Gupta v. Securities and Exchange Commission Doc. 16

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

RAJAT K. GUPTA,	:	
Plaintiff,	:	No. 11-cv-1900 (JSR)
v.	:	
SECURITIES AND EXCHANGE COMMISSION,	:	April 11, 2011
Defendant.	:	

MEMORANDUM OF LAW OF PLAINTIFF RAJAT K. GUPTA
IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS COMPLAINT

KRAMER LEVIN NAFTALIS & FRANKEL LLP
Gary P. Naftalis
Michael S. Oberman
Alan R. Friedman
David S. Frankel
Robin M. Wilcox
Michael J. Sternhell
1177 Avenue of the Americas
New York, New York 10036
(212) 715-9100

Attorneys for Plaintiff Rajat K. Gupta

Dockets.Justia.com

Table of Contents

Page

Table of Authorities ii

Preliminary Statement 1

Argument 5

I. THE COURT HAS SUBJECT MATTER JURISDICTION OVER THE FEDERAL QUESTIONS RAISED IN THIS ACTION 5

A. Subject Matter Jurisdiction Exists Under § 1331 5

B. Sovereign Immunity Has Been Waived By APA § 702 6

1. Mr. Gupta Could Not Obtain Meaningful Review In a Court of Appeals 11

2. Adjudication of Mr. Gupta's Claims Would Be Outside of the Commission's Expertise 12

3. Mr. Gupta's Claims Are Collateral to Section 25(a) 14

II. THE EXHAUSTION AND RIPENESS DOCTRINES ARE INAPPLICABLE TO THIS CASE 16

Conclusion 20

Statutory Appendix A-1

Speech by SEC Staff: Remarks at SIFMA's Compliance and Legal Society Annual Seminar, by Robert Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission (March 23, 2011) .... Exhibit A

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. Law 111-203, Section 929P, 124 Stat. 1376, 1862-65 (2010) .... Exhibit B

Table of Authorities

Page(s)

Cases

Adkins v. Rumsfeld,
389 F. Supp. 2d 579 (D. Del. 2005) 12

Altman v. S.E.C.,
2011 WL 781918 (S.D.N.Y. Mar. 6, 2011) 3, 15

Aquavella v. Richardson,
437 F.2d 397 (2d Cir. 1971) 18

Athlone Ind., Inc. v. Consumer Product Safety Comm'n,
707 F.2d 1485 (1983) 16, 17

Atlantic Richfield Co. v. U.S. Dep't of Energy,
769 F.2d 771 (D.C. Cir. 1984) 18

Bastek v. Fed. Crop Ins. Corp.,
145 F.3d 90 (2d Cir. 1998) 16

Bowen v. Massachusetts,
487 U.S. 879 (1988) 6

Califano v. Sanders,
430 U.S. 99 (1977) 5

City of New York v. U.S. Dep't of Commerce,
739 F. Supp. 761 (E.D.N.Y. 1990) 18

Commonwealth of Puerto Rico v. United States,
490 F.3d 50 (1st Cir. 2007) 7

Empire Healthchoice Assur., Inc. v. McVeigh,
547 U.S. 677 (2006) 5

Fed. Trade Comm'n v. Standard Oil Co. of Cal.,
449 U.S. 232 (1980) 8, 9

Free Enterprise Fund v. Public Co. Accounting Oversight Bd.,
130 S.Ct. 3138 (2010) .... *passim*

In the Matter of Jeffrey L. Feldman,
Admin. Proc. File No. 3-8063, 1994 SEC LEXIS 186 (Jan. 14, 1994) 11

Table of Authorities (Cont'd)

Page(s)

Merritt v. Shuttle, Inc.,
245 F.3d 182 (2d Cir. 2001)....................15 n.6

Presbyterian Church (U.S.A.) v. United States,
870 F.2d 518 (9th Cir. 1989) 7

Raz v. Lee,
343 F.3d 936 (8th Cir. 2003) 7

Sharkey v. Quarantillo,
541 F.3d 75 (2d Cir. 2008)....................7, 18

Thunder Basin Coal Co. v. Reich,
501 U.S. 200 (1994).................... 10-12, 13 n.5

Touche Ross & Co. v. S.E.C.,
609 F.2d 570 (2d Cir. 1979)....................14, 16, 17

Trudeau v. Fed. Trade Comm'n,
456 F.3d 178 (D.C. Cir. 2006) 7, 8

United States v. City of Detroit,
329 F.3d 515 (6th Cir. 2003) 7

Up State Federal Credit Union v. Walker,
198 F.3d 372 (2d Cir. 1999)....................7

Docketed Cases

S.E.C. v. Carroll,
No. 3:11-cv-00165-JGH (W.D. Ky. Mar. 17, 2011)....................4 n.2

S.E.C. v. Kluger,
No. 2:11-cv-01936-KSH-PS (D. N.J. Apr. 6, 2011)....................4 n.2

S.E.C. v. Liang,
No. 8:11-cv-00819-RWT (D. Md. Mar. 29, 2011) 4 n.2

S.E.C. v. Treadway,
No. 1:11-cv-01534-RJH (S.D.N.Y. Mar. 7, 2011) 4 n.2

Table of Authorities (Cont'd)

Page(s)

