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## State Municipalities, Beware of SEC Administrative Proceedings

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The municipal securities market, consisting of approximately 51,000 issuers and \$2.8 trillion in outstanding securities, has long been one of lax oversight and limited transparency. No longer. With the advent of the verbose Dodd Frank Wall Street Reform and Consumer Protection Act, and revisions to applicable securities law, including Section 15c-2-12 of the Securities and Exchange Act of 1934, the U.S. Securities and Exchange Commission - an entity that has no authority to regulate issuers of municipal securities and only limited power to regulate municipal security brokers and dealers - now not only has the ability to require significant disclosures from

municipalities on their bonds, but also has an iron-fist administrative tool to unilaterally enforce its investigative rulings.

A provision tucked-away in the 2,322 page Dodd-Frank Act empowers the SEC to bring many more cases for monetary and other corrective penalties in administrative law courts. Previously, the use of these courts was limited to actions against those directly regulated by the SEC - i.e. not municipal securities issuers. The Tower Amendment to the Securities Exchange Act of 1934 essentially exempts "muni issuers" from federal regulation. With the enactment of the Dodd-Frank Act, the SEC has the authority to use administrative law courts to seek financial penalties and other remedies from anyone whose activities involve securities - from chief financial officers, to amateur day-traders, to municipalities, their employees and elected officials.

Perhaps most surprising is that these administrative law courts are little more than extensions of the SEC itself, employing SEC judges to decide the merits of SEC investigations, providing them a considerable "home court advantage" in the adjudication of securities claims.

Given this newfound power, how will administrative law courts, and indeed the SEC's carte blanche authority with respect to security regulation, investigation, and now adjudication, pass constitutional due process scrutiny? Unfortunately, what appears at first blush to be a system of "kangaroo courts" is entirely constitutional.

While courts necessarily have taken the position that the principles of due process apply to administrative adjudications (see *Antoniou v. SEC* (1989) 877 F.2d 721, 724), the application of such due process protection provides minimal assurances to defendants. According to the 9th U.S. Circuit Court of Appeals in *Kennerly v. United States*, "a due process hearing need not take the form of a judicial proceeding." (1983) 721 F.2d 1252, 1256-57. "[A]n administrative hearing with an impartial decision maker satisfy due process and the impartial decision maker may come from within the agency against which the claim is made," explained the 9th Circuit

### What is critical for municipalities is that these SEC actions are occurring even in the absence of any default.

The imbalance of power in favor of the SEC in administrative law courts does not stop there. These courts also have evidentiary shortcomings, and are not burdened with the obligation of *stare decisis* imposed upon state and federal judges alike. An SEC administrative court must uphold the legal conclusions of the SEC unless those conclusions are "arbitrary, capricious, or an abuse of discretion," and must treat the SEC's findings of fact as final if they are supported by evidence in the record. *Korman v. SEC* (2010) 592 F.3d 173, 184.

Nor is the SEC required to follow any mechanistic formula in determining an appropriate sanction. The SEC is not obligated to make its sanctions uniform, and a

Monday, May 9, 2011

#### Criminal

##### Foreign Bribery Case Goes to the Jury

Closing arguments in one of the most significant federal criminal trials to date involving the FCPA ended the four-week trial of two Southern California executives accused of bribing Mexican officials.

#### Insurance

##### Fight Over Farmers Settlement Continues

Farmers Group Inc. is trying to block a consumer rights group from conducting unusual post-settlement discovery in connection with \$545 million settlement of a long-running class action.

#### Law Practice

##### On the Move

Seven attorneys from Los Angeles boutique Reeder Lu LLP have joined the Century City office of Robins, Kaplan, Miller & Ciresi LLP. The move shutter the Reeder firm's operations.

#### Government

##### State Municipalities, Beware of SEC Administrative Proceedings

The imbalance of power in favor of the U.S. Securities and Exchange Commission in administrative law courts is shockingly constitutional. By Joel T. Shackelford and Joan Stevens Smyth

#### Labor/Employment

##### Pension Advisors and Prison Wardens — the Reality Show

The government declares war on retirement fiduciaries who violate the law. By David McFarlane of Snell & Wilmer LLP and Samuel Krause.

#### Law Practice

##### Legal Jobs Rise in April

The legal services sector added 1,500 jobs in April, according to the U.S. Labor Department. The largest increase since September, the boost means a net gain in employment over the past year.

##### Turning Up the Turbo Boost: Manipulation of Modified Cash Basis Accounting in Law Firms

Don't drive blind. Know your firm's financial reporting practices. By Edwin B. Reeser and James B. Hunt

##### State Bar Considers Discipline Alerts

The State Bar may post warnings on its webpage against lawyers facing discipline charges involving mortgage modification.

