UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

RAJAT K. GUPTA,	:	
Plaintiff,	:	No. 11-cv-1900 (JSR)
v.	:	
SECURITIES AND EXCHANGE COMMISSION,	:	April 11, 2011
Defendant.	:	

MEMORANDUM OF LAW OF PLAINTIFF RAJAT K. GUPTA
IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS COMPLAINT

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Plaintiff Rajat K. Gupta respectfully submits this memorandum of law in opposition to the Securities and Exchange Commission's motion to dismiss the Complaint under Fed. R. Civ. P. 12(b)(1) and (6).

Preliminary Statement

On March 1, 2011, the Commission took the unprecedented step of instituting an administrative proceeding for civil penalties alleging insider trading against a non-regulated person. This is not just Mr. Gupta's characterization of the Commission's order instituting proceedings ("OIP"); in a March 23, 2011 speech, Director of Enforcement Robert Khuzami lauded the *Gupta* case as "*the first use by the SEC of its new authority under Dodd-Frank to obtain penalties in an Administrative Proceeding against persons not associated with a regulated entity*." (Ex. A hereto) (emphasis added). The impact of this "first use" is to single out Mr. Gupta as the *only* Galleon-related defendant being pursued by the Commission administratively in contrast to more than two dozen other Galleon-related defendants named in Commission complaints filed in *this* Court. In other — and more important — words, Mr. Gupta is the only Galleon-related defendant faced with the denial of the right to a jury and important procedural protections available only in federal court.

Without denying its disparate treatment of Mr. Gupta and without offering any, let alone a legitimate, reason for it, the Commission argues that this Court is without power to review — and, if warranted, remedy — the disparate treatment. But subject matter jurisdiction exists under 28 U.S.C. § 1331 to hear this action for declaratory judgment brought under § 2201. The Commission's jurisdictional challenge rests only on its assertion that it has not waived sovereign immunity as to Mr. Gupta's claims, and its invocation of the doctrines of exhaustion and ripeness. The grounds for this motion all fail.

Section 702 of the APA waives sovereign immunity as to all actions against federal agencies seeking relief "other than money damages," whether a claim is asserted under the APA or not: that is what the case law holds. This waiver is *not* restricted by the "final agency action" requirement of § 704 applicable to claims asserted under the APA (which Mr. Gupta's are not), nor does § 703 limit Mr. Gupta to relief under the "special statutory review proceeding" of Section 25(a) of the Exchange Act. Mr. Gupta is *not* invoking Section 25(a) because he is not challenging a final order of the Commission imposing a sanction for violations of the securities laws. He is seeking equitable relief to prevent an impermissible retroactive application of Dodd-Frank and a violation of his constitutional rights.

Just last term, the Commission presented its Section 25(a) argument to the Supreme Court, and the Court rejected it. The Court held that Section 25(a) "*does not* expressly limit the jurisdiction that other statutes confer on district courts" (citing § 1331 and § 2201), "[n]or does it do so implicitly." *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 130 S.Ct. 3138, 3150 (2010) (emphasis added). In addition, the Court found a presumption *against* such jurisdictional limitations over collateral challenges to agency action when, as here, jurisdictional preclusion would "'foreclose all meaningful judicial review'" and a plaintiff's claims are "'outside the agency's expertise.'" *Id.* (citation omitted).

In addressing *Free Enterprise*, the motion virtually ignores Mr. Gupta's equal protection challenge to the Commission's discriminatory selection of forum. More troubling, the motion suggests, misleadingly, that the procedural protections afforded respondents in SEC administrative proceedings are equivalent to those in federal court — when they are not. The SEC Rules of Practice nowhere provide for discovery depositions or for strict adherence to the Federal Rules of Evidence, a critical procedural distinction because the Commission's case as

alleged in the OIP appears to depend largely on a few ambiguous phone records and hearsay conversations (including triple levels of hearsay). If there were truly no difference in proceeding administratively or in federal court, the Commission's unexplained decision to subject Mr. Gupta alone to its "first use" of Dodd-Frank becomes all the more perplexing.

The Commission heavily relies on Judge Holwell's recent decision in *Altman v. S.E.C.*, 2011 WL 781918 (S.D.N.Y. Mar. 6, 2011), when arguing that Section 25(a) excludes district court jurisdiction. But *Altman* turned on a wholly different set of facts — a challenge to a Commission sanction imposed at the conclusion of administrative proceedings by an attorney who had suborned perjury in an investigation by the Commission itself. In all events, *Altman* cannot trump the Supreme Court's reading of the words of Section 25(a) in *Free Enterprise*.

The Commission — for purposes of this motion — does not dispute Mr. Gupta's allegations showing that the Commission is impermissibly applying Dodd-Frank retroactively against him and has acted towards him with discriminatory purpose and effect. Indeed, the Commission does not dispute that — but for Dodd-Frank — it would have brought suit against Mr. Gupta for civil penalties in federal court (as opposed to proceeding administratively against him without seeking civil penalties); Mr. Khuzami's speech precludes any challenge to this fact. The issue of retroactivity is accordingly neither contingent nor unripe; it is only because of its attempted retroactive application of Dodd-Frank that the Commission issued the OIP instead of filing a complaint in this Court.[1]

[1] The Commission, in its page 4 chart, invites the Court to conclude that parts of its case against Mr. Gupta could have been brought administratively without enactment of Dodd-Frank, but the chart rests on an unstated — and inaccurate — factual premise: that Mr. Gupta is a regulated person. Prior to Dodd-Frank, civil penalties under Section 21B(e) of the Exchange Act, Section 203(i) of the Investment Advisers Act and Section 9(d) of the Investment Company Act could be imposed in SEC administrative proceedings only against persons associated with, respectively, broker-dealers, investment advisers and investment companies. Paragraph 4 of the

And Mr. Gupta is already sustaining injury as a result of the Commission's actions, which include the Commission's decision to file and announce publicly administrative proceedings against him less than two business days after receiving his Wells submission and only a week before the start of the criminal trial of Raj Rajaratnam. Mr. Gupta alone faces an imminent administrative proceeding seeking civil penalties for insider trading, with a firm July 18, 2011 date for the start of hearings — even as the Commission continues after the OIP to sue other persons for insider trading in federal court.[2] Mr. Gupta chose neither that date nor that forum. The Commission put the administrative proceeding in motion, and the Commission cannot escape prompt judicial review when this action provides Mr. Gupta with the *only* viable forum for adjudicating his claims and when any delay in judicial review would only deepen his injury. Neither exhaustion nor ripeness constitutes a serious defense.

