

SECURITIES LAW

The Dodd-Frank Earthquake

by BRAD FOSTER and MATTHEW NIELSEN

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) is the most sweeping financial legislation since the Great Depression. The 2,300-page law contains a number of provisions that impact securities litigation and enforcement, including significant new whistle-blower protections and expanded Securities and Exchange Commission enforcement tools. These changes will affect Texas lawyers for years to come. Here are four key portions of the act.

Whistleblower provisions: Dodd-Frank §922 contains powerful new whistle-blower provisions. If an individual voluntarily contacts the SEC and provides “original information” about a violation of the securities laws and the information leads to a successful enforcement action with a monetary sanction of more than \$1 million, the whistle-blower is entitled to a bounty of between 10 percent and 30 percent of the total sanction. The act also creates a new private right of action for whistle-blowers against retaliating employers. Remedies include reinstatement, double back-pay with interest and attorneys’ fees.

Expanded secondary liability: Dodd-Frank relaxes the culpability standard for aiding-and-abetting claims brought by the SEC. Previously, the SEC was required to show that a defendant “knowingly” provided substantial assistance to a violator of the federal securities laws. Dodd-Frank §929-O has expanded liability to those who have acted “recklessly.” Also, for the first time, the SEC may pursue aiding-and-abetting claims under the Securities Act of 1933, the Investment Company Act and the Investment Advisers Act. Finally, Congress has ordered the comptroller general to conduct a study on the impact of authorizing a private right of action against aiders and abettors. The U.S. Supreme Court eliminated private aiding-and-abetting claims in 1994, and any reinstatement of such claims would have monumental consequences for law firms, accounting firms and underwriters.

Enhanced SEC enforcement power: Dodd-Frank authorizes a doubling of the SEC’s budget over the next five years. It gives the SEC nationwide subpoena power for trial witnesses, expanded jurisdiction over foreign securities transactions and broader authority to bar individuals from the securities industry. It also provides the SEC with the ability to seek financial penalties in administrative proceedings and to bring such proceedings against anyone who allegedly violates the securities laws, regardless of whether he or she is registered with or practices before the SEC. As a result, the SEC may choose to bring more cases as administrative proceedings, which are expedited, involve limited discovery and do not permit jury trials.

Future SEC rule-making: Dodd-Frank has empowered the SEC to make significant changes to existing law through rule-making. Under the act, the SEC may impose fiduciary standards on stockbrokers, and it may restrict or eliminate the mandatory arbitration of broker-customer disputes. Together, these changes would alter the current landscape significantly and would be likely to generate a flood of securities cases in Texas state courts.

Dodd-Frank is a complex statute that has triggered a dynamic and controversial rule-making process. Its ultimate effects likely will be far-reaching, although it may be several years before the strengths and weaknesses of the legislation are fully revealed.

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