

ADVISORY | Dodd-Frank Act

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JUDGE RULES SEC CANNOT RETROACTIVELY APPLY DODD-FRANK TO AIDING AND ABETTING CLAIMS UNDER THE INVESTMENT COMPANY ACT

Before the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) was enacted, the SEC had no right to bring aiding and abetting claims under the Investment Company Act of 1940 (“ICA”) and the Securities Act of 1933. The SEC highlighted this deficiency when it sought such enforcement authority from Congress as part of Dodd-Frank.¹

Congress responded by adopting provisions in Dodd-Frank that significantly expanded the SEC’s enforcement arsenal. Among the wide-ranging changes was section 929M, which gave the SEC new authority to pursue persons who aid and abet violations under both the Securities Act and the ICA.

This new enforcement power raises a familiar yet difficult question: Can the new laws be applied retroactively to conduct that pre-dates the statute’s enactment?

On June 6, 2011, Judge William H. Alsup of the United States District Court for the Northern District of California weighed in on this question in *SEC v. Daifotis*, No. C 11-00137. The court dismissed the SEC’s claims for aiding and abetting violations of sections 13 and 34 of the ICA, holding that section 929M(2)(b) could *not* be applied retroactively.

In *Landgraf v. USI Film Products*, the Supreme Court set forth a two-step analysis for determining whether a new statute can be applied retroactively.² A court must first decide whether Congress has expressed its intent to apply the statute retroactively. If so, then the statute may be applied retroactively (provided no other constitutional hurdles remain). But, absent such congressional intent, the court must next determine whether the new statute would have “retroactive effect,” *i.e.*, “whether it would impair rights a party possessed when he acted, increase a party’s liability for past conduct, or impose new duties with respect to transactions already completed.”³ A statute having such “retroactive effect” cannot be applied retroactively.

Applying *Landgraf*, Judge Alsup found that Dodd-Frank contained no express directive to apply the statute retroactively and that section 929M(2)(b) *had* “retroactive effect” because it impaired a defendant’s rights, increased liability, and imposed new duties:

- **Impaired Rights:** Dodd-Frank eliminates a defense to an SEC claim for penalties by no longer requiring a finding that penalties are in the public interest.⁴
- **Increased Liability:** Dodd-Frank increases the extent of a party’s liability as an aider and abettor is now liable to the same extent as” the primary violator.⁵

¹ Chairman Mary L. Shapiro, U.S. Securities and Exchange Commission, Regulatory Perspectives on the Obama Administration’s Financial Regulatory Reform Proposals, Testimony Before the United States House of Representatives Committee on Financial Services (July 22, 2009).

² 511 U.S. 244 (1994).

³ *Id.* at 280.

⁴ *Hughes Aircraft*, 520 U.S. 948 (statutes eliminating a defense cannot be applied retroactively).

- **New Duties:** Dodd-Frank subjects an alleged aider and abettor to new sanctions including injunctive relief and increased monetary penalties.⁶

Notably, the court rejected the SEC's argument that it already had the authority to prosecute aiding and abetting ICA violations in administrative proceedings under section 9(b)(3) of the ICA and, thus, Dodd-Frank merely provided an additional forum—the federal courts—to bring such claims.⁷ Judge Alsup ruled that Dodd-Frank did more than merely provide another forum for the SEC to litigate aiding and abetting ICA violations. Indeed, the court observed that the SEC's litigation position was inconsistent with the SEC Chairman's testimony to Congress in which she stated that section 929M "would provide the SEC with authority to bring actions for aiding and abetting violations of the Securities Act and the [ICA], *which authority the SEC currently does not have.*"⁸

Retroactivity of Dodd-Frank requires a section by section analysis and will be litigated for years to come.⁹ But Judge Alsup's decision provides timely guidance for determining which of the expanded enforcement tools the SEC may use against individuals whose alleged misconduct occurred before Dodd-Frank's passage.

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⁵ *Rivers v. Roadway Express, Inc.*, 511 U.S. 298, 303 (1994) (statutes that increase liability cannot be applied retroactively).

⁶ Judge Alsup dismissed as irrelevant the SEC's promise to seek no more in remedies than it could have obtained in administrative proceedings, holding that a statute's retroactive effect depends on whether it changes the rights, liabilities and remedies, not on what the Commission promises to do or not do in a case.

⁷ *Hughes Aircraft Co. v. United States ex rel Schumer*, 520 U.S. 939, 951 (1997) (a statute that merely adds an additional jurisdiction to bring a cause of action may be applied retroactively).

⁸ See *supra* n. 1 (emphasis added).

⁹ Two other federal courts have weighed in on the retroactivity of other Dodd-Frank provisions. *Riddle v. Dyncorp Int'l Inc.*, 733 F. Supp. 2d 743 (N.D. Tex. 2010) (Act's three-year statute of limitations for § 3730(h) claims is *not* retroactive); *Pezza v. Investors Capital Corp.*, 2011 U.S. Dist. Lexis 20038 (D. Mass. Mar. 1, 2011) (Dodd-Frank's ban on arbitration of whistleblower claims may be applied retroactively). Retroactivity of Dodd-Frank's provisions authorizing the SEC to pursue penalties against non-regulated persons in administrative proceedings is currently being litigated in *Gupta v. SEC*, 11 CV 01900 (JSR) (S.D.N.Y.).