Statutes

5 U.S.C. § 702 .... 2, 6, 8

5 U.S.C. § 703 2

5 U.S.C. § 704 .... 2, 8, 11

15 U.S.C. § 78y 9

28 U.S.C. § 1331 .... 1, 5, 6

28 U.S.C. § 2201 .... 1, 6

Dodd-Frank Wall Street Reform and Consumer Protection Act,
Pub. Law 111-203, Section 929P, 124 Stat. 1376, 1862-65 (2010) .... 4 n.1, 18, Ex. B

Rules

Fed. R. Civ. P. 12(b)(1) 1

Fed. R. Civ. P. 12(b)(6) 1, 5 n.3

Miscellaneous

13B Wright & Miller, Fed. Prac. & Proc. Juris. § 3521 (3d ed.) 18

Plaintiff Rajat K. Gupta respectfully submits this memorandum of law in opposition to the Securities and Exchange Commission's motion to dismiss the Complaint under Fed. R. Civ. P. 12(b)(1) and (6).

Preliminary Statement

On March 1, 2011, the Commission took the unprecedented step of instituting an administrative proceeding for civil penalties alleging insider trading against a non-regulated person. This is not just Mr. Gupta's characterization of the Commission's order instituting proceedings ("OIP"); in a March 23, 2011 speech, Director of Enforcement Robert Khuzami lauded the *Gupta* case as "*the first use by the SEC of its new authority under Dodd-Frank to obtain penalties in an Administrative Proceeding against persons not associated with a regulated entity.*" (Ex. A hereto) (emphasis added). The impact of this "first use" is to single out Mr. Gupta as the *only* Galleon-related defendant being pursued by the Commission administratively in contrast to more than two dozen other Galleon-related defendants named in Commission complaints filed in *this* Court. In other — and more important — words, Mr. Gupta is the only Galleon-related defendant faced with the denial of the right to a jury and important procedural protections available only in federal court.

Without denying its disparate treatment of Mr. Gupta and without offering any, let alone a legitimate, reason for it, the Commission argues that this Court is without power to review — and, if warranted, remedy — the disparate treatment. But subject matter jurisdiction exists under 28 U.S.C. § 1331 to hear this action for declaratory judgment brought under § 2201. The Commission's jurisdictional challenge rests only on its assertion that it has not waived sovereign immunity as to Mr. Gupta's claims, and its invocation of the doctrines of exhaustion and ripeness. The grounds for this motion all fail.

Section 702 of the APA waives sovereign immunity as to all actions against federal agencies seeking relief "other than money damages," whether a claim is asserted under the APA or not: that is what the case law holds. This waiver is *not* restricted by the "final agency action" requirement of § 704 applicable to claims asserted under the APA (which Mr. Gupta's are not), nor does § 703 limit Mr. Gupta to relief under the "special statutory review proceeding" of Section 25(a) of the Exchange Act. Mr. Gupta is *not* invoking Section 25(a) because he is not challenging a final order of the Commission imposing a sanction for violations of the securities laws. He is seeking equitable relief to prevent an impermissible retroactive application of Dodd-Frank and a violation of his constitutional rights.

Just last term, the Commission presented its Section 25(a) argument to the Supreme Court, and the Court rejected it. The Court held that Section 25(a) "*does not* expressly limit the jurisdiction that other statutes confer on district courts" (citing § 1331 and § 2201), "[n]or does it do so implicitly." *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 130 S.Ct. 3138, 3150 (2010) (emphasis added). In addition, the Court found a presumption *against* such jurisdictional limitations over collateral challenges to agency action when, as here, jurisdictional preclusion would "'foreclose all meaningful judicial review'" and a plaintiff's claims are "'outside the agency's expertise.'" *Id.* (citation omitted).

In addressing *Free Enterprise*, the motion virtually ignores Mr. Gupta's equal protection challenge to the Commission's discriminatory selection of forum. More troubling, the motion suggests, misleadingly, that the procedural protections afforded respondents in SEC administrative proceedings are equivalent to those in federal court — when they are not. The SEC Rules of Practice nowhere provide for discovery depositions or for strict adherence to the Federal Rules of Evidence, a critical procedural distinction because the Commission's case as

alleged in the OIP appears to depend largely on a few ambiguous phone records and hearsay conversations (including triple levels of hearsay). If there were truly no difference in proceeding administratively or in federal court, the Commission's unexplained decision to subject Mr. Gupta alone to its "first use" of Dodd-Frank becomes all the more perplexing.

The Commission heavily relies on Judge Holwell's recent decision in *Altman v. S.E.C.*, 2011 WL 781918 (S.D.N.Y. Mar. 6, 2011), when arguing that Section 25(a) excludes district court jurisdiction. But *Altman* turned on a wholly different set of facts — a challenge to a Commission sanction imposed at the conclusion of administrative proceedings by an attorney who had suborned perjury in an investigation by the Commission itself. In all events, *Altman* cannot trump the Supreme Court's reading of the words of Section 25(a) in *Free Enterprise.*

The Commission — for purposes of this motion — does not dispute Mr. Gupta's allegations showing that the Commission is impermissibly applying Dodd-Frank retroactively against him and has acted towards him with discriminatory purpose and effect. Indeed, the Commission does not dispute that — but for Dodd-Frank — it would have brought suit against Mr. Gupta for civil penalties in federal court (as opposed to proceeding administratively against him without seeking civil penalties); Mr. Khuzami's speech precludes any challenge to this fact. The issue of retroactivity is accordingly neither contingent nor unripe; it is only because of its attempted retroactive application of Dodd-Frank that the Commission issued the OIP instead of filing a complaint in this Court.[1]

