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Financial Reform Expands SEC Enforcement Authority

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In addition to expanding the regulatory authority of the Securities and Exchange Commission, the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act includes several notable changes to the SEC's enforcement powers. In conjunction with authorizing increases in the SEC's budget over the next several years, these provisions of Dodd-Frank clearly signal Congress's intent that the SEC intensify its enforcement activity in the years to come. Congress also mandated a number of studies to examine areas where additional changes might be made, both in relation to the Commission's own enforcement powers, and with respect to private securities litigation matters.

This report summarizes several of the more significant provisions addressing these issues.

Administrative Penalties

The SEC has historically been able to bring certain types of enforcement actions before its own administrative law judges, rather than in a court before a judge or a jury. Until Dodd-Frank, however, the SEC could only obtain monetary penalties in these administrative cease-and-desist proceedings if the respondent was a regulated entity (*e.g.*, a broker-dealer or investment adviser), or a person associated with such a regulated entity. Section 929P(a) of Dodd-Frank eliminates this limitation, and expands the SEC's ability to obtain monetary penalties in administrative proceedings from *any* person who violates the federal securities laws, such as a public company and its officers and directors.

Dodd-Frank also establishes a multi-tier penalty schedule under the Securities Act of 1933, similar to the one previously established under Section 21B of the Securities Exchange Act of 1934.

While Section 929P(a) establishes that a person is entitled to notice and opportunity for a hearing, it does not include the same types of extensive rights ordinarily available to defendants in federal court proceedings, such as discovery pursuant to the Federal Rules of Civil Procedure, motion practice, trial by jury, and standards for review on appeal.

Going forward, it seems likely that this change could result in a shift of SEC enforcement actions against issuers, officers and directors, and others, from the courts to administrative proceedings.

Extraterritorial Jurisdiction

Section 929P(b) of Dodd-Frank extends the jurisdiction of the United States district courts to cases where the SEC seeks to enforce the antifraud provisions of the federal Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 with respect to transactions that occurred outside the United States. The district courts may now exercise jurisdiction when the SEC alleges that (a) the defendant took "significant steps" in the United States to further the violation,

even if the securities transaction occurred outside the United States, or (b) foreign misconduct had a "foreseeable substantial effect" within the United States.

Section 929Y also directs the SEC to study whether extraterritorial jurisdiction should be extended to private rights of action under the antifraud provisions of the federal securities laws. This directive appears to be at least in part a response to the June 2010 ruling by the United States Supreme Court in the *Morrison v. National Australia Bank Ltd.* case, which rejected extraterritorial jurisdiction over claims brought under the antifraud provisions of the Securities Exchange Act by foreign plaintiffs who bought a foreign issuer's stock on a foreign exchange.

Aiding and Abetting Violations and "Control Person" Liability

Similarly, Dodd-Frank expands the SEC's enforcement powers with respect to "aiding and abetting" claims under the antifraud provisions of the federal securities laws, and orders a study of whether to expand such claims to private antifraud actions.

Section 929O explicitly authorizes the SEC to impose aiding and abetting liability on any person who "knowingly *or recklessly* has aided, abetted, counseled, commanded, induced or procured" a Securities Exchange Act violation. This amends earlier language that imposed liability only for "knowing" violations, which some courts had interpreted to exclude reckless conduct. Similarly, Section 929N adds a "knowing or reckless" aiding and abetting provision to the Investment Advisers Act. Under Section 929M, the SEC is now permitted, for the first time, to assert aiding and abetting claims for violations of the Securities Act and the Investment Company Act of 1940. This expanded authority, combined with the lower scienter threshold, will make it easier for the SEC to bring aiding and abetting claims and likely result in a more aggressive approach in asserting such claims.

Section 929Z of Dodd-Frank directs the GAO to study the impact of allowing private plaintiffs to sue for aiding and abetting violations of the federal securities laws. With this study, Congress appears to be seeking support for new legislation that might overturn aspects of the Supreme Court's decisions in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* which held that private claims for so-called "scheme liability" or for aiding and abetting are not permitted under Section 10(b) of the Securities Exchange Act.

Section 929P(c) of Dodd-Frank also clarifies Section 20(a) of the Securities Exchange Act so that it explicitly authorizes the SEC to bring enforcement actions against so-called "control persons," *i.e.*, persons who directly or indirectly control a primary violator. Previously, the Exchange Act might have been interpreted to limit such claim to private plaintiffs.

Nationwide SEC Trial Subpoenas

Section 929E of Dodd-Frank enables the parties in SEC federal court litigation to issue subpoenas to compel the trial appearance of witnesses located anywhere in the United States.

Collateral Bars

Prior to Dodd-Frank, the SEC could only suspend or bar a securities violator from associating with the type of regulated entity that the violator was associated with at the time of the violation. Under Section 925 of Dodd-Frank, however, the SEC now has authority to impose collateral bars, which would prohibit the violator from associating with a much larger group of regulated entities. For example, a securities violator who was associated with an investment adviser at the time of the violation can now be barred from associating with an investment adviser as well as a broker-dealer, municipal securities dealer, transfer agent, or nationally recognized statistical rating organization.

Conclusion

Although the SEC unsuccessfully sought self-funding for its operations, its budget will still nearly double over the next several years. Further, the SEC may experience an increase in enforcement leads and investigations resulting from the new whistleblower program established by Dodd-Frank. These significant changes, combined with the expanded enforcement powers discussed above, will very likely result in a more active, informed, and aggressive SEC.

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