The Commission contends that Mr. "Gupta provides no reason to believe that the SEC will disregard any meritorious due process argument." (Br. at 23). But Paragraph 19 of the Complaint provided compelling reasons for such a belief:

> The Commission's order has all of the markings of a strategic decision, and it is a foregone conclusion that the Commission would decline to change course. Assuming it adhered to its own procedures, the Commission itself approved of this choice of forum. The Commission has already acted arbitrarily against Mr. Gupta: The Staff and the Commission effectively deprived Mr. Gupta of a full and fair Wells submission process.

Complaint alleges that Mr. Gupta "is not a regulated person under the federal securities laws," an allegation that now must be accepted as true on this motion. Attached as Ex. B is § 929P of Dodd-Frank, showing the statutory amendments to the provisions included in the Commission's chart.

[2] *See S.E.C. v. Treadway*, No. 11-cv-01534-RJH (S.D.N.Y. Mar. 7, 2011); *S.E.C. v. Carroll*, No. 3:11-cv-00165-JGH (W.D. Ky. Mar. 17, 2011); *S.E.C. v. Liang*, No, 8:11-cv-00819-RWT (D. Md. Mar. 29, 2011); *S.E.C. v. Kluger*, No. 2:11-cv-01936-KSH-PS (D. N.J. Apr. 6, 2011).

Beyond these reasons, it is simply too much to imagine that the Commission would ever rule in an administrative proceeding that the Commission itself has impermissibly applied Dodd-Frank retroactively against Mr. Gupta and acted in bad faith in denying him equal protection under law. The Commission's failure even to acknowledge the quoted allegations from Paragraph 19 of the Complaint when it represented to the Court that "Mr. Gupta provides no reason to believe that the SEC will disregard any meritorious due process argument" proves at once that the Commission would quickly reject any allegations about its own conduct and that judicial review of the OIP is urgent.[3]

Argument

I. THE COURT HAS SUBJECT MATTER JURISDICTION OVER THE FEDERAL QUESTIONS RAISED IN THIS ACTION

A. Subject Matter Jurisdiction Exists Under § 1331

To establish subject matter jurisdiction under § 1331, a plaintiff must assert claims arising under the Constitution or "Laws of the United States." *Empire Healthchoice Assur., Inc. v. McVeigh*, 547 U.S. 677, 678 (2006) ("[a] case 'aris[es] under' federal law within the meaning of § 1331 . . . if 'a well-pleaded complaint establishes either that federal law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal law.'") (citation omitted). The Supreme Court has also held that, subject only to preclusion-of-review statutes, district court jurisdiction to review agency action is conferred by § 1331. *See Califano v. Sanders*, 430 U.S. 99, 104-07 (1977).

[3] Bypassing the Court's pre-motion rules, the Commission tacks on a 12(b)(6) prong in its motion, asserting that the Complaint fails to allege facts that warrant the remedy of injunctive relief. Suffice it to say that the Commission does not even attempt to show a failure to state a claim for declaratory relief based on Mr. Gupta's equal protection and retroactivity allegations — allegations which, if proven, would clearly support injunctive relief.

This action presents two questions for declaratory judgment: (1) whether the Commission is violating Mr. Gupta's equal protection rights by treating him differently from all of the other Galleon-related defendants charged in federal court; and (2) whether the Commission is improperly applying Dodd-Frank retroactively against Mr. Gupta. The Complaint pleads claims "arising under" the Constitution and "Laws of the United States," and the Commission does not contend otherwise. This Court therefore has subject matter jurisdiction under § 1331 to grant declaratory relief under § 2201. *See Free Enterprise*, 130 S.Ct. at 3150 (sustaining jurisdiction and citing §§ 1331 and 2201).[4]

B. Sovereign Immunity Has Been Waived By APA § 702

Section 702 of the APA is the short and dispositive answer to the Commission's sovereign immunity defense. The statute provides in pertinent part:

> A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. . . . Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

A consistent body of case law applying § 702 holds that sovereign immunity is waived for "complaints [seeking] declaratory and injunctive relief," because they are "certainly not actions for money damages." *Bowen v. Massachusetts*, 487 U.S. 879, 893 (1988). *See also*

[4] Because § 1331 is a basis for subject matter jurisdiction and § 702 of the APA waives sovereign immunity, the Court need not reach the other bases pled in paragraph 3 of the Complaint.

Sharkey v. Quarantillo, 541 F.3d 75, 91 (2d Cir. 2008) ("Section 702 of the APA waives the federal government's sovereign immunity in actions [for non-monetary relief against an agency] brought under the general federal question jurisdictional statute.") (citation and quotation marks omitted); *Raz v. Lee*, 343 F.3d 936, 938 (8th Cir. 2003) (same); *Presbyterian Church (U.S.A.) v. United States*, 870 F.2d 518, 524-25 (9th Cir. 1989) (same).

Consistent case law further teaches that "the APA's waiver of sovereign immunity applies to any suit whether under the APA or not" because § 702 "waives sovereign immunity for [any] action in a court of the United States seeking relief other than money damages, not [solely] for an action brought under the APA." *Trudeau v. Fed. Trade Comm'n*, 456 F.3d 178, 186 (D.C. Cir. 2006) (citation, quotation marks, and alterations omitted). *See also Up State Federal Credit Union v. Walker*, 198 F.3d 372, 375 (2d Cir. 1999) (unless exceptions in last sentence of § 702 apply, "the APA does create a general waiver of sovereign immunity as to equitable claims against government agencies"); *Commonwealth of Puerto Rico v. United States*, 490 F.3d 50, 57-58 (1st Cir. 2007) ("This waiver is for '*all* equitable actions for specific relief against a Federal agency . . . ,' and thus 'applies to any suit whether under the APA or not.'") (quoting *Trudeau*, 456 F.3d at 186)); *United States v. City of Detroit*, 329 F.3d 515, 520-21 (6th Cir. 2003) (en banc) (holding that "the waiver of sovereign immunity in section 702 [applies] in cases brought under statutes other than the APA" and noting that five other circuits have so held). This reading is supported by the legislative history of § 702 (as described by *Trudeau*, 456 F.3d at 186-87):

> [T]he Senate Report [on the 1976 amendment] plainly indicated that Congress expected the waiver to apply to nonstatutory actions, and thus not only to actions under the APA. "The committee does not believe," the Report stated, that the amendment's "partial elimination of sovereign immunity, as a barrier to *nonstatutory review* of Federal administrative action, will create undue

> interference with administrative action." S. REP. NO. 94-996, at 8, 1976 U.S. Code Cong. & Ad.News, at 6129.