---

[1] The Commission, in its page 4 chart, invites the Court to conclude that parts of its case against Mr. Gupta could have been brought administratively without enactment of Dodd-Frank, but the chart rests on an unstated — and inaccurate — factual premise: that Mr. Gupta is a regulated person. Prior to Dodd-Frank, civil penalties under Section 21B(e) of the Exchange Act, Section 203(i) of the Investment Advisers Act and Section 9(d) of the Investment Company Act could be imposed in SEC administrative proceedings only against persons associated with, respectively, broker-dealers, investment advisers and investment companies. Paragraph 4 of the

And Mr. Gupta is already sustaining injury as a result of the Commission's actions, which include the Commission's decision to file and announce publicly administrative proceedings against him less than two business days after receiving his Wells submission and only a week before the start of the criminal trial of Raj Rajaratnam. Mr. Gupta alone faces an imminent administrative proceeding seeking civil penalties for insider trading, with a firm July 18, 2011 date for the start of hearings — even as the Commission continues after the OIP to sue other persons for insider trading in federal court.[2] Mr. Gupta chose neither that date nor that forum. The Commission put the administrative proceeding in motion, and the Commission cannot escape prompt judicial review when this action provides Mr. Gupta with the *only* viable forum for adjudicating his claims and when any delay in judicial review would only deepen his injury. Neither exhaustion nor ripeness constitutes a serious defense.

The Commission contends that Mr. "Gupta provides no reason to believe that the SEC will disregard any meritorious due process argument." (Br. at 23). But Paragraph 19 of the Complaint provided compelling reasons for such a belief:

> The Commission's order has all of the markings of a strategic decision, and it is a foregone conclusion that the Commission would decline to change course. Assuming it adhered to its own procedures, the Commission itself approved of this choice of forum. The Commission has already acted arbitrarily against Mr. Gupta: The Staff and the Commission effectively deprived Mr. Gupta of a full and fair Wells submission process.

Complaint alleges that Mr. Gupta "is not a regulated person under the federal securities laws," an allegation that now must be accepted as true on this motion. Attached as Ex. B is § 929P of Dodd-Frank, showing the statutory amendments to the provisions included in the Commission's chart.

[2] *See S.E.C. v. Treadway*, No. 11-cv-01534-RJH (S.D.N.Y. Mar. 7, 2011); *S.E.C. v. Carroll*, No. 3:11-cv-00165-JGH (W.D. Ky. Mar. 17, 2011); *S.E.C. v. Liang*, No, 8:11-cv-00819-RWT (D. Md. Mar. 29, 2011); *S.E.C. v. Kluger*, No. 2:11-cv-01936-KSH-PS (D. N.J. Apr. 6, 2011).

Beyond these reasons, it is simply too much to imagine that the Commission would ever rule in an administrative proceeding that the Commission itself has impermissibly applied Dodd-Frank retroactively against Mr. Gupta and acted in bad faith in denying him equal protection under law. The Commission's failure even to acknowledge the quoted allegations from Paragraph 19 of the Complaint when it represented to the Court that "Mr. Gupta provides no reason to believe that the SEC will disregard any meritorious due process argument" proves at once that the Commission would quickly reject any allegations about its own conduct and that judicial review of the OIP is urgent.[3]

Argument

I. THE COURT HAS SUBJECT MATTER JURISDICTION OVER THE FEDERAL QUESTIONS RAISED IN THIS ACTION

A. Subject Matter Jurisdiction Exists Under § 1331

To establish subject matter jurisdiction under § 1331, a plaintiff must assert claims arising under the Constitution or "Laws of the United States." *Empire Healthchoice Assur., Inc. v. McVeigh*, 547 U.S. 677, 678 (2006) ("[a] case 'aris[es] under' federal law within the meaning of § 1331 . . . if 'a well-pleaded complaint establishes either that federal law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal law.'") (citation omitted). The Supreme Court has also held that, subject only to preclusion-of-review statutes, district court jurisdiction to review agency action is conferred by § 1331. *See Califano v. Sanders*, 430 U.S. 99, 104-07 (1977).

---

[3] Bypassing the Court's pre-motion rules, the Commission tacks on a 12(b)(6) prong in its motion, asserting that the Complaint fails to allege facts that warrant the remedy of injunctive relief. Suffice it to say that the Commission does not even attempt to show a failure to state a claim for declaratory relief based on Mr. Gupta's equal protection and retroactivity allegations — allegations which, if proven, would clearly support injunctive relief.

This action presents two questions for declaratory judgment: (1) whether the Commission is violating Mr. Gupta's equal protection rights by treating him differently from all of the other Galleon-related defendants charged in federal court; and (2) whether the Commission is improperly applying Dodd-Frank retroactively against Mr. Gupta. The Complaint pleads claims "arising under" the Constitution and "Laws of the United States," and the Commission does not contend otherwise. This Court therefore has subject matter jurisdiction under § 1331 to grant declaratory relief under § 2201. *See Free Enterprise*, 130 S.Ct. at 3150 (sustaining jurisdiction and citing §§ 1331 and 2201).[4]

B. Sovereign Immunity Has Been Waived By APA § 702

Section 702 of the APA is the short and dispositive answer to the Commission's sovereign immunity defense. The statute provides in pertinent part:

> A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. . . . Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

A consistent body of case law applying § 702 holds that sovereign immunity is waived for "complaints [seeking] declaratory and injunctive relief," because they are "certainly not actions for money damages." *Bowen v. Massachusetts*, 487 U.S. 879, 893 (1988). *See also*

[4] Because § 1331 is a basis for subject matter jurisdiction and § 702 of the APA waives sovereign immunity, the Court need not reach the other bases pled in paragraph 3 of the Complaint.

