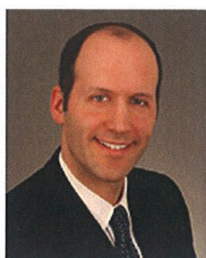

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Three Scandals — Three Key Dodd-Frank Developments

Law360, New York (August 22, 2012) — For bankers, lawyers and others who advise the financial sector, the summer of 2012 has been anything but typical. While the months of June, July and August typically mean long weekends and a general slowdown, this summer has offered nothing like a vacation from major financial scandals. To the contrary, the last few months have begat three significant scandals.

First, JPMorgan Chase announced that it had lost billions on bets made by derivatives traders in its London office. Second, regulators imposed significant fines on Barclays Bank, and pursued investigations into many other prominent banks, in connection with the alleged manipulation of Libor during the height of the financial crisis. Third, brokerage firm Peregrine Financial Group collapsed in mid-July, with hundreds of millions of dollars of customer funds reportedly missing, just months after the collapse of MF Global.

This summer's scandals arrive as ever more rulemaking deadlines associated with the Dodd-Frank Wall Street Reform and Consumer Protection Act loom on the horizon, and as the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission — recipients of significant new enforcement powers under the act — ramp up their enforcement activities, with more investigations initiated and more actions filed than ever before.

The JPMorgan Chase, Libor and Peregrine scandals thus provide instructive snapshots of what may be the three most significant Dodd-Frank enforcement and litigation issues that we're likely to see in the months ahead.

More Fraud Actions

The CFTC has a new and potentially potent tool at its disposal to combat alleged fraud and manipulation in derivatives markets. CFTC Rule 180.1, authorized by the Dodd-Frank Act, prohibits fraud-based manipulation of derivatives and is therefore the functional equivalent of SEC Rule10b-5 for derivatives.

As has been widely reported, Rule 180.1 represents a significant expansion of enforcement power for the CFTC because — unlike the pre-Dodd-Frank version of the CFTC's anti-manipulation authority in the Commodity Exchange Act (CEA) — the CFTC no longer needs to prove that the defendant "specifically intended" to manipulate the derivative's price, but instead, only must show that the defendant acted recklessly.[1]

Because Rule 180.1 only applies to conduct that occurred on or after Aug. 20, 2011,[2] very few CFTC or private actions alleging violations of Rule 180.1 have appeared to date. Although a plethora of class actions alleging manipulation of Libor by banks have already been filed, they have generally centered on behavior that occurred well before Rule 180.1's effective date, and thus feature claims that focus either on alleged violations of federal antitrust law or pre-Dodd-Frank manipulation claims under the CEA.

The unavailability of Rule 180.1 claims to the plaintiffs in the Libor class actions will likely prove to be significant, as one of the defendants' chief arguments on their motion to dismiss the CEA claims in those lawsuits is that the plaintiffs have not sufficiently alleged the "specific intent" required under the pre-Dodd-Frank standard.[3]

The JPMorgan Chase trading losses could potentially lead to the first significant 180.1 cases. Rule 180.1 may, for example, apply to any misleading statements or omissions made by individuals (even internally) in connection with the swaps that are allegedly at the heart of the losses.[4]

Whereas pre-Dodd-Frank investigations were significantly hamstrung by the requirement that the CFTC prove specific intent — which led to only one successful enforcement action in 35 years — the agency's options, and those available to plaintiffs' firms, will be far broader under the Rule 180.1 standard.

Broader Reach

The heart of both the JPMorgan Chase trading losses and the Libor manipulation scandal lies in London, as opposed to Wall Street. But that has not dissuaded U.S. regulators from taking an active role in both.

CFTC Chairman Gary Gensler recently justified the CFTC's role in these crises by explaining that "[d]uring a default or crisis, the risk that builds up offshore inevitably comes crashing back onto U.S. shores. The recent events of JPMorgan Chase, where it executed swaps through its London branch, are a stark reminder of this reality of modern finance."[5]

The Dodd-Frank Act has certainly enhanced the CFTC's and the SEC's ability to take action with respect to financial misconduct that occurs (at least in part) abroad. Section 722(d) of Dodd-Frank extends the CFTC's authority to extraterritorial swaps transactions that have a "direct and significant" connection to U.S. commerce. (The CFTC has recently issued proposed guidance interpreting this provision.[6])

Section 929P(b) of the Dodd-Frank Act, in turn, extends the SEC's antifraud authority to conduct with "significant steps [in the United States] in furtherance of the violation," even if the transaction occurred outside the U.S.

The SEC has taken the position that Section 929P(b) overrules the Supreme Court's decision in *Morrison v. National Australia Bank*, which limited § 10(b) claims to "transactions in securities listed on domestic exchanges and domestic transactions in other securities."[7]

Others disagree, and claim that Morrison actually addressed a substantive, rather than jurisdictional, requirement for § 10(b) claims, and therefore survives Dodd-Frank. Whether or not the SEC's view

prevails, we can undoubtedly expect the CFTC and SEC to grow increasingly involved in financial scandals centered abroad.