In *Trudeau*, the plaintiff sued the Federal Trade Commission challenging the veracity of an FTC press release. Trudeau sought only declaratory and injunctive relief, and the D.C. Circuit concluded that "there is no doubt that § 702 waives the Government's immunity from actions seeking relief other than money damages." *Id.* at 186 (citation and quotation marks omitted). The court then rejected the FTC's argument that § 702's waiver was limited to actions arising under the APA challenging "final agency action." In the words of Judge Garland:

> We have previously, and repeatedly, rejected the FTC's first argument, expressly holding that the APA's waiver of sovereign immunity applies to any suit whether under the APA or not. . . . Although we have never directly considered the contention that the "final agency action" requirement of § 704 restricts § 702's waiver of sovereign immunity, our holding that the waiver is not limited to APA cases — and hence that it applies regardless of whether the elements of an APA cause of action are satisfied — removes the linchpin of the FTC's argument. Moreover, the language of the waiver sentence again provides no support for the FTC's contention. While the sentence does refer to a claim against an "agency" and hence waives immunity only when the defendant falls within that category, it does not use either the term "final agency action" or the term "agency action." Nor does the legislative history refer to either limitation. To the contrary, the House and Senate Reports' repeated declarations that Congress intended to waive immunity for "any," H.R. REP. NO. 94-1656, at 3, and "all," *id*. at 9; S. REP. NO. 94-996, at 8, 1976 U.S. Code Cong. & Ad. News, at 6129, actions for equitable relief against an agency make clear that no such limitations were intended.

Id. at 186-87 (citations omitted).

The Commission makes the exact argument rejected in *Trudeau:* that sovereign immunity bars Mr. Gupta's claims because the OIP does not constitute "final agency action" under § 704. (Br. at 9). Mr. Gupta, in seeking relief under § 2201, did not allege that the OIP is a final order. Section 704 is inapposite, and § 702 controls. The Commission's reliance on *Fed. Trade Comm'n v. Standard Oil Co. of Cal.*, 449 U.S. 232, 101 S.Ct. 488 (1980) ("*SoCal*") (Br. at

2, 9, 10, 16, 23, 24) for the point that an order instituting proceedings is not final agency action is therefore misplaced. Additionally, unlike *SoCal*'s complaint, which sought "[j]udicial review of the averments in the [Federal Trade] Commission's complaints" before the conclusion of the administrative proceedings, *see SoCal*, 449 U.S. at 243, Mr. Gupta's Complaint does not seek to challenge the *merits* of the OIP in this Court; it challenges the Commission's unfair and discriminatory treatment in issuing the OIP.

The Commission next asserts that, pursuant to § 703 of the APA, Mr. Gupta must seek judicial review of the Commission's actions only in a court of appeals through "the special statutory review proceeding" provided by Section 25(a) of the Exchange Act, 15 U.S.C. § 78y(a). (Br. at 11). Section 703 states that the "form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments . . . in a court of competent jurisdiction." The Commission lost this precise point before the Supreme Court in *Free Enterprise*, when it argued that Section 25(a) provides the "exclusive mechanism" for parties aggrieved by actions of the Commission to seek review in the federal courts. *See* Br. of the United States On Writ of Certiorari to the U.S. Court of Appeals for the D.C. Circuit, No. 08-861, 2009 WL 3290435, at *15., Doc. No. 24 (Oct. 13, 2009).

Free Enterprise involved an action for declaratory and injunctive relief challenging on separation of powers grounds the constitutionality of the Public Company Accounting Oversight Board ("PCAOB") created by Sarbanes-Oxley. Under Sarbanes-Oxley, the Commission was empowered to review any PCAOB rule or sanction, and aggrieved parties were allowed to challenge "a final order of the Commission" or "a rule of the Commission" in a

court of appeals under Section 25(a). 130 S.Ct. at 3150. The Commission contended there (as it does again here) that Section 25(a) provided the exclusive route to judicial review for plaintiffs. *Id.* Scrutinizing the language of Section 25(a), the Court squarely rejected the Commission's contention:

> The Government reads § 78y as an exclusive route to review. But the text *does not* expressly limit the jurisdiction that other statutes confer on district courts. *See, e.g.,* 28 U.S.C. §§ 1331, 2201. Nor does it do so implicitly.

Id. (emphasis added). The Court's reading of Section 25(a) was not confined to the facts of *Free Enterprise*; the Court gave plain meaning to statutory words.

The Court added that "[p]rovisions for agency review do not restrict judicial review unless the 'statutory scheme' displays a 'fairly discernible' intent to limit jurisdiction, and the claims at issue 'are of the type Congress intended to be reviewed within th[e] statutory structure.'" *Id.* (quoting *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 207, 212 (1994)):

> Generally, when Congress creates procedures "designed to permit agency expertise to be brought to bear on particular problems," those procedures "are to be exclusive." *Whitney Nat. Bank in Jefferson Parish v. Bank of New Orleans & Trust Co.,* 379 U.S. 411, 420, 85 S.Ct. 551, 13 L.Ed.2d 386 (1965). But we presume that Congress does not intend to limit jurisdiction if "a finding of preclusion could foreclose all meaningful judicial review"; if the suit is "wholly collateral to a statute's review provisions"; and if the claims are "outside the agency's expertise." *Thunder Basin, supra,* at 212-213, 114 S.Ct. 771 (internal quotation marks omitted). These considerations point against any limitation on review here. *We do not see how petitioners could meaningfully pursue their constitutional claims under the Government's theory.*

Free Enterprise, 130 S.Ct. at 3150 (emphasis added).

The Court finally rejected the Commission's argument that plaintiffs were required first to incur a PCAOB sanction before commencing their action in federal court — and then only in a court of appeals: "We normally do not require plaintiffs to 'bet the farm . . . by

taking the violative action' before 'testing the validity of the law,' . . . and we do not consider this a 'meaningful' avenue of relief." *Id.* at 3151 (citing *Thunder Basin*, 510 U.S. at 212). The Court found that plaintiffs' constitutional claims were "outside the Commission's competence and expertise" and that "the statutory questions involved do not require 'technical considerations of [agency]' policy. . . . They are instead standard questions of administrative law, which the courts are at no disadvantage in answering." *Id.*

For all of these same reasons, § 704 of the APA and Section 25(a) of the Exchange Act do not strip this Court of subject matter jurisdiction over Mr. Gupta's claims.