Sharkey v. Quarantillo, 541 F.3d 75, 91 (2d Cir. 2008) ("Section 702 of the APA waives the federal government's sovereign immunity in actions [for non-monetary relief against an agency] brought under the general federal question jurisdictional statute.") (citation and quotation marks omitted); *Raz v. Lee,* 343 F.3d 936, 938 (8th Cir. 2003) (same); *Presbyterian Church (U.S.A.) v. United States,* 870 F.2d 518, 524-25 (9th Cir. 1989) (same).

Consistent case law further teaches that "the APA's waiver of sovereign immunity applies to any suit whether under the APA or not" because § 702 "waives sovereign immunity for [any] action in a court of the United States seeking relief other than money damages, not [solely] for an action brought under the APA." *Trudeau v. Fed. Trade Comm'n*, 456 F.3d 178, 186 (D.C. Cir. 2006) (citation, quotation marks, and alterations omitted). *See also Up State Federal Credit Union v. Walker*, 198 F.3d 372, 375 (2d Cir. 1999) (unless exceptions in last sentence of § 702 apply, "the APA does create a general waiver of sovereign immunity as to equitable claims against government agencies"); *Commonwealth of Puerto Rico v. United States*, 490 F.3d 50, 57-58 (1st Cir. 2007) ("This waiver is for '*all* equitable actions for specific relief against a Federal agency . . . ,' and thus 'applies to any suit whether under the APA or not.'") (quoting *Trudeau*, 456 F.3d at 186)); *United States v. City of Detroit*, 329 F.3d 515, 520-21 (6th Cir. 2003) (en banc) (holding that "the waiver of sovereign immunity in section 702 [applies] in cases brought under statutes other than the APA" and noting that five other circuits have so held). This reading is supported by the legislative history of § 702 (as described by *Trudeau*, 456 F.3d at 186-87):

> [T]he Senate Report [on the 1976 amendment] plainly indicated that Congress expected the waiver to apply to nonstatutory actions, and thus not only to actions under the APA. "The committee does not believe," the Report stated, that the amendment's "partial elimination of sovereign immunity, as a barrier to *nonstatutory review* of Federal administrative action, will create undue

KL3 2824885.1

> interference with administrative action." S. REP. NO. 94-996, at 8, 1976 U.S. Code Cong. & Ad.News, at 6129.

In *Trudeau*, the plaintiff sued the Federal Trade Commission challenging the veracity of an FTC press release. Trudeau sought only declaratory and injunctive relief, and the D.C. Circuit concluded that "there is no doubt that § 702 waives the Government's immunity from actions seeking relief other than money damages." *Id.* at 186 (citation and quotation marks omitted). The court then rejected the FTC's argument that § 702's waiver was limited to actions arising under the APA challenging "final agency action." In the words of Judge Garland:

> We have previously, and repeatedly, rejected the FTC's first argument, expressly holding that the APA's waiver of sovereign immunity applies to any suit whether under the APA or not. . . . Although we have never directly considered the contention that the "final agency action" requirement of § 704 restricts § 702's waiver of sovereign immunity, our holding that the waiver is not limited to APA cases — and hence that it applies regardless of whether the elements of an APA cause of action are satisfied — removes the linchpin of the FTC's argument. Moreover, the language of the waiver sentence again provides no support for the FTC's contention. While the sentence does refer to a claim against an "agency" and hence waives immunity only when the defendant falls within that category, it does not use either the term "final agency action" or the term "agency action." Nor does the legislative history refer to either limitation. To the contrary, the House and Senate Reports' repeated declarations that Congress intended to waive immunity for "any," H.R. REP. NO. 94-1656, at 3, and "all," *id*. at 9; S. REP. NO. 94-996, at 8, 1976 U.S. Code Cong. & Ad. News, at 6129, actions for equitable relief against an agency make clear that no such limitations were intended.

Id. at 186-87 (citations omitted).

The Commission makes the exact argument rejected in *Trudeau:* that sovereign immunity bars Mr. Gupta's claims because the OIP does not constitute "final agency action" under § 704. (Br. at 9). Mr. Gupta, in seeking relief under § 2201, did not allege that the OIP is a final order. Section 704 is inapposite, and § 702 controls. The Commission's reliance on *Fed. Trade Comm'n v. Standard Oil Co. of Cal.*, 449 U.S. 232, 101 S.Ct. 488 (1980) ("*SoCal*") (Br. at

2, 9, 10, 16, 23, 24) for the point that an order instituting proceedings is not final agency action is therefore misplaced. Additionally, unlike *SoCal*'s complaint, which sought "[j]udicial review of the averments in the [Federal Trade] Commission's complaints" before the conclusion of the administrative proceedings, *see SoCal*, 449 U.S. at 243, Mr. Gupta's Complaint does not seek to challenge the *merits* of the OIP in this Court; it challenges the Commission's unfair and discriminatory treatment in issuing the OIP.