More Whistleblowers

The CFTC's failure to uncover the fraud at Peregrine Financial Group — whose CEO was recently indicted on charges of lying to the CFTC — has been roundly criticized. Even CFTC Chairman Gensler recently admitted that "the system failed to protect the customers of Peregrine."[8]

Although much of the hand-wringing since disclosure of the scandal has focused on the inadequacies of the layered regulatory system for futures firms — under which the National Futures Association, not the CFTC, was responsible for front-line oversight of Peregrine — the debacle also illustrates the degree to which the SEC and CFTC, whose resources are arguably strained even after the Dodd-Frank enhancements, will, in the Dodd-Frank era, increasingly look to whistleblowers as sources for potential enforcement actions.

The Dodd-Frank whistleblower programs mandate bounties of 10 percent to 30 percent where a tip about any securities- or swaps-related law violation results in a recovery of more than $1 million from the wrongdoers. By all accounts, the programs have led to a sharp increase in tips received by the agencies, with the SEC receiving an average of seven tips per day.[9]

In time, at least some of those tips will lead to well-publicized awards, which surely will encourage others to identify and report misconduct. And whistleblowers may be further emboldened by a recent decision in the Southern District of New York, which held that a provision of Dodd-Frank clarifying that whistleblowers employed by private subsidiaries of public companies are protected by Sarbanes-Oxley's anti-retaliation provision applies retroactively.[10]

Inspired by activity in the False Claims Act arena — which has led to staggering whistleblower awards in pharmaceutical industry cases (AstraZeneca, $45 million; GlaxoSmithKline, $96 million), as well as cases in other industries — plaintiffs' firms are aggressively courting Dodd-Frank whistleblowers. If regulators act on even a fraction of the whistleblower tips, we can expect a significant increase in enforcement activity in the months and years ahead.

Whatever this summer's big three financial scandals may say about the effectiveness of the SEC's and CFTC's current regulation and enforcement regimes, they will certainly provide the impetus for these agencies to act more aggressively. They will also likely lead to the aggressive recruitment of whistleblowers by plaintiffs' firms and more private fraud actions. A busy summer for scandals portends an even busier fall for regulators and the defense bar.

--By Peter L. Welsh, Steven S. Goldschmidt and Matthew L. McGinnis, Ropes & Gray LLP

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[1] See 76 Fed. Reg. 41,398 (July 14, 2011) (codified at 17 C.F.R. 180.1); see also DiPlacido v. CFTC, 364 F. App'x 657, 661 (2d Cir. 2009) (discussing pre-Dodd-Frank anti-manipulation standard).

[2] 76 Fed. Reg. at 41,398.

[3] Mem. in Supp. of Defs.' Mot. to Dismiss Exchange-Based Pls.' Claims (Dkt. 168) at 24, In re Libor-Based Financial Instruments Antitrust Litig., No. 11-2262 (S.D.N.Y. filed June 29, 2012).

[4] See Jean Eaglesham and Dan Fitzpatrick, U.S. Probe of J.P. Morgan Widens, Wall Street Journal, June 1, 2012, available at
http://online.wsj.com/article/SB10001424052702304821304577438801123604344.html?KEYWORDS=Morgan+Widens+CFTC.

[5] Testimony before the U.S. House Committee on Agriculture, July 25, 2012, at
http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-119.

[6] 77 Fed. Reg. 41,214 (July 12, 2012).

[7] 130 S. Ct. 2869, 2884 (2010).

[8] Testimony Before the U.S. House Committee on Agriculture, July 25, 2012, at
http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-119.

[9] See Ian Thomas, SEC Enforcement Division Buried in Whistleblower Tips, Law360, June 5, 2012,
http://www.law360.com/articles/347095/sec-enforcement-division-buried-in-whistleblower-tips.

[10} See Leshinsky v. Telvent Git, S.A., No. 10-4511, 2012 WL 2686111 (S.D.N.Y. July 9, 2012).

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Peter L. Welsh

Partner

Peter focuses his practice on the areas of transactional and securities litigation as well as government enforcement, corporate governance, and director and officer representations. Known for guiding directors and officers as well as buyout, hedge, and venture capital firms through difficult situations, Peter regularly represents such clients in litigation, pre-litigation, and regulatory investigations. An experienced litigator, Peter has litigated contested merger transactions, including strategic, financial, and going private transactions, complex securities and corporate litigation matters, including the representation of the directors and officers of several public companies in securities class actions and breach of fiduciary duty actions. Peter has also handled a range of regulatory investigations, including investigations by the Securities and Exchange Commission, Department of Justice, and a number of state governments. A trusted counselor, Peter advises boards of directors and board committees on mergers and acquisitions and other strategic alternatives, as well as related-party transactions, internal investigations, and litigation. Peter also regularly advises private equity, hedge fund, and mutual fund clients on indemnification and general partner liability insurance matters.

