
Dodd-Frank One-Year Anniversary: Emerging Litigation Trends Post Dodd-Frank and the Financial Crisis

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Ted is a partner in our Litigation Group and practices in our New York office. He represents clients in securities, derivative, professional liability, acquisition-related, and other complex litigation in federal and state courts around the country, as well as in arbitration. He also represents companies and boards of directors in internal investigations, as well as in investigations and other proceedings before various regulatory agencies, including the Securities and Exchange Commission. His recent clients include Bank of America, CVS Caremark, GSC Group, Hitachi, Morgan Stanley, PartnerRe, Pfizer, Toll Brothers, and Warner Chilcott.



Linda Chatman Thomsen

Linda is a partner in our Litigation Group and practices in our Washington DC office. Her practice concentrates in matters related to the enforcement of the federal securities laws. She returned to the firm after serving for 14 years in various positions within the SEC. Linda joined the SEC staff in 1995 as Assistant Chief Litigation Counsel. In 1997, she was named Assistant Director of the Enforcement Division. She became an Associate Director in 2000, Deputy Director in 2002 and was named Director of the Enforcement Division in 2005, a position she held until 2009.



Raul F. Yanes

Raul is a partner in Davis Polk's Litigation Department, practicing in our Washington DC office. He represents clients in Congressional investigations, white collar criminal defense matters, securities enforcement actions, internal investigations and complex civil litigation. Mr. Yanes left the firm from 2003-2009 to serve in various government positions including, Associate Counsel to the President, Senior Counselor to the Attorney General at the U.S. Department of Justice, General Counsel of the Office of Management and Budget, and Staff Secretary and Assistant to the President.

Today's Discussion

- Key Enforcement and Litigation Provisions in Dodd-Frank
 - Whistleblowers
 - Extraterritoriality
 - Aiding and Abetting
 - Administrative Proceedings
 - Proxy Access
 - Say on Pay

- Recent Trends in Financial Crisis and Securities Litigation
 - Recent Trends
 - Recent Supreme Court Decisions

Dodd-Frank Whistleblower Provisions

KEY STATUTORY REQUIREMENTS

Mandatory awards of 10-30% when:

- One or more whistleblowers ***voluntarily*** provides the SEC/CFTC
- With ***original information***
 - Derived from independent knowledge or analysis
- That leads to the ***successful enforcement*** by the SEC/CFTC of an action
 - Which caused the staff to commence an action; or
 - Where the information would not have otherwise been received and was essential to the success of an ongoing action
- In which the SEC/CFTC obtains monetary sanctions totaling ***more than \$1 million***

Dodd-Frank Whistleblower Provisions

ANTI-RETALIATION

■ Sarbanes-Oxley

- Covers whistleblowers who report both internally and externally.
- Must go to Department of Labor with complaint first.

■ Dodd-Frank

- More generous procedurally to whistleblowers.
 - Allows a claim to be filed six years after the retaliation or three years after the date when the facts about the retaliation should have been known.
 - Whistleblower may go directly to district court.
- May also be enforced by the SEC.

Dodd-Frank Whistleblower Provisions

REGULATIONS

- Rule requires that the person have a “reasonable belief” as to a possible securities law violation.
- Rules do not require whistleblowers to use internal compliance systems first.
- Auditors, compliance personnel and officers and directors will be eligible for an award if (1) disclosure is necessary to prevent substantial injury to the financial interests of the entity or investors; or (2) the entity is engaging in conduct that will impede an investigation; or (3) 120 days has passed since the whistleblower reported internally.
- Attorneys or others with privileged information will be eligible for an award if disclosure is permitted under attorney conduct rules.

Dodd-Frank Whistleblower Provisions

IMPACT ON SEC ENFORCEMENT PROCESSES

- Enforcement Staff has indicated that in most cases it will refer complaints to issuers for initial response.
- Staff's handling of initial whistleblower rewards will be key.
- Staff will need to make it clear that:
 - Use or misuse of internal compliance systems will be a “real” factor in determining rewards.
 - Reports by legal, audit and compliance personnel will only be rewarded where internal compliance systems are clearly broken.
 - Staff cooperation with compliance systems and internal investigations will be a key part of the program.