The Commission next asserts that, pursuant to § 703 of the APA, Mr. Gupta must seek judicial review of the Commission's actions only in a court of appeals through "the special statutory review proceeding" provided by Section 25(a) of the Exchange Act, 15 U.S.C. § 78y(a). (Br. at 11). Section 703 states that the "form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments . . . in a court of competent jurisdiction." The Commission lost this precise point before the Supreme Court in *Free Enterprise*, when it argued that Section 25(a) provides the "exclusive mechanism" for parties aggrieved by actions of the Commission to seek review in the federal courts. *See* Br. of the United States On Writ of Certiorari to the U.S. Court of Appeals for the D.C. Circuit, No. 08-861, 2009 WL 3290435, at *15., Doc. No. 24 (Oct. 13, 2009).

Free Enterprise involved an action for declaratory and injunctive relief challenging on separation of powers grounds the constitutionality of the Public Company Accounting Oversight Board ("PCAOB") created by Sarbanes-Oxley. Under Sarbanes-Oxley, the Commission was empowered to review any PCAOB rule or sanction, and aggrieved parties were allowed to challenge "a final order of the Commission" or "a rule of the Commission" in a

court of appeals under Section 25(a). 130 S.Ct. at 3150. The Commission contended there (as it does again here) that Section 25(a) provided the exclusive route to judicial review for plaintiffs. *Id*. Scrutinizing the language of Section 25(a), the Court squarely rejected the Commission's contention:

> The Government reads § 78y as an exclusive route to review. But the text *does not* expressly limit the jurisdiction that other statutes confer on district courts. *See, e.g.,* 28 U.S.C. §§ 1331, 2201. Nor does it do so implicitly.

Id. (emphasis added). The Court's reading of Section 25(a) was not confined to the facts of *Free Enterprise*; the Court gave plain meaning to statutory words.

The Court added that "[p]rovisions for agency review do not restrict judicial review unless the 'statutory scheme' displays a 'fairly discernible' intent to limit jurisdiction, and the claims at issue 'are of the type Congress intended to be reviewed within th[e] statutory structure.'" *Id.* (quoting *Thunder Basin Coal Co. v. Reich,* 510 U.S. 200, 207, 212 (1994)):

> Generally, when Congress creates procedures "designed to permit agency expertise to be brought to bear on particular problems," those procedures "are to be exclusive." *Whitney Nat. Bank in Jefferson Parish v. Bank of New Orleans & Trust Co.,* 379 U.S. 411, 420, 85 S.Ct. 551, 13 L.Ed.2d 386 (1965). But we presume that Congress does not intend to limit jurisdiction if "a finding of preclusion could foreclose all meaningful judicial review"; if the suit is "wholly collateral to a statute's review provisions"; and if the claims are "outside the agency's expertise." *Thunder Basin, supra,* at 212-213, 114 S.Ct. 771 (internal quotation marks omitted). These considerations point against any limitation on review here. *We do not see how petitioners could meaningfully pursue their constitutional claims under the Government's theory.*

Free Enterprise, 130 S.Ct. at 3150 (emphasis added).

The Court finally rejected the Commission's argument that plaintiffs were required first to incur a PCAOB sanction before commencing their action in federal court — and then only in a court of appeals: "We normally do not require plaintiffs to 'bet the farm . . . by

taking the violative action' before 'testing the validity of the law,' . . . and we do not consider this a 'meaningful' avenue of relief." *Id.* at 3151 (citing *Thunder Basin,* 510 U.S. at 212). The Court found that plaintiffs' constitutional claims were "outside the Commission's competence and expertise" and that "the statutory questions involved do not require 'technical considerations of [agency]' policy. . . . They are instead standard questions of administrative law, which the courts are at no disadvantage in answering." *Id.*

For all of these same reasons, § 704 of the APA and Section 25(a) of the Exchange Act do not strip this Court of subject matter jurisdiction over Mr. Gupta's claims.

1. Mr. Gupta Could Not Obtain Meaningful Review In a Court of Appeals

If this Court lacked jurisdiction to hear Mr. Gupta's equal protection claim, he would be deprived of all meaningful judicial review. An administrative proceeding would provide no means of asserting the equal protection claim alleged in this action. For one thing, the SEC's Rules of Practice do not permit counterclaims against the Commission. *See In the Matter of Jeffrey L. Feldman*, Admin. Proc. File No. 3-8063, 1994 SEC LEXIS 186, at *4-5 (Jan. 14, 1994). Those rules also severely limit discovery by a respondent, especially by denying discovery depositions. The Commission does not represent to this Court that Mr. Gupta could conduct discovery in an administrative proceeding on the discriminatory purpose and effect of the Commission's OIP by use of document requests and discovery depositions (which its rules do not permit). As a result, any appellate review of the agency's ultimate determination would be severely truncated and largely meaningless. Beyond that, if the Court declined to adjudicate this action, Mr. Gupta would be forced to endure the very administrative proceeding he alleges to be unconstitutional. Appellate review of any final order would thus be too little and too late: It

is the very administrative proceeding itself that deprives Mr. Gupta of his constitutional rights — and appellate review once the damage is done would be cold comfort.

2. Adjudication of Mr. Gupta's Claims Would Be Outside of the Commission's Expertise

The Commission argues that it is better placed than this Court to adjudicate "the issues [Mr. Gupta] raises" (Br. at 17), but it can only sustain this position by mischaracterizing the relief Mr. Gupta seeks. Contrary to the assertions in the motion, the Complaint does not ask this Court to "[d]etermin[e] whether a person has violated the securities law and what sanction should result" (*id.*); rather, it challenges the Commission's decision to single out Mr. Gupta for retroactive application of Dodd-Frank and thereby deny him the procedural protections enjoyed by every other Galleon-related defendant.