Representative Clients and Matters

- **J.Crew:** Part of a deal and trial team that successfully represented private equity buyer in shareholder litigation in Delaware and New York arising out of the $3.1 billion acquisition of J.Crew Group, Inc. by a consortium of private equity funds.
- **Lehman Brothers**: Represented several financial institutions in litigation, mediation and contested negotiations in the Lehman Brothers bankruptcy proceedings, including swap collateral disputes and other complex matters.
- **Special Committee of Affiliated Computer Services**: Part of deal and trial team that successfully represented the Special Committee of Affiliated Computer Services in the $6 billion acquisition of ACS by Xerox Corporation. Successfully represented Special Committee in numerous shareholder actions in Delaware and Texas.
- **Major University Endowments**: Lead litigation counsel in litigation in California and Delaware involving a real estate joint venture and a real estate project recapitalization. Orchestrated a litigation strategy across multiple jurisdictions that achieved a very favorable settlement for our client.
- **Large international investment company**: Successfully represented a large international investment company in shareholder litigation arising out of the bankruptcy of one of its portfolio companies within weeks of making a $10 million investment. Recovered 87.5% of the investment in the portfolio company.
- **BioForm Medical**: Successfully represented BioForm in shareholder litigation in California arising out of the acquisition of BioForm by Merz, GMBH. Successfully opposed a motion for preliminary injunction and merger closed.
- **Green Mountain Coffee Roasters**: Successfully represented Green Mountain in shareholder litigation arising out of the acquisition of Diedrich Coffee. Succeeded in opposing plaintiffs' motion for expedited discovery allowing transaction to close on schedule.
- **M&A Advice**: Advise numerous private equity sponsors and public and private companies concerning fiduciary duties and transaction process in financial and strategic transactions.

Steven S. Goldschmidt

Counsel

Steven S. Goldschmidt is counsel in the New York office of Ropes & Gray and a member of the firm's Government Enforcement and Securities Enforcement practice groups. Steven concentrates his practice on white-collar criminal defense and enforcement actions involving federal and state regulators and administrative agencies.

Steven has extensive experience representing corporate and individual clients in matters involving health care fraud and abuse, securities fraud, Foreign Corrupt Practices Act violations, anti-kickback violations, off-label marketing practices, antitrust abuse, and in response to Congressional investigations and federal and state regulatory inquiries. He has led numerous internal investigations for clients in the financial services, healthcare, insurance, entertainment, legal, retail products and other industries.

Steven has worked with clients to design and implement compliance programs and has advised clients about the compliance implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act. He is a member of the firm's E-Discovery Committee and regularly advises clients in matters involving complex electronic discovery and information management. Steven also handles employment counseling and litigation.

Steven has served as counsel on numerous trials in federal and state court as well as before arbitration panels and administrative bodies.

Representative Clients and Matters

- Representing a major pharmaceutical company in a Department of Justice and FDA investigation that resulted in hundreds of thousands of dollars in restitution paid to the client;
- Representing a medical device manufacturer in a Department of Justice investigation and federal False Claims Act matter that resulted in closure of the government investigation and voluntary dismissal of the *qui tam* complaint;
- Conducting a compliance assessment for an international pharmaceutical company;
- Representing an international insurance broker in an SEC investigation of alleged violations of the Foreign Corrupt Practices Act;
- Representing a national hospital system in Department of Homeland Security, Department of Justice, and Congressional investigations of alleged healthcare fraud;
- Representing an international pharmaceutical company in wide-ranging Department of Justice, FDA and Congressional investigations into fraudulent marketing and promotional practices;
- Representing a financial services company in an SEC investigation of allegedly improper trading activities;
- Representing a prominent money manager in a securities arbitration;
- Representing an international law firm in a federal employment litigation that resulted in complete summary judgment in favor of the client.

Matthew L. McGinnis

Associate

Matt McGinnis, an associate in the Litigation Department since 2007, focuses his practice on complex civil litigation, including antitrust litigation and securities litigation. Matt has represented companies and organizations in a wide range of commercial and business matters, including fraud and misrepresentation cases, securities litigation, antitrust litigation, contract disputes, and consumer class action litigation. Matt is a member of the Complex Business Litigation group.

Representative Clients and Matters

- **Goldman Sachs**. Counsel for Goldman Sachs in litigation concerning its role as financial adviser in connection with a $600 million sale to Lernout & Hauspie before that firm's fraud was revealed.
- **Five Star Quality Care**. Counsel for publicly traded healthcare company in pending suit against manager of healthcare facilities.
- **TravelCenters of America**. Counsel for Fortune 500 company in pending antitrust litigation involving allegations of conspiracy and boycott.
- **Gillette**. Counsel to Gillette in multi-district consumer class action based on advertising claims relating to its market-leading M3Power razor.

Professional & Civic Activities

- Prior to attending law school, Matt worked for Microsoft as an international recruiter with a focus on India.
- Boston Bar Association, Administration of Justice Standing Committee

Clerkships

- Honorable Harris L Hartz, U.S. Court of Appeals for the Tenth Circuit (2006 - 2007)

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