

# Featured Article

## I Don't Live in the United States, So How Can the SEC Sue Me? SEC Actions against a Foreign National Living Outside the United States

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### *Introduction*

As globalization continues to create new markets and expand the breadth of worldwide financial transactions, so too has the Securities and Exchange Commission (SEC) expanded its enforcement of federal securities laws beyond the borders of the United States. The SEC's approach poses a basic question: To what extent is the SEC empowered to institute enforcement proceedings in the United States against foreign nationals living outside the United States? While the SEC has brought a number of proceedings against foreign defendants, which have resulted in negotiated settlements without jurisdictional challenges, the situation gets more complicated in contested actions when there are challenges to jurisdiction. The threshold question that must be addressed is whether any U.S. court has personal jurisdiction over this type of defendant.

Given the unique set of facts and circumstances of every case, it is difficult to predict how a court will rule on a challenge to personal jurisdiction. This article will explore the reach of the SEC's enforcement authority over foreign nationals by presenting a brief overview of the personal jurisdiction requirements of the federal securities laws; the application of those principles to SEC enforcement actions and securities class action suits involving insider trading, fraudulent offering schemes, and false reporting; and the basic guidelines to consider when analyzing whether a defendant can mount a successful defense of lack of personal jurisdiction.

### *The SEC's Mission and Personal Jurisdiction Requirements of the Federal Securities Laws*

The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.<sup>1</sup> To help achieve these goals, the SEC requires public companies to disclose meaningful financial and other information to the public, and it oversees the key participants in the securities markets, including securities exchanges, brokers and dealers, investment advisors, and mutual funds.<sup>2</sup> The SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.<sup>3</sup> The SEC's enforcement authority is crucial to its effectiveness in meeting its mission. Every year, the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of the securities laws.<sup>4</sup> Increasingly, these actions are being brought against foreign-based defendants. Like actions against domestic defendants, these actions are typically based on violations of the Securities Act of 1933 (Securities Act) or the Securities Exchange Act of 1934 (Exchange Act).

The Securities Act and the Exchange Act<sup>5</sup> permit the exercise of personal jurisdiction<sup>6</sup> over foreign-based defendants to the extent permitted by the Due Process Clause of the Fifth Amendment.<sup>6</sup> The Due Process Clause requires that a defendant have sufficient "minimum contacts" with the forum where the case is commenced and that the exercise of the court's jurisdiction comport with "traditional notions of fair play and substantial justice."<sup>7</sup> Unlike an action against a domestically based defendant, which would focus on the defendant's contacts with the state that serves as the situs of the federal court, a foreign-based defendant's contacts with the United States as a whole must be examined.<sup>8</sup> Courts focus on whether the defendant's conduct and connection are such that "he should reasonably anticipate being haled into court" in that district.<sup>9</sup> One indicator is whether a defendant's actions have "caused consequences" in the forum.<sup>10</sup> Not every causal connection between an action taken abroad and one that ultimately injures the American investor will be sufficient for the court to exercise jurisdiction.<sup>11</sup> After the minimum contacts analysis is complete, the second part of the test is determining whether the court's

exercise of jurisdiction is reasonable.

### *Personal Jurisdiction Requirements as Applied in Various Cases*

#### *Insider Trading*

The SEC has been very successful in establishing personal jurisdiction over foreign-based defendants in contested insider trading cases. This success is not surprising as the vast majority of these defendants could not argue they did not reasonably anticipate being subject to a U.S. court's jurisdiction since they traded in U.S. securities on a U.S. exchange.

In *SEC v. Unifund Sal*,<sup>12</sup> two foreign investment companies<sup>13</sup> challenged a preliminary injunction against them on the ground that the court lacked personal jurisdiction. The defendants engaged in the trading of the stock and stock options of a U.S. pharmaceutical company incorporated in Pennsylvania, which exclusively listed its common stock on the NYSE and option contracts for its common stock on the American Stock Exchange. The trades were based upon material non-public information about a confidential merger. Because the defendants' transactions involved the trading in approximately \$2 million in stock and \$300,000 in call option contracts listed on a U.S. stock exchange, the court held that there was a "direct and an unmistakably foreseeable effect within the [United States]."<sup>14</sup> Consequently, each company could reasonably expect that its conduct would affect U.S. investors, and the defendants' challenges to personal jurisdiction were denied.<sup>15</sup> Although this case involved foreign institutions, the same jurisdictional principles would apply to individuals, as illustrated by *SEC v. Ero Sec. Fund, Coim, S.A.*<sup>16</sup> There, the court found that improper trading by the fund's officers—which exceeded \$6 million in a one-month period and constituted a significant portion of the daily trading volume in a company's stock, which was exclusively listed on the NYSE—was sufficient for the foreign-based individual defendants<sup>17</sup> to reasonably expect being subject to an American court's jurisdiction. In both these cases, given the volume and value of the trading on U.S. exchanges, it was completely foreseeable to the defendants that their actions would effect American shareholders. Accordingly, minimum contacts were easily established.

On the other end of the spectrum, transactions of lesser value and smaller volumes, coupled with a lack of knowledge that the stocks involved are traded on a U.S. stock exchange, have helped foreign-based defendants succeed in personal jurisdiction challenges. In *SEC v. Alexander*,<sup>18</sup> the U.S. District Court for the Southern District of New York granted a motion to dismiss for lack of personal jurisdiction when a resident of Italy used inside information to sell a small amount of an Italian company's shares through her Italian bank.<sup>19</sup> In an unchallenged affidavit, the defendant asserted that she was unaware that the shares she had directed her broker to sell were traded on the NYSE. The court concluded that the circumstances of the defendant's transaction—a one-time trade through her local bank which allegedly avoided losses of \$20,250—made it unlikely that her actions presented foreseeable effects within the United States and on U.S. shareholders.<sup>20</sup> Notwithstanding the result in *Alexander*, insider trading cases present less difficulty for the SEC when pursuing a foreign national, because the foreign defendant should reasonably anticipate that his improper trades would have a foreseeable effect on the U.S. market and U.S. investors.

#### *Fraudulent Offering Schemes*

Generally, courts find it relatively easy to exercise jurisdiction over foreign-based corporations that engage in fraudulent securities offerings to American investors. The situation is slightly complicated, however, when the SEC also seeks to bring an action against the foreign-based officers of that corporation. The SEC cannot rely