “already a well-developed public record of Gupta being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why this should be so.” (Judge Rakoff held that Mr. Gupta’s other principal claim, based on alleged improper “retroactive” application of the penalty provisions, was not appropriate for resolution in the separate federal court action.)

Shortly thereafter, in August 2011, the SEC and Mr. Gupta dismissed the administrative proceeding and the federal court lawsuit, respectively. Pursuant to a related joint stipulation, the SEC agreed that it would not institute any similar administrative proceeding in the future against Mr. Gupta based on the same factual allegations, and that any future action would instead be filed in the federal court in New York and designated as related to other Galleon cases pending before Judge Rakoff.

At this time the SEC has not yet filed a federal court enforcement action against Mr. Gupta, but has confirmed that it is “fully committed” to further pursuing the matter against Mr. Gupta.

Conclusions

The new powers granted to the SEC in the Dodd-Frank Act were challenged, but only to a limited extent, in the *Gupta* matter. Because the *Gupta* administrative proceeding was dismissed, along with the related lawsuit by Mr. Gupta against the SEC, several issues have been left unresolved. At a minimum, though, the Court’s decision suggests possible defenses for future cases. For instance, can a defendant subjected to administrative proceedings avoid those proceedings by pointing to defendants named in related civil enforcement actions – or by pointing to defendants in unrelated but similar enforcement actions? Time will tell.

In any event, it is clear that the SEC has now obtained enhanced powers through the Dodd-Frank Act. How these powers will be exercised by the SEC in the future remains uncertain at this time, but it is clear that nonregulated persons – including public companies and their officers and directors – now have the additional risk of facing a full range of potential remedies for alleged securities law violations in the more agency-friendly context of administrative proceedings.

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