The Commission cannot contend that adjudication of Mr. Gupta's equal protection claim *against the Commission itself* is peculiarly within the Commission's competence or expertise. And how could it be? The Administrative Law Judge would be asked to make findings about the actions and motivations of the Commissioners, hardly a subject of agency expertise. Simply put, concerns regarding "administrative expertise are not implicated where a constitutional violation is alleged, because such allegations are particularly suited to the expertise of the judiciary." *Adkins v. Rumsfeld*, 389 F. Supp. 2d 579, 588 (D. Del. 2005).

Free Enterprise distinguished the type of constitutional claim that is at issue here from the petitioner's claims in *Thunder Basin*, which were primarily statutory:

> "[A]t root . . . [they] ar[o]se under the Mine Act and f[e]ll squarely within the [agency's] expertise," given that the agency had "extensive experience" on the issue and had "recently addressed the precise . . . claims presented." [*Thunder Basin*], 501 U.S. at 214). Likewise, in *United States v. Ruzicka*, 329 U.S. 287, 67 S.Ct. 207, 91 L.Ed. 290 (1946), . . . we reserved for the agency fact-bound inquiries that, even if "formulated in constitutional terms," rested ultimately on "factors that call for [an]

> understanding of the milk industry," to which the Court made no pretensions. *Id.* at 294, 67 S.Ct. 207.

Free Enterprise, 130 S.Ct. at 3151. In contrast to those cases, the Court in *Free Enterprise* found (as noted above) that "[n]o similar expertise is required here, and the statutory questions involved do not require 'technical considerations of [agency] policy.' . . . They are instead standard questions of administrative law, which the courts are at no disadvantage in answering." *Id.* at 3151.[5]

Mr. Gupta's challenge to the Commission's authority to proceed administratively for civil penalties and its discriminatory treatment in doing so are the type of issues regularly determined by federal courts. And the Commission — in resisting this point — appears to have forgotten that it brought *all* of the other Galleon-related cases in this Court, a clear indication that, at least for those defendants, the Commission has no apparent qualms about this Court's competence to adjudicate insider trading cases.

---

[5] The Commission cites *Thunder Basin* for the proposition that Mr. Gupta's claims, including his constitutional claim, can be meaningfully addressed in a court of appeals. (Br. at 14). But *Thunder Basin* did not involve an equal protection claim against the very agency charged with overseeing the administrative proceeding that the court of appeals would eventually review. Rather, the plaintiff in that case brought a pre-enforcement challenge to regulations promulgated under the Federal Mine Safety and Health Amendments Act of 1977, 30 U.S.C. § 801 *et seq.*, alleging that compliance with those regulations would violate the Due Process Clause of the Fifth Amendment. *Id.* at 205. Although the Department of Labor is charged with enforcing those regulations, under the statute challenges to enforcement are reviewed by the Federal Mine Safety and Health Review Commission, which the Court noted is independent of the Department. *Id.* at 204. Thus, while the Court acknowledged that "[a]djudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies, . . . [t]his rule is not mandatory . . . and is perhaps of less consequence where, as here, the reviewing body is not the agency itself but an independent commission established exclusively to adjudicate Mine Act disputes." *Id.* at 215 (citations and internal quotation marks omitted).

3. <u>Mr. Gupta's Claims Are Collateral to Section 25(a).</u>

Touche Ross & Co. v. S.E.C., 609 F.2d 570 (2d Cir. 1979) — although decided over thirty years before *Free Enterprise* — illustrates how Mr. Gupta's claims are collateral to Section 25(a). There, the Commission instituted an administrative proceeding pursuant to SEC Rule 2(e) against the Touche Ross accounting firm and three of its former partners to determine whether the respondents had engaged in improper auditing conduct and should be disqualified on that basis from appearing before the Commission. Prior to the administrative hearing, Touche Ross brought an action in this Court for declaratory and injunctive relief, alleging that Rule 2(e) and the proceeding initiated under it were without statutory authority. The Second Circuit held that Touche Ross was not required to submit to the administrative proceeding before challenging the Commission's rule-making authority in federal court, because "to require [Touche Ross] to exhaust their administrative remedies would be to require them to submit to the very procedures which they are attacking." 609 F.2d at 577.

Against *Free Enterprise*, the Commission primarily relies on *Altman*. In *Altman*, an attorney sued the Commission and its Chairwoman and Secretary in this Court seeking (1) a stay of the Commission's administrative proceedings against him and (2) an order vacating the Commission's decision imposing a lifetime ban from the attorney's practice before the SEC. The Commission had imposed that sanction after an Administrative Law Judge found at the conclusion of a hearing that the attorney had knowingly offered to have his client provide false testimony to the Commission during an investigation; thus, the administrative proceeding had been completed before the suit in federal court.