Dodd-Frank Whistleblower Provisions

DEVELOPMENT AND TRENDS SO FAR

- “While the SEC has a long history of receiving high volumes of tips and complaints, the quality of the tips has improved since the enactment of [the whistleblower provisions], and this trend is expected to continue.”
– SEC Chairman Mary Schapiro
- Anecdotally, Commission staff have said that many of the referrals are coming from senior personnel, but often not from individuals at the company itself, but rather from individuals employed by competitors.
- An industry has already developed to represent and assist potential whistleblowers.

Dodd-Frank Extraterritoriality Provisions

EXTRATERRITORIAL REACH OF DOJ AND SEC

- Dodd-Frank extends the reach of the jurisdiction of the antifraud provisions of the securities laws, but only with respect to actions by the DOJ or the SEC.
 - 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.
 - Conduct occurring outside the United States that has a foreseeable substantial effect within the U.S.
- Implements Second Circuit test originally articulated by Judge Friendly.

Dodd-Frank Extraterritoriality Provisions

PRIVATE ACTIONS POST MORRISON v. AUSTRALIA BANK

- Dodd-Frank purports to expand territorial reach for government actors only. Private actions remain limited in the way articulated in Morrison.
- Lower courts have since grappled with the application of the limitations articulated in Morrison.
 - Courts have held that “transactions in securities listed on domestic exchanges” do not permit actions by U.S. investors in foreign securities even if some aspect of the transaction occurred in the U.S. and even if the same issuer also has securities listed on a U.S. exchange.
 - Courts have taken different approaches to the more fact-specific question of what constitutes “domestic transactions in other securities.”

Dodd-Frank Aiding and Abetting Provisions

SUMMARY

- Gives the SEC explicit authority under the Securities Act, the Investment Company Act, and the Investment Advisers Act to bring enforcement actions against aiders and abettors.
- Lowers the scienter standard for SEC aiding and abetting actions to include both knowledge and recklessness.
- Since Dodd-Frank, the SEC has exercised its authority to pursue individuals on aiding and abetting theories.

Dodd-Frank Aiding and Abetting Provisions

PRIVATE RIGHTS OF ACTION AND GAO REPORT

- In connection with the passage of Dodd-Frank, Congress considered, but ultimately rejected, proposals to expand private rights of action to include aiding and abetting liability for secondary actors.
- In Dodd-Frank, Congress commissioned a report from the GAO on the impact of a possible private right of action against aiders and abettors.
- The GAO Report sets forth arguments for and against authorizing a private right of action for aiding and abetting securities fraud, but did not offer a conclusion or recommendation on the advisability of doing so.

Dodd-Frank Aiding and Abetting Provisions

JANUS CAPITAL GROUP, INC v. FIRST DERIVATIVE TRADERS

- The Court in *Janus* addressed the question of who can be liable under Rule 10b-5 for “making” false statements.
- The Court held that a person or entity generally does not “make” a statement within the meaning of Section 10(b) unless that person actually states it.
- The Court rejected the notion that individuals who “substantially participate” in the creation of statements made by others face primary liability under Rule 10b-5.
- The Court focused on attribution and control as key considerations in determining whether a party can be deemed to have “made” a statement.

Dodd-Frank Administrative Proceedings Provisions

SUMMARY

- The Act provides the SEC with uniform authority to seek civil penalties in cease and desist proceedings.
- This allows the SEC to bring numerous actions in an administrative proceeding that would have previously only been able to be brought in district court.
 - SEC administrative proceedings provide fewer procedural protections like the Federal Rules of Evidence and full discovery.
 - Some would also argue that they give the SEC a home court advantage.