1. Mr. Gupta Could Not Obtain Meaningful Review In a Court of Appeals

If this Court lacked jurisdiction to hear Mr. Gupta's equal protection claim, he would be deprived of all meaningful judicial review. An administrative proceeding would provide no means of asserting the equal protection claim alleged in this action. For one thing, the SEC's Rules of Practice do not permit counterclaims against the Commission. *See In the Matter of Jeffrey L. Feldman*, Admin. Proc. File No. 3-8063, 1994 SEC LEXIS 186, at *4-5 (Jan. 14, 1994). Those rules also severely limit discovery by a respondent, especially by denying discovery depositions. The Commission does not represent to this Court that Mr. Gupta could conduct discovery in an administrative proceeding on the discriminatory purpose and effect of the Commission's OIP by use of document requests and discovery depositions (which its rules do not permit). As a result, any appellate review of the agency's ultimate determination would be severely truncated and largely meaningless. Beyond that, if the Court declined to adjudicate this action, Mr. Gupta would be forced to endure the very administrative proceeding he alleges to be unconstitutional. Appellate review of any final order would thus be too little and too late: It

is the very administrative proceeding itself that deprives Mr. Gupta of his constitutional rights — and appellate review once the damage is done would be cold comfort.

2. Adjudication of Mr. Gupta's Claims Would Be Outside of the Commission's Expertise

The Commission argues that it is better placed than this Court to adjudicate "the issues [Mr. Gupta] raises" (Br. at 17), but it can only sustain this position by mischaracterizing the relief Mr. Gupta seeks. Contrary to the assertions in the motion, the Complaint does not ask this Court to "[d]etermin[e] whether a person has violated the securities law and what sanction should result" (*id.*); rather, it challenges the Commission's decision to single out Mr. Gupta for retroactive application of Dodd-Frank and thereby deny him the procedural protections enjoyed by every other Galleon-related defendant.

The Commission cannot contend that adjudication of Mr. Gupta's equal protection claim *against the Commission itself* is peculiarly within the Commission's competence or expertise. And how could it be? The Administrative Law Judge would be asked to make findings about the actions and motivations of the Commissioners, hardly a subject of agency expertise. Simply put, concerns regarding "administrative expertise are not implicated where a constitutional violation is alleged, because such allegations are particularly suited to the expertise of the judiciary." *Adkins v. Rumsfeld*, 389 F. Supp. 2d 579, 588 (D. Del. 2005).

Free Enterprise distinguished the type of constitutional claim that is at issue here from the petitioner's claims in *Thunder Basin*, which were primarily statutory:

> "[A]t root . . . [they] ar[o]se under the Mine Act and f[e]ll squarely within the [agency's] expertise," given that the agency had "extensive experience" on the issue and had "recently addressed the precise . . . claims presented." [*Thunder Basin*], 501 U.S. at 214). Likewise, in *United States v. Ruzicka*, 329 U.S. 287, 67 S.Ct. 207, 91 L.Ed. 290 (1946), . . . we reserved for the agency fact-bound inquiries that, even if "formulated in constitutional terms," rested ultimately on "factors that call for [an]

> understanding of the milk industry," to which the Court made no pretensions. *Id.* at 294, 67 S.Ct. 207.

Free Enterprise, 130 S.Ct. at 3151. In contrast to those cases, the Court in *Free Enterprise* found (as noted above) that "[n]o similar expertise is required here, and the statutory questions involved do not require 'technical considerations of [agency] policy.' . . . They are instead standard questions of administrative law, which the courts are at no disadvantage in answering." *Id.* at 3151.[5]

Mr. Gupta's challenge to the Commission's authority to proceed administratively for civil penalties and its discriminatory treatment in doing so are the type of issues regularly determined by federal courts. And the Commission — in resisting this point — appears to have forgotten that it brought *all* of the other Galleon-related cases in this Court, a clear indication that, at least for those defendants, the Commission has no apparent qualms about this Court's competence to adjudicate insider trading cases.

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[5] The Commission cites *Thunder Basin* for the proposition that Mr. Gupta's claims, including his constitutional claim, can be meaningfully addressed in a court of appeals. (Br. at 14). But *Thunder Basin* did not involve an equal protection claim against the very agency charged with overseeing the administrative proceeding that the court of appeals would eventually review. Rather, the plaintiff in that case brought a pre-enforcement challenge to regulations promulgated under the Federal Mine Safety and Health Amendments Act of 1977, 30 U.S.C. § 801 *et seq*., alleging that compliance with those regulations would violate the Due Process Clause of the Fifth Amendment. *Id.* at 205. Although the Department of Labor is charged with enforcing those regulations, under the statute challenges to enforcement are reviewed by the Federal Mine Safety and Health Review Commission, which the Court noted is independent of the Department. *Id.* at 204. Thus, while the Court acknowledged that "[a]djudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies, . . . [t]his rule is not mandatory . . . and is perhaps of less consequence where, as here, the reviewing body is not the agency itself but an independent commission established exclusively to adjudicate Mine Act disputes." *Id.* at 215 (citations and internal quotation marks omitted).

3. Mr. Gupta's Claims Are Collateral to Section 25(a).

Touche Ross & Co. v. S.E.C., 609 F.2d 570 (2d Cir. 1979) — although decided over thirty years before *Free Enterprise* — illustrates how Mr. Gupta's claims are collateral to Section 25(a). There, the Commission instituted an administrative proceeding pursuant to SEC Rule 2(e) against the Touche Ross accounting firm and three of its former partners to determine whether the respondents had engaged in improper auditing conduct and should be disqualified on that basis from appearing before the Commission. Prior to the administrative hearing, Touche Ross brought an action in this Court for declaratory and injunctive relief, alleging that Rule 2(e) and the proceeding initiated under it were without statutory authority. The Second Circuit held that Touche Ross was not required to submit to the administrative proceeding before challenging the Commission's rule-making authority in federal court, because "to require [Touche Ross] to exhaust their administrative remedies would be to require them to submit to the very procedures which they are attacking." 609 F.2d at 577.

Against *Free Enterprise*, the Commission primarily relies on *Altman*. In *Altman*, an attorney sued the Commission and its Chairwoman and Secretary in this Court seeking (1) a stay of the Commission's administrative proceedings against him and (2) an order vacating the Commission's decision imposing a lifetime ban from the attorney's practice before the SEC. The Commission had imposed that sanction after an Administrative Law Judge found at the conclusion of a hearing that the attorney had knowingly offered to have his client provide false testimony to the Commission during an investigation; thus, the administrative proceeding had been completed before the suit in federal court.