#### Litigation

##### MGA Asks for More Bratz Damages

Bratz manufacturer MGA Entertainment Inc., which persuaded a jury last month to hit Mattel Inc. with an \$88 million judgment in the two toymakers' war over the famous dolls, asked a judge to award it \$177 million in punitive damages.

#### Obituaries

##### Thomas G. Nelson

1936-2011

#### Discipline

##### Discipline

Disciplinary action

For representation of your interests on the B  
— VOTE Craig Holden.

court will not compare SEC sanctions to those imposed in previous cases. At least one target has referred to this as "Gitmo-Style Wall Street Justice." *Reuters*, April 14, 2011, *Business Law Currents*.

It is clear that the SEC is continuing to broaden its efforts to regulate municipal securities issuers, even though precluded from direct regulation by the Tower Amendment. In addition to the behemoth Dodd-Frank Act, in January 2010, the SEC announced that one of the five new specialized units in the Division of Enforcement would be dedicated to municipal securities to further SEC Chairman Mary Shapiro's often stated aims of better disclosures in the municipal market.

What is critical for municipalities is that these SEC actions are occurring even in the absence of any default. In its zeal, the absence of any damages does not appear to hinder an SEC investigation, which by itself can cost the municipality hundreds of thousands of dollars at a time, particularly in California where a local governmental agency can least afford it.

Even though adjudicated in 2006, prior to the financial reform overhaul, the recent SEC action against the city of San Diego is illustrative of the SEC's ever broadening reach. There, the SEC issued a series of sanctions through cease and desist orders against San Diego and individuals working in leadership roles at the city after the SEC determined that San Diego faced severe financial difficulty in funding its future pension and health care obligations and had failed to accurately disclose these future obligations when the city issued a series of bonds from 2001-2003.

Since the SEC had no direct regulatory power over San Diego, it commenced an administrative cease and desist action, forcing the city into a costly settlement that included an overhaul of disclosure requirements and hiring by the city of numerous oversight officials, such as disclosure lawyers and consultants. In addition, four city officials involved in the purported fraud were ordered to personally pay fines of up to \$25,000 without the possibility of reimbursement from the city. Under current regulations, the SEC has unilateral authority to fine individuals up to \$150,000.

After this case, there is substantial concern that the recent securities legislation changes, the enhanced whistle-blower rewards, and other penalties with respect to costly oversight alterations to municipalities, many municipalities will be regulated without the benefit of promulgated rules. While Shapiro's goals of enhanced disclosures and transparency are lofty, without specific legislation, the local governments are forced to incur hundreds of thousands of dollars in investigation costs for actions that occurred many years prior to the Dodd-Frank Act, without any legislative guidance.

Securities defense litigators often state that if your municipality is under investigation by the SEC, it's already over. No good can result. While the SEC arguably should have the right to regulate securities transactions of state and local governments, and the need for transparency in the municipal securities market is logical given the market size and risk of default, carte blanche investigative and adjudicative power of the SEC is a cause for concern for all participants in the securities markets.

#### Corporate Counsel Taking TV on the Road

Chief business officer, general counsel and senior vice president for PacketVideo Corp.  
San Diego

#### Law Practice

##### Wilson Sonsini Looks to Next 50 Years

Wilson Sonsini Goodrich & Rosati PC turned 50 this year - it was founded in 1961 as McCloskey, Wilson & Mosher - and in that time, the firm pioneered and sustained a novel law firm business model. Now it's figuring out what's next.

Previous Next

## Vote for Craig Holden

STATE BAR OF GOVERNORS, DISTRICT 7



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**MULTICULTURAL BAR ALLIANCE** (coalition of Los Angeles-area minority bar associations)

#### PROFESSIONAL ASSOCIATIONS & LEADERSHIP

- Member, SoCal 50 Leadership Council, Rand Institute for Civil Justice (2010-11)
- Chair, Council on Access & Fairness, CA State Bar
- Co-Chair, IP Litigation Committee, CA State Bar IP Section
- Advisor/Member, Executive Committee, IP Section, CA State Bar (2003-2007)
- Member, California Law Academy Strategic Task Force
- Chief Strategy Officer, Corporate Diversity, National Bar Association (2010-11)
- Founder and Chair, CA State Bar Diversity Coalition (2006-2008)
- Member, Executive Committee, Law Practice Management & Technology Section (2000-2003)
- Judge, Pro Tem, Los Angeles Superior Court (2002-2005)

#### AWARDS & RECOGNITION

- Awarded, Advocate of the Year (2007), by Public Counsel
- Member, American Lawyer's Intellectual Property Litigation Department of the Year (2004)
- Member, American Lawyer's A-list law firm (2004, 2007)
- Faculty, National Institute of Trial Advocacy (2003-2004)