



Holly Stein Sollod

Partner
303.295.8085
Denver
hsteinsollod@hollandhart.com

Securities Litigation and Regulation: Sweeping Changes Expected with Dodd-Frank Wall Street Reform and Consumer Protection Act

Securities Litigation and Regulation: Sweeping Changes Expected with Dodd-Frank Wall Street Reform and Consumer Protection Act

Insight — August 5, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Act”) signed into law on July 21, 2010, will have broad implications in many areas of law and will subject companies to new legal risks. Here are some highlights of the changes coming to Wall Street:

- **Aiding and Abetting Liability-** Under the Act, the Securities and Exchange Commission (“SEC”) can bring enforcement actions against persons or entities who “knowingly or recklessly” aid and abet a violation of the Securities Exchange Act of 1934 (“Exchange Act”) and the Securities Act of 1933, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. The law previously required proof that the person acted “knowingly” and only gave the SEC authority to prosecute claims under the Exchange Act. This expanded scope of aiding and abetting liability to include recklessness eases the burden of proof for the SEC.
- **Whistleblower Incentives and Protections-** The Act creates new incentives and protections for whistleblowers. In any judicial or administrative proceeding brought by the SEC resulting in monetary sanctions exceeding \$1 million, individual whistleblowers would be able to recover 10-30% of monetary sanctions (including penalties, disgorgement and interest, as well as any monies deposited into a disgorgement fund) as a result of any “original information” voluntarily supplied, to be paid from the newly established SEC Investor Protection Fund funded by monetary sanctions collected by the SEC. Employees can bring anti-retaliation claims in federal court seeking reinstatement and double back-pay. This provision differs from the whistleblower provisions in Section 806 of the Sarbanes-Oxley Act of 2002, which required employees to file a claim with the Secretary of Labor as a precondition to filing a civil action, and under which an award of reinstatement and back-pay (not double back-pay) can be awarded. Section 806 is amended to preclude waiver by any agreement (including an employment agreement) of whistleblower rights and renders unenforceable any predispute arbitration

agreement.

- **Broker's Fiduciary Duty-** The Act mandates the SEC to conduct a study of the costs and benefits of expanding investor protection by imposing a fiduciary duty on brokers similar to the standard for investment advisors, that is, should be required to act in their clients' best interest. The Act authorizes the SEC to adopt a rule on the subject after its study.
- **Regulation of Swaps and Derivatives-** The Act grants authority to the SEC and the Commodity Futures Trading Commission ("CFTC") to regulate derivatives and swaps. The CFTC now has primary responsibility for swaps, in addition to most derivatives. The SEC has oversight of only securities-based swaps. Swap Agreements are broadly defined.
- **Prohibition of Manipulative Short Sale-** The Act prohibits the manipulative short sale of any security. The SEC is to promulgate rules requiring public disclosures by institutional investment managers concerning short sales.
- **Securities Arbitration-** The Act calls into question the enforceability of arbitration provisions that brokerage firms impose on their employees and on their customers. The SEC is given authority to issue a rule restricting or even prohibiting enforcement of arbitration provisions in contracts between customers and brokers, dealers or advisers.
- **Hedge Fund Regulation-** Domestic hedge funds managing more than \$100 million must register with the SEC as investment advisers and disclose financial data needed to monitor systematic risk and protect investors. As a result, states will have greater supervision of hedge funds managing less than \$100 million.
- **Private Rights of Action Against Credit Rating Agencies-** A new Office of Credit Rating Agencies at the SEC is created to strengthen regulation of credit rating agencies, with its own compliance staff and authority to fine agencies. The Act amends the Exchange Act so that it expressly applies to statements made by a credit rating agency in the same manner and to the same extent as such provisions apply to statements made by a registered public accounting firm or a securities analyst under the securities laws and such statements shall not be deemed forward-looking statements for the purposes of the PSLRA safe harbor. The Act also lowers the plaintiff's burden for state of mind in actions against credit rating agencies or their controlling persons.
- **Monetary Penalties in Administrative Proceedings-** The Act changes the remedies available to the SEC in administrative proceedings by adding monetary penalties in cease and desist proceedings. Formally, the SEC would have to bring suit in federal court to recover monetary penalties.
- **Market Manipulation of Over the Counter Securities-** The Act expands the SEC's enforcement authority to market manipulation and short selling of over-the-counter securities, just like securities traded on a national securities exchange.

- **Federal Jurisdiction over Fraudulent Foreign Transactions-**
The SEC can now pursue foreign issuers for fraud, even when the transactions occurred overseas (i) when significant steps were taken in the United States in furtherance of the violation, or (ii) when conduct occurring outside the United States had a foreseeable substantial effect within the United States.

The Act contains many other sweeping provisions, including those on executive compensation and corporate governance, criminal sentencing, consumer protection, federal bank supervision, insurance and mortgage reform. Stay tuned for more changes as the administrative agencies draft the rules to support the statute.

This publication is designed to provide general information on pertinent legal topics. The statements made are provided for educational purposes only. They do not constitute legal or financial advice nor do they necessarily reflect the views of Holland & Hart LLP or any of its attorneys other than the author(s). This publication is not intended to create an attorney-client relationship between you and Holland & Hart LLP. Substantive changes in the law subsequent to the date of this publication might affect the analysis or commentary. Similarly, the analysis may differ depending on the jurisdiction or circumstances. If you have specific questions as to the application of the law to your activities, you should seek the advice of your legal counsel.