The issue before Judge Holwell was simply whether the attorney should have brought his challenge before a court of appeals, rather than a district court. The Court ruled that the attorney's claims that the Commission's sanction wrongfully usurped powers properly held

by the New York State court system could be "meaningfully addressed in the Court of Appeals should the attorney appeal the SEC's sanction against him." *Id.* at *5. In that key respect, *Altman* found *Touche Ross* distinguishable:

> The court [in *Touche* Ross] reasoned that administrative review of the question in the first instance would be inappropriate because of the plaintiff's hardship in submitting to the disciplinary provisions it was challenging, and because the SEC had no need to develop its own factual or legal record in the dispute. *Id.* at 576-77. . . . Here any harm to Altman due to the requirement that he raise his constitutional challenges before the SEC seems minimal *as he has already litigated at least two hearings on the issue-one before an administrative law judge and one before the SEC itself.*

2011 WL 781918, at *6 (emphasis added).

The Commission itself recognized this distinction when it briefed the *Altman* case, stating: "*Touche Ross* is further distinguishable because the Court's concern was subjecting the plaintiffs to the procedures they were attacking. Altman, however, did not bring his challenge until the completion of the Commission's proceeding. . . ." *See* Mem. of Law in Opposition to Motion to Stay and Vacate, 1:10-cv-09141-RJH (Doc. No. 2 at 7) dated Dec. 9, 2010.[6]

---

[6] The Commission (Br. at 16) attempts to equate Mr. Gupta's allegations to a claim of agency bias that was also asserted by the plaintiffs in *Touche Ross* and as to which the Second Circuit held exhaustion was required. 609 F.2d at 574. Mr. Gupta's claims, however, mirror the claim in *Touche Ross* where immediate judicial review was allowed: a challenge to the Commission's authority to initiate an administrative proceeding. The Commission also relies on *Merritt v. Shuttle, Inc*., 245 F.3d 182 (2d Cir. 2001) (Br. at 14, 15, 17), but that case actually undercuts the Commission's arguments. The Second Circuit stated that a statute vesting judicial review exclusively in the courts of appeals precludes a district court from hearing claims that are "inescapably intertwined with" review of the type of agency order entrusted to the courts of appeal. 245 F. 3d at 187. As already shown, Mr. Gupta's Complaint does not arise from a final order of the Commission, and *Free Enterprise* held that Section 25(a) "does not expressly limit the jurisdiction that other statutes confer on district courts," 130 S. Ct. at 3150 — words that the Commission did not call to the Court's attention in *Altman*.

Like the plaintiffs in *Free Enterprise* and *Touche Ross*, Mr. Gupta's claims are wholly collateral to the Commission's charges against Mr. Gupta under the securities laws. Those cases are on point; *Altman* is not.

II. THE EXHAUSTION AND RIPENESS DOCTRINES ARE INAPPLICABLE TO THIS CASE

The doctrine of exhaustion does not divest a court of subject matter jurisdiction. *Bastek v. Fed. Crop Ins. Corp.*, 145 F.3d 90, 94 (2d Cir. 1998) (in the absence of statutory provision requiring exhaustion, courts have "discretion to employ a broad array of exceptions that allow a plaintiff to bring his case in district court"). Rather, courts consider whether application of the exhaustion doctrine to a particular case would serve the prudential concerns upon which the doctrine is premised:

> The exhaustion doctrine was designed primarily to prevent premature interruption of the administrative process. In that regard it serves three main purposes. First, it preserves the autonomy of the administrative agency by allowing the agency to apply its expertise and exercise its discretion in appropriate circumstances, by giving the agency a chance to discover and correct its own errors, and by discouraging "frequent and deliberate flouting of administrative processes [which] could weaken the effectiveness of an agency." Second, application of the exhaustion doctrine aids judicial review which "may [otherwise] be hindered by the failure of the litigant to allow the agency to make a factual record, or to exercise its discretion or apply its expertise." Third, requiring exhaustion in appropriate cases promotes judicial and administrative efficiency by prohibiting repeated interruptions of the agency proceeding and by increasing the possibility that no judicial decision will be necessary, since the complaining party's rights may ultimately be vindicated at the agency level.

Athlone Ind., Inc. v. Consumer Product Safety Comm'n, 707 F.2d 1485, 1488 (D.C. Cir. 1983). These goals would not be served by dismissing Mr. Gupta's claim against the Commission. *See Touche Ross*, 609 F.2d at 577 (where there is "no need for the development of a factual record, no room for the exercise of agency discretion, and little need for agency expertise in deciding the

question . . . '[t]o require exhaustion . . . would be overly harsh and wasteful.'") (citation omitted).

In *Athlone*, the D.C. Circuit reversed a district court's dismissal of a suit to enjoin the Consumer Product Safety Commission ("CPSC") from continuing an administrative proceeding for civil penalties against a manufacturer and distributor. The manufacturer and distributor argued that civil penalties were unavailable under the Consumer Product Safety Act. *Id.* at 1487. The D.C. Circuit noted that the CPSC's statutory authority was "strictly a legal issue" and "[n]o factual development or application of agency expertise [would] aid the court's decision." *Id.* at 1489. "Nor [would] a decision by the court invade the field of agency expertise or discretion. '[W]here the only . . . dispute relates to the meaning of the statutory term . . . [the controversy] presents issues on which courts, and not [administrators] are relatively more expert.'" *Id.* (citation omitted). Additionally, the court found that any attempt by plaintiffs to challenge the CPSC's actions administratively would likely be futile:

> The Commission filed the complaint in the first place, presumably on the basis of its conclusion that it had jurisdiction to assess civil penalties administratively. It has defended that position before this and other courts. And, after oral argument in this case, the Commission unanimously ruled that it had the authority to assess civil penalties in an administrative proceeding. When resort to the agency would in all likelihood be futile, the cause of overall efficiency will not be served by postponing judicial review, and the exhaustion requirement need not be applied.