The issue before Judge Holwell was simply whether the attorney should have brought his challenge before a court of appeals, rather than a district court. The Court ruled that the attorney's claims that the Commission's sanction wrongfully usurped powers properly held

by the New York State court system could be "meaningfully addressed in the Court of Appeals should the attorney appeal the SEC's sanction against him." *Id.* at *5. In that key respect, *Altman* found *Touche Ross* distinguishable:

> The court [in *Touche* Ross] reasoned that administrative review of the question in the first instance would be inappropriate because of the plaintiff's hardship in submitting to the disciplinary provisions it was challenging, and because the SEC had no need to develop its own factual or legal record in the dispute. *Id.* at 576-77. . . . Here any harm to Altman due to the requirement that he raise his constitutional challenges before the SEC seems minimal *as he has already litigated at least two hearings on the issue-one before an administrative law judge and one before the SEC itself.*

2011 WL 781918, at *6 (emphasis added).

The Commission itself recognized this distinction when it briefed the *Altman* case, stating: "*Touche Ross* is further distinguishable because the Court's concern was subjecting the plaintiffs to the procedures they were attacking. Altman, however, did not bring his challenge until the completion of the Commission's proceeding. . . ." *See* Mem. of Law in Opposition to Motion to Stay and Vacate, 1:10-cv-09141-RJH (Doc. No. 2 at 7) dated Dec. 9, 2010.[6]

[6] The Commission (Br. at 16) attempts to equate Mr. Gupta's allegations to a claim of agency bias that was also asserted by the plaintiffs in *Touche Ross* and as to which the Second Circuit held exhaustion was required. 609 F.2d at 574. Mr. Gupta's claims, however, mirror the claim in *Touche Ross* where immediate judicial review was allowed: a challenge to the Commission's authority to initiate an administrative proceeding. The Commission also relies on *Merritt v. Shuttle, Inc.*, 245 F.3d 182 (2d Cir. 2001) (Br. at 14, 15, 17), but that case actually undercuts the Commission's arguments. The Second Circuit stated that a statute vesting judicial review exclusively in the courts of appeals precludes a district court from hearing claims that are "inescapably intertwined with" review of the type of agency order entrusted to the courts of appeal. 245 F. 3d at 187. As already shown, Mr. Gupta's Complaint does not arise from a final order of the Commission, and *Free Enterprise* held that Section 25(a) "does not expressly limit the jurisdiction that other statutes confer on district courts," 130 S. Ct. at 3150 — words that the Commission did not call to the Court's attention in *Altman*.

Like the plaintiffs in *Free Enterprise* and *Touche Ross*, Mr. Gupta's claims are wholly collateral to the Commission's charges against Mr. Gupta under the securities laws. Those cases are on point; *Altman* is not.

II. THE EXHAUSTION AND RIPENESS DOCTRINES ARE INAPPLICABLE TO THIS CASE

The doctrine of exhaustion does not divest a court of subject matter jurisdiction. *Bastek v. Fed. Crop Ins. Corp.*, 145 F.3d 90, 94 (2d Cir. 1998) (in the absence of statutory provision requiring exhaustion, courts have "discretion to employ a broad array of exceptions that allow a plaintiff to bring his case in district court"). Rather, courts consider whether application of the exhaustion doctrine to a particular case would serve the prudential concerns upon which the doctrine is premised:

> The exhaustion doctrine was designed primarily to prevent premature interruption of the administrative process. In that regard it serves three main purposes. First, it preserves the autonomy of the administrative agency by allowing the agency to apply its expertise and exercise its discretion in appropriate circumstances, by giving the agency a chance to discover and correct its own errors, and by discouraging "frequent and deliberate flouting of administrative processes [which] could weaken the effectiveness of an agency." Second, application of the exhaustion doctrine aids judicial review which "may [otherwise] be hindered by the failure of the litigant to allow the agency to make a factual record, or to exercise its discretion or apply its expertise." Third, requiring exhaustion in appropriate cases promotes judicial and administrative efficiency by prohibiting repeated interruptions of the agency proceeding and by increasing the possibility that no judicial decision will be necessary, since the complaining party's rights may ultimately be vindicated at the agency level.

Athlone Ind., Inc. v. Consumer Product Safety Comm'n, 707 F.2d 1485, 1488 (D.C. Cir. 1983). These goals would not be served by dismissing Mr. Gupta's claim against the Commission. *See Touche Ross*, 609 F.2d at 577 (where there is "no need for the development of a factual record, no room for the exercise of agency discretion, and little need for agency expertise in deciding the

question . . . '[t]o require exhaustion . . . would be overly harsh and wasteful.'") (citation omitted).

In *Athlone*, the D.C. Circuit reversed a district court's dismissal of a suit to enjoin the Consumer Product Safety Commission ("CPSC") from continuing an administrative proceeding for civil penalties against a manufacturer and distributor. The manufacturer and distributor argued that civil penalties were unavailable under the Consumer Product Safety Act. *Id.* at 1487. The D.C. Circuit noted that the CPSC's statutory authority was "strictly a legal issue" and "[n]o factual development or application of agency expertise [would] aid the court's decision." *Id.* at 1489. "Nor [would] a decision by the court invade the field of agency expertise or discretion. '[W]here the only . . . dispute relates to the meaning of the statutory term . . . [the controversy] presents issues on which courts, and not [administrators] are relatively more expert.'" *Id.* (citation omitted). Additionally, the court found that any attempt by plaintiffs to challenge the CPSC's actions administratively would likely be futile:

> The Commission filed the complaint in the first place, presumably on the basis of its conclusion that it had jurisdiction to assess civil penalties administratively. It has defended that position before this and other courts. And, after oral argument in this case, the Commission unanimously ruled that it had the authority to assess civil penalties in an administrative proceeding. When resort to the agency would in all likelihood be futile, the cause of overall efficiency will not be served by postponing judicial review, and the exhaustion requirement need not be applied.

707 F.2d at 1489; *see also Touche Ross*, 609 F.2d at 577 ("exhaustion would be futile when the 'very administrative procedure under attack in the one which the agency says must be exhausted.'") (citation omitted).

Here, the question of the Commission's statutory authority to seek civil penalties against Mr. Gupta in an administrative proceeding is strictly a legal issue. Importantly, the constitutional claim Mr. Gupta has asserted would not be subject to any factual development in

the administrative proceeding and could be litigated effectively only in this action. Nor would a decision by the Court invade the field of Commission expertise or discretion. Statutory interpretation and adjudication of constitutional claims is the work of federal district courts.