Dodd-Frank Administrative Proceedings Provisions

RAJAT GUPTA

- The SEC has charged Gupta with insider trading in connection with his alleged assistance to Galleon Group founder Raj Rajaratnam.
- Before Dodd-Frank it is arguable that this action would only have been able to have been brought in District Court.
- All other Galleon-related insider trading actions have been filed in District Court.

Dodd-Frank Administrative Proceedings Provisions

GUPTA v. SEC

- Gupta filed a complaint in the Southern District of New York challenging the action on Equal Protection and Due Process grounds.
 - Gupta's Equal Protection argument is that the SEC has singled him out for uniquely unfavorable treatment.
 - Gupta's Due Process argument is that the SEC is trying to retroactively apply Dodd-Frank to Gupta in order to deprive him of the procedural safeguards of federal court including the constitutional right to a jury trial.
- Judge Rakoff has so far allowed this suit to proceed.

Dodd-Frank Proxy Access

BUSINESS ROUNDTABLE AND CHAMBER OF COMMERCE v. SEC

- Exchange Act Rule 14a-11, would have required U.S. public companies to include shareholder nominees for election as directors in their proxy materials under certain conditions.
- The D.C. Circuit found that, in adopting the rule, the SEC violated the Administrative Procedure Act by failing to adequately consider the rule's effect on efficiency, competition, and capital formation.

Dodd-Frank Say-on-Pay Provisions

SUMMARY

- Not less frequently than once every 3 years, at any annual or other meeting of shareholders companies must provide their shareholders with a non-binding shareholder vote to approve the compensation of executives as disclosed pursuant to the SEC rules.
- Shareholders will also be provided with a non-binding shareholder vote, at least once every 6 years, to determine whether this vote should be held every 1, 2 or 3 years.

Dodd-Frank Say-on-Pay Provisions

CURRENT LITIGATION

- To date, derivative lawsuits have been filed against 7 companies with failed say on pay votes.
- Complaints allege a disconnect between pay and performance – e.g., increasing executive pay in the face of declining earnings – and bring claims for breaches of fiduciary duty, corporate waste, and aiding and abetting by compensation consultants.
- Though these claims would likely be very difficult to prove under Delaware law, they may also be expensive and distracting to litigate. Some have already settled for injunctive relief and attorneys' fees.

Financial Crisis and Securities Litigation

RECENT TRENDS

- Cornerstone and NERA report that financial crisis filings have now tailed off, reflecting the passage of time and the associated expiration of statutes of limitations.
- Cases against financial institutions in connection with their crisis-related write-downs have met with mixed results.
 - Some dismissals.
 - Some cases have survived motions to dismiss and are proceeding into class certification and discovery.
- Large volume of cases involving CDOs, RMBSs, and SIVs have largely proceeded as individual actions, often under state law in state court.

Notable Supreme Court Decision

ERICA P. JOHN FUND, INC. v. HALLIBURTON CO.

- The Supreme Court rejected a Fifth Circuit requirement that plaintiffs must establish loss causation at the class certification stage as an additional requirement to invoke the *Basic* presumption of reliance.
- The Court's decision should not disturb the law in other circuits, including the Second Circuit, which expressly permits defendants to rebut market impact on class certification.
- The Court also reaffirmed that the *Basic* presumption of reliance is rebuttable, and that the presumption applied only “so long as” the alleged misrepresentation “was reflected in the market price at the time of [the plaintiff’s] transaction.”

Notable Supreme Court Decision

MATRIX INITIATIVES v. SIRACUSANO

- The Court reaffirmed the standard first articulated in *Basic* for when an omission of information can be actionable.
 - “Whether a reasonable investor would have viewed the nondisclosed information as having significantly altered the ‘total mix’ of information made available.”
 - Rejected any bright-line test for determining whether plaintiffs had sufficiently pled that the company made material misstatements and omissions.
- The Court also confirmed the well-known rule, and stated that it “bears emphasis” that § 10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information.
- The Court assumed, without deciding, that the recklessness standard applied by the Court of Appeals is sufficient to establish scienter.

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