

**SEC FILES CONTESTED ADMINISTRATIVE PROCEEDING AGAINST FORMER  
DIRECTOR FOR INSIDER TRADING**

On March 1, 2011, the Securities and Exchange Commission (the “SEC”) filed insider trading charges against Rajat K. Gupta, a well-known 62-year old investor and executive. The case garnered media attention because of the prominence of Mr. Gupta and the connections with the ongoing criminal and civil insider trading cases against Raj Rajaratnam related to Galleon Management. From a legal and policy perspective, though, what makes this case noteworthy is the choice of forum—the SEC filed the case as an administrative proceeding, rather than as a federal court proceeding. This complex insider trading case will thus be tried before an SEC administrative law judge, under the SEC’s Rules of Practice, and will be appealable in the first instance to the SEC itself.

The SEC historically has brought enforcement cases alleging fraud against public companies and individuals (other than those who are not licensed securities professionals) in federal court, where defendants have stood on equal footing with the SEC as civil litigants. The Dodd-Frank Act may have changed that traditional preference, by empowering the SEC for the first time to seek civil penalties from any respondent in an administrative proceeding. As it would in an insider trading case filed in federal court, the SEC has now sought that relief against Mr. Gupta administratively. It remains to be seen whether this unusual litigation strategy by the SEC is the beginning of a trend, or a unique response to perceived barriers in the related *Galleon* insider trading litigation.

In its Order Instituting Proceedings,<sup>1</sup> the SEC alleges that Mr. Gupta disclosed material nonpublic information that he received in his capacity as a member of various boards of directors to Mr. Rajaratnam, founder of hedge fund adviser Galleon Management. Mr. Gupta is alleged to have told Mr. Rajaratnam of these companies’ quarterly financial results as well as specific and significant capital investments in advance of their public announcement.

Administrative proceedings under the SEC’s Rules of Practice are a true “rocket docket.” The proceeding must be heard by an administrative law judge approximately four months after the Order Instituting Proceedings is filed, and the administrative law judge must in turn issue an Initial Decision on the charges within 300 days.<sup>2</sup> In addition, discovery in such proceedings is sharply limited or non-existent.<sup>3</sup> The Division of Enforcement is required to provide its

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<sup>1</sup> Order Instituting Public Administrative Proceedings, *In the Matter of Rajat K. Gupta*, Securities Act Release No. 9192, Admin. Proceeding File No. 3-14279 (March 1, 2011), *available at* <http://sec.gov/litigation/admin/2011/33-9192.pdf>. (hereinafter “*Order*”)

<sup>2</sup> Rule 360(a)(2), U.S. Securities & Exchange Commission Rules of Practice, 17 CFR § 201.360(a)(2) (as amended and corrected March 2006), *available at* <http://www.sec.gov/about/rulesprac2006.pdf> (hereinafter “*SEC Rules of Practice*”); *see also Order*, *supra* note 1 at 10.

<sup>3</sup> Rules 221, 222, 230, 231, *SEC Rules of Practice*, *supra* note 2.

investigative file to the respondent, as well as *Brady* and *Jencks* material (roughly requiring the production of inculpatory materials and materials otherwise helpful to the defendant/respondent). Note, though, that the *Brady* and *Jencks* requirement is most often met by the filing of a declaration by Enforcement counsel that it has provided all responsive documents, and that *in camera* inspection by the administrative law judge is rare.

The SEC's administrative law judges are an experienced and independent group of judges, and the SEC's choice of a familiar forum is no guarantee of a friendly outcome. But in addition to the timing imperatives and limitations on discovery in administrative actions, it is worth noting that the SEC itself acts as the first-level reviewing body, and applies a *de novo* standard of review. Judicial review of administrative trial rulings are two steps removed, and typically require final agency action before a federal court of appeals can review the dispute.

Since the passage of the Dodd-Frank Act, commentators have speculated whether and when the SEC's Division of Enforcement would use its new authority to move more of its litigation docket away from federal court into an administrative forum. Complex discovery in the SEC's related civil case against Raj Rajaratnam, now proceeding in the U.S. District Court for the Southern District of New York, may have made this case an appealing candidate.<sup>4</sup> Use of the SEC's administrative forum in a case that appears clearly related to ongoing civil and criminal litigation, however, is likely to be characterized by the respondent as an end-run around discovery obligations that would be available in federal court. Whether this case represents a trend, or an isolated event, bears watching.

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<sup>4</sup> See *SEC v. Raj Rajaratnam, et al.*, Case No. 10-462-cv (2d Cir. Sept. 29, 2010) (vacating the district court's discovery order for Rajaratnam and codefendants to disclose thousands of wiretapped conversations, which the U.S. Attorney's Office originally provided to them, to the SEC for use in its civil enforcement proceedings).