Ripeness serves the same general purposes as exhaustion, *see* Wright & Miller, 13B Fed. Prac. & Proc. Juris. § 3521.1 (3d ed.); *Aquavella v. Richardson*, 437 F.2d 397, 403-04 (2d Cir. 1971), and those purposes would not be served by delayed judicial review of the Commission's actions. The ripeness doctrine cautions courts not to render decisions absent a genuine need to resolve a real dispute. *See City of New York v. U.S. Dep't of Commerce*, 739 F. Supp. 761, 765 (E.D.N.Y. 1990). "Determining whether administrative action is ripe for judicial review requires [a court] to evaluate (1) the fitness of the issues for judicial decision and (2) the hardship to the parties of withholding court consideration." *Sharkey*, 541 F.3d at 89 (quoting *Nat'l Park Hospitality Ass'n v. Dep't of Interior*, 538 U.S. 803, 808 (2003)). The question whether an agency has authority to undertake an ongoing proceeding is ripe if the question can be answered without factual development in agency proceedings. *See Atlantic Richfield Co. v. U.S. Dep't of Energy*, 769 F.2d 771, 782-84 (D.C. Cir. 1984).

Under these principles, Mr. Gupta's claims are clearly ripe for review by the Court. Mr. Gupta pleads a colorable equal protection claim along with a pure question of statutory interpretation. The Commission made these claims ripe by its "first use . . . of its new authority under Dodd-Frank" against only one Galleon-related defendant. The Commission inexplicably claims that it "has not determined that Section 929P of Dodd-Frank can be applied retroactively" (Br. at 20); but the charges set forth in the OIP reflect otherwise, as do the Director of Enforcement's recent remarks. The Commission no doubt would have charged Mr. Gupta in this Court with the other Galleon-related defendants had it not concluded that it could apply

Dodd-Frank retroactively. Suing in a federal district court had been and — but for *this* case remains — the Commission's consistent practice in litigated insider trading cases seeking civil penalties against a non-regulated person. (Compl. ¶ 12).

Mr. Gupta is not asking the Court to make any broad pronouncements that might disrupt the traditional path to judicial review of Commission action. The Complaint describes a unique set of facts: Mr. Gupta is indisputably the first non-regulated person against whom the Commission seeks to apply Dodd-Frank retroactively, and he is the only Galleon-related defendant (in a class of over two dozen defendants) to be singled out to be tried administratively and not in federal court. He commenced this action promptly after issuance of the OIP, and before any agency action other than the OIP. The claims he raises are not embraced within the language of Section 25(a) of the Exchange Act, and the facts of the case do not trigger application of either the exhaustion or ripeness doctrine. Just as he has been singled out by the Commission, he presents a singular set of facts, for which relief should be granted.

Conclusion

For the foregoing reasons, the Commission's motion to dismiss should be denied in all respects.

Dated: New York, New York
April 11, 2011

Respectfully submitted,

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Statutory Appendix

5 U.S.C. § 702

§ 702. Right of review

A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States: *Provided*, That any mandatory or injunctive decree shall specify the Federal officer or officers (by name or by title), and their successors in office, personally responsible for compliance. Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

5 U.S.C. § 703

§ 703. Form and venue of proceeding

The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus, in a court of competent jurisdiction. If no special statutory review proceeding is applicable, the action for judicial review may be brought against the United States, the agency by its official title, or the appropriate officer. Except to the extent that prior, adequate, and exclusive opportunity for judicial review is provided by law, agency action is subject to judicial review in civil or criminal proceedings for judicial enforcement.

5 U.S.C. § 704

§ 704. Actions reviewable

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

15 U.S.C. § 78y

§ 78y. Court review of orders and rules

(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence

(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

EXHIBIT A

U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks at SIFMA's Compliance and Legal Society Annual Seminar

by

Robert Khuzami

Director, Division of Enforcement
U.S. Securities and Exchange Commission

Phoenix, Arizona (Video Presentation)
March 23, 2011

I'd like to thank Dick Walker *(moderator)*, my fellow panelists, and all of the SIFMA members in the audience for the opportunity to speak with you today.

We are seven days shy of my two-year anniversary at the SEC. That seems like an appropriate point to take stock of what we have accomplished.

First, we completed the most significant restructuring since the Division was created almost 40 years ago.

The restructuring, while composed of many initiatives, had some common goals – to make us smarter about the products, markets, transactions and practices that we police; to make us quicker to stop fraud and misconduct before it's on the front page and all the investor money is squandered; to make us more efficient in how we use our resources, thus allowing us to do more within existing budgets; and to maximize our deterrent impact by moving quickly to address newly-emerging threats before they take hold across entire business lines or even industries.

Highlights of the restructuring include:

- The introduction of five new national specialized investigative units dedicated to developing expertise in high-priority areas of Asset Management (including investment advisers and private funds), Market Abuse (large-scale trading-related issues, including computer-driven trading platforms and related services and arrangements); Structured Products, Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions.

- A doubling of our front-line manager-to-staff ratio by eliminating the branch chief position, an entire layer of management, thus adopting a flatter, more streamlined organizational structure and reallocating many of these highly qualified former managers back to front-line

investigative work.

- The establishment of an Office of Market Intelligence to utilize technology and improved workflow to collect, risk-weight, triage, assign, and monitor the thousands of tips, complaints and referrals received by the Division each year.

- Creation of an Office of the COO with a network of business managers throughout the Division to handle operations such as IT, workflow, budget, HR and project management tasks, thus relieving investigative staff from these tasks so they can focus on their core competency of conducting investigations.

- Delegation of authority to approve formal orders to senior staff, so that we no longer have to get Commission pre-approval to issue a subpoena; we also eliminated the necessity of obtaining approvals from the Home Office for MUI openings, routine settlements and Wells Notice calls.

- Adoption of a Cooperation Program, where we offer reduced or even no sanctions to encourage "insiders" with knowledge of wrongdoing to come forward early, thus allowing us to bring stronger cases and shut down fraudulent schemes earlier than would otherwise be possible.

Lastly, not specifically related to the restructuring, the talent we have hired into the Division in the last two years has been remarkable. Adding to the tremendous talent of the current staff, over half of the senior staff of the Division is new, and of those, over half are from outside the agency, bringing incredible knowledge and perspective to the job.

Effective Results Metrics

While we do not measure our work by statistics alone, metrics for Fiscal Year 2010 suggest the Division continues to perform at a high level, an accomplishment particularly noteworthy since much of the year was spent absorbing the restructuring changes. Let me just tick off some of these.

- 681 cases filed in fiscal year 2010, more than in any of the previous five years.

- $2.85 billion in disgorgement and penalties was ordered in fiscal year 2010, an increase of 17 percent over fiscal year 2009 and 176 percent over fiscal year 2008.

- Nearly $2.0 billion distributed to injured investors from 42 separate Fair Funds.