707 F.2d at 1489; *see also Touche Ross*, 609 F.2d at 577 ("exhaustion would be futile when the 'very administrative procedure under attack in the one which the agency says must be exhausted.'") (citation omitted).

Here, the question of the Commission's statutory authority to seek civil penalties against Mr. Gupta in an administrative proceeding is strictly a legal issue. Importantly, the constitutional claim Mr. Gupta has asserted would not be subject to any factual development in

the administrative proceeding and could be litigated effectively only in this action. Nor would a decision by the Court invade the field of Commission expertise or discretion. Statutory interpretation and adjudication of constitutional claims is the work of federal district courts.

Ripeness serves the same general purposes as exhaustion, *see* Wright & Miller, 13B Fed. Prac. & Proc. Juris. § 3521.1 (3d ed.); *Aquavella v. Richardson*, 437 F.2d 397, 403-04 (2d Cir. 1971), and those purposes would not be served by delayed judicial review of the Commission's actions. The ripeness doctrine cautions courts not to render decisions absent a genuine need to resolve a real dispute. *See City of New York v. U.S. Dep't of Commerce*, 739 F. Supp. 761, 765 (E.D.N.Y. 1990). "Determining whether administrative action is ripe for judicial review requires [a court] to evaluate (1) the fitness of the issues for judicial decision and (2) the hardship to the parties of withholding court consideration." *Sharkey*, 541 F.3d at 89 (quoting *Nat'l Park Hospitality Ass'n v. Dep't of Interior*, 538 U.S. 803, 808 (2003)). The question whether an agency has authority to undertake an ongoing proceeding is ripe if the question can be answered without factual development in agency proceedings. *See Atlantic Richfield Co. v. U.S. Dep't of Energy*, 769 F.2d 771, 782-84 (D.C. Cir. 1984).

Under these principles, Mr. Gupta's claims are clearly ripe for review by the Court. Mr. Gupta pleads a colorable equal protection claim along with a pure question of statutory interpretation. The Commission made these claims ripe by its "first use . . . of its new authority under Dodd-Frank" against only one Galleon-related defendant. The Commission inexplicably claims that it "has not determined that Section 929P of Dodd-Frank can be applied retroactively" (Br. at 20); but the charges set forth in the OIP reflect otherwise, as do the Director of Enforcement's recent remarks. The Commission no doubt would have charged Mr. Gupta in this Court with the other Galleon-related defendants had it not concluded that it could apply

Dodd-Frank retroactively. Suing in a federal district court had been and — but for *this* case remains — the Commission's consistent practice in litigated insider trading cases seeking civil penalties against a non-regulated person. (Compl. ¶ 12).

Mr. Gupta is not asking the Court to make any broad pronouncements that might disrupt the traditional path to judicial review of Commission action. The Complaint describes a unique set of facts: Mr. Gupta is indisputably the first non-regulated person against whom the Commission seeks to apply Dodd-Frank retroactively, and he is the only Galleon-related defendant (in a class of over two dozen defendants) to be singled out to be tried administratively and not in federal court. He commenced this action promptly after issuance of the OIP, and before any agency action other than the OIP. The claims he raises are not embraced within the language of Section 25(a) of the Exchange Act, and the facts of the case do not trigger application of either the exhaustion or ripeness doctrine. Just as he has been singled out by the Commission, he presents a singular set of facts, for which relief should be granted.

Conclusion

For the foregoing reasons, the Commission's motion to dismiss should be denied in all respects.

Dated: New York, New York
April 11, 2011

Respectfully submitted,

KRAMER LEVIN NAFTALIS & FRANKEL LLP

By: /s/ Gary P. Naftalis

Gary P. Naftalis
Michael S. Oberman
Alan R. Friedman
David S. Frankel
Robin M. Wilcox
Michael J. Sternhell
1177 Avenue of the Americas
New York, New York 10036
(212) 715-9100 (phone)
(212) 715-8000 (fax)
gnaftalis@kramerlevin.com
moberman@kramerlevin.com
afriedman@kramerlevin.com
dfrankel@kramerlevin.com
rwilcox@kramerlevin.com
msternhell@kramerlevin.com

Attorneys for Plaintiff Rajat K. Gupta

Of Counsel:

Lawrence S. Robbins
ROBBINS, RUSSELL, ENGLERT, ORSECK, UNTEREINER & SAUBER LLP
1801 K Street, NW
Suite 411L
Washington, DC 20006
(202) 775-4501 (phone)
(202) 775-4510 (fax)
lrobbins@robbinsrussell.com

Statutory Appendix

5 U.S.C. § 702

§ 702. Right of review

A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States: *Provided*, That any mandatory or injunctive decree shall specify the Federal officer or officers (by name or by title), and their successors in office, personally responsible for compliance. Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

5 U.S.C. § 703

§ 703. Form and venue of proceeding

The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus, in a court of competent jurisdiction. If no special statutory review proceeding is applicable, the action for judicial review may be brought against the United States, the agency by its official title, or the appropriate officer. Except to the extent that prior, adequate, and exclusive opportunity for judicial review is provided by law, agency action is subject to judicial review in civil or criminal proceedings for judicial enforcement.

5 U.S.C. § 704

§ 704. Actions reviewable

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

15 U.S.C. § 78y

§ 78y. Court review of orders and rules

(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence

(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.