- And, lastly, some of my favorite metrics, we are both filing and closing cases more quickly – an 11 percent decrease in the last two years in the average amount of time it takes to file an action; a nearly 10 percent increase in the percentage of actions first filed within two years of the opening of an investigation, and a 33 percent increase in cases closed in fiscal year 2010 and 2009 as compared to previous years. This trend translates into more timely cases with

greater deterrent impact, and a decrease in the uncertainty for the subjects of our investigations about their status.

Recent Significant Cases

As for particular cases filed in the past year, it is no secret that a priority for us has been misconduct arising out of the financial crisis. In total, we've filed 20 cases generally understood as constituting core financial crisis conduct, ultimately suing 40 defendants, including 26 CEOs, CFOs and other senior officers. Fifteen of these 20 cases have been settled in whole or in part, resulting in more than $1.3 billion in penalties, disgorgement, and other monetary relief. Noteworthy matters include actions against Countrywide Financial, Citigroup, Morgan Keegan, Goldman Sachs, State Street Bank, Charles Schwab, New Century Financial, IndyMac Bancorp, and collateral manager ICP Asset Management to name a few.

I also want to highlight other cases we have filed that might be of interest to this audience, including significant actions against broker-dealers, hedge funds, investment advisers, and financial advisers.

In January, Merrill Lynch paid a $10 million penalty because while representing to customers that their order information would be maintained on a strict need-to-know basis, the firm's proprietary trading desk obtained information about institutional customer orders from traders on the market making desk, and used that information to place trades on Merrill's behalf after executing the customers' trades. We determined that Merrill failed to establish and maintain written policies and procedures designed to prevent the misuse of material nonpublic information.

In September, we charged Pinnacle Capital Markets with failing to have an adequate Customer Identification Program to verify the identities of all of its customers. Although it had a CIP program on paper, it failed to comply with those procedures for a six-year period. This violation had real consequences, since Pinnacle marketed its direct market access business to foreign customers, thus presenting real AML risks.

In addition, we have held accountable those firms and individuals that failed to accurately describe product risk – especially the widely-held mutual funds that are the bread-and-butter investments of retail investors.

In February, we charged TD Ameritrade for failing to reasonably supervise certain registered representatives who misled customers when selling shares of the Reserve Yield Plus Fund – a mutual fund that "broke the buck" in September 2008. We found that these representatives mischaracterized the Fund as a money market fund, as safe as cash, or as an investment with guaranteed liquidity.

In January, we charged Charles Schwab affiliates and individuals with making misleading statements regarding the Schwab YieldPlus Fund – formerly the largest ultra short bond fund in its class – including statements concerning the pace of redemptions in the Fund. The Schwab Entities agreed to pay more than $118 million. Our suit against the individuals, including the former CIO for fixed income and the former President of the investment adviser, is ongoing.

We have also brought several recent cases against investment advisers who violated basic fiduciary principles. In the AXA Rosenberg case, we charged an investment adviser with concealing an error in the computer code of the quantitative investment model that they used to manage client risk, resulting in the firm paying $217 million to harmed clients and a $25 million penalty. We charged two former portfolio managers at Aquila Investment Management with defrauding a mutual fund that invests primarily in municipal bonds issued by the State of Utah by improperly charging municipal bond issuers more than a half-million dollars in undisclosed "credit monitoring fees" that they secretly pocketed for themselves.

We also have stepped up our enforcement activity against those who misappropriated investor funds or otherwise engaged in illicit schemes, including through the use of "side pocket" investments. These cases include Baystar Capital Management, where we charged a San Francisco Bay Area hedge fund manager with concealing more than $12 million in investment proceeds owed to investors through the use of a "side pocket" into which investors had limited visibility; and Hunter World Markets, where we charged two securities professionals, a hedge fund trader, two firms and a Chief Compliance Officer in connection with a scheme that manipulated several U.S. microcap stocks and generated more than $63 million in illicit proceeds through stock sales, commissions and sales credits, and allowed them to materially overstate by at least $440 million the hedge funds' performance and net asset values (NAVs) in a fraudulent practice known as "portfolio pumping."

At the same time, we continue to vigorously enforce insider trading laws. Earlier this month, we charged Rajat Gupta, former director of Goldman Sachs and Procter & Gamble, for illegally tipping Galleon Management founder and hedge fund manager Raj Rajaratnam with inside information about the quarterly earnings at both firms as well as an impending $5 billion investment by Berkshire Hathaway in Goldman. This case also represented the first use by the SEC of its new authority under Dodd-Frank to obtain penalties in an Administrative Proceeding against persons not associated with a regulated entity.

In addition, in the Expert Network Insider Trading Cases, we charged hedge funds and four technology company employees who, while moonlighting as consultants or "experts" without the knowledge of their employers, abused their access to inside information about such technology companies as AMD, Apple, Dell, Flextronics, and Marvell and passed it to the funds.

We also remain focused on the conduct of boards and senior executives in contexts other than insider trading. For example, in addition to charging the Company and senior executives, we recently charged three outside directors and members of Audit Committee for ignoring obvious signs of the fraud at DHB Industries, including inappropriate management involvement in the internal investigation, resignation of the law firm conducting the internal investigation, and termination of the outside firm looking into allegation of unauthorized expenses by the CEO. Last year in the InfoUSA case, we similarly brought charges against senior executives based on the misappropriation of assets by the former CEO and we also charged an outside director and chair of the Audit Committee for failing to respond to obvious red flags relating to the CEO's misappropriation of funds.

We also have brought cases concerning the growing municipal securities market. In December, we charged Banc of America Securities, LLC (BAS) for repeatedly paying undisclosed gratuitous payments and kickbacks to various bidding agents and affirmatively misrepresenting that certain bidding processes were proper. To settle the SEC's charges, BAS agreed to pay more than $36 million in disgorgement and interest and another $101 million to other federal and state authorities.

Another new area is actions under Section 304 of the Sarbanes-Oxley Act. Passed in the wake of the Enron and WorldCom accounting scandals, this provision seeks to incentivize CEOs and CFOs to implement strong internal financial reporting and accounting controls by authorizing the SEC to clawback their incentive compensation and personal stock profits when their companies are required to prepare an accounting restatement as a result of "misconduct," even to clawback such compensation where the CEO or CFO are not personally charged with wrongdoing. We filed the first of these so-called "stand alone" cases against former CSK Auto CEO Maynard Jenkins, seeking that he reimburse the company for bonuses and stock sale profits that he received while CSK was committing accounting fraud. In another 304 case filed earlier this month, Ian McCarthy, the CEO of Beazer Homes USA, agreed to reimburse the company more than $6 million in bonuses and stock profits that he received while Beazer was issuing false and misleading financial results.

Dodd-Frank Act

I also would like to mention two provisions under Dodd-Frank that impact our program.

First is collateral bar authority, where we now can impose industry-wide bars for securities laws professionals who violate the law, meaning if the misconduct arises out of activity associated with a broker-dealer, the person can be barred not only from association with a broker-dealer, but from all regulated entities, including investment advisers, municipal securities dealers, municipal advisers, transfer agents and nationally rated securities rating organizations.

Second, we now have new whistleblower authority which authorizes the agency to compensate individuals who provide the SEC with useful information suggesting securities law violations. We have received and studied many comments to the proposed rules, and adoption of the rule is set for April. The proposed rule has provoked some passionate views, particularly on the issue of the role of internal corporate compliance programs. In the proposed rule, we have worked hard to strike the right balance between incentivizing and protecting whistleblowers who want to report suspected misconduct, but at the same time acknowledging the value and obligation of corporate compliance programs to identify and remediate misconduct in the company's operations. We look forward to implementing the whistleblower program in a way that factors in the important role of corporate compliance programs while providing whistleblowers a direct path to the SEC in appropriate circumstances.

Upcoming Priorities

There are no shortages of challenges to the enforcement program. We must

be current with market developments. For example, in the market abuse area, we need the expertise to understand and analyze new trading technologies such as high-frequency and algorithmic trading, data feed latency issues, and large volume trading, as well as systemic insider trading and manipulation schemes. In the asset management area, we must increase our understanding of issues related to valuation of illiquid portfolios, false performance claims, preferential redemptions, and high-risk emerging products.

In the municipal securities markets, we must be up-to-date on pension liability disclosures, valuation issues, and tax-arbitrage activities. These examples are just part of a broader array of challenges stemming from the fast-paced change and increasing complexity apparent in the financial products, markets, transactions, and practices that the Division confronts.

To give but one example of the technology challenges we face, critical to our mission is increased capacity to analyze large volumes of information, including both structured and unstructured data. The Division receives each month approximately three to four terabytes of electronic data. As a comparison, 20 terabytes is often noted as the equivalent to the printed book collection of the U.S. Library of Congress. The capacity and functionality of our systems to handle this volume is not what it should be.

But despite these limitations, I see every day the incredible talent and commitment of the staff, and I am confident that we will continue to bring new energy and vision to the critical task of policing our financial markets.

http://www.sec.gov/news/speech/2011/spch032311rk.htm

EXHIBIT B

H. R. 4173

One Hundred Eleventh Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Tuesday, the fifth day of January, two thousand and ten

An Act

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Dodd-Frank Wall Street Reform and Consumer Protection Act".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

violation of a provision of this Act, or of any rule or regulation issued under this Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.".

SEC. 929N. AUTHORITY TO IMPOSE PENALTIES FOR AIDING AND ABETTING VIOLATIONS OF THE INVESTMENT ADVISERS ACT.

Section 209 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9) is amended by inserting at the end the following new subsection:

"(f) AIDING AND ABETTING.—For purposes of any action brought by the Commission under subsection (e), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of this Act, or of any rule, regulation, or order hereunder, shall be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation.".

SEC. 929O. AIDING AND ABETTING STANDARD OF KNOWLEDGE SATISFIED BY RECKLESSNESS.

Section 20(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(e)) is amended by inserting "or recklessly" after "knowingly".

SEC. 929P. STRENGTHENING ENFORCEMENT BY THE COMMISSION.

(a) AUTHORITY TO IMPOSE CIVIL PENALTIES IN CEASE AND DESIST PROCEEDINGS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end the following new subsection:

"(g) AUTHORITY TO IMPOSE MONEY PENALTIES.—

"(1) GROUNDS.—In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person if the Commission finds, on the record, after notice and opportunity for hearing, that—

"(A) such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder; and

"(B) such penalty is in the public interest.

"(2) MAXIMUM AMOUNT OF PENALTY.—

"(A) FIRST TIER.—The maximum amount of a penalty for each act or omission described in paragraph (1) shall be $7,500 for a natural person or $75,000 for any other person.

"(B) SECOND TIER.—Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be $75,000 for a natural person or $375,000 for any other person, if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

"(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $150,000 for a natural person or $725,000 for any other person, if—

"(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

"(ii) such act or omission directly or indirectly resulted in—

"(I) substantial losses or created a significant risk of substantial losses to other persons; or

"(II) substantial pecuniary gain to the person who committed the act or omission.

"(3) EVIDENCE CONCERNING ABILITY TO PAY.—In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the ability of the respondent to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of the ability of the respondent to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon the assets of the respondent and the amount of the assets of the respondent.".

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended—

(A) by striking the matter following paragraph (4);

(B) in the matter preceding paragraph (1), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest and";

(C) by redesignating paragraphs (1) through (4) as subparagraphs (A) through (D), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(1) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following:

"(2) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted under section 21C against any person, the Commission may impose a civil penalty, if the Commission finds, on the record after notice and opportunity for hearing, that such person—

"(A) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(B) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(3) UNDER THE INVESTMENT COMPANY ACT OF 1940.—Section 9(d)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(d)(1)) is amended—

(A) by striking the matter following subparagraph (C);

(B) in the matter preceding subparagraph (A), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest, and";

(C) by redesignating subparagraphs (A) through (C) as clauses (i) through (iii), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(4) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 203(i)(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(i)(1)) is amended—

(A) by striking the matter following subparagraph (D);

(B) in the matter preceding subparagraph (A), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest and";

(C) by redesignating subparagraphs (A) through (D) as clauses (i) through (iv), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following new subparagraph:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(b) EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by adding at the end the following new subsection:

"(c) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(3) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–14) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 206 involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(c) CONTROL PERSON LIABILITY UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(a)) is amended by inserting after "controlled person is liable" the following: "(including to the Commission in any action brought under paragraph (1) or (3) of section 21(d))".

SEC. 929Q. REVISION TO RECORDKEEPING RULE.

(a) INVESTMENT COMPANY ACT OF 1940 AMENDMENTS.—Section 31 of the Investment Company Act of 1940 (15 U.S.C. 80a–30) is amended—

(1) in subsection (a)(1), by adding at the end the following: "Each person having custody or use of the securities, deposits, or credits of a registered investment company shall maintain and preserve all records that relate to the custody or use by such person of the securities, deposits, or credits of the registered investment company for such period or periods as the Commission, by rule or regulation, may prescribe, as necessary or appropriate in the public interest or for the protection of investors."; and

(2) in subsection (b), by adding at the end the following:

"(4) RECORDS OF PERSONS WITH CUSTODY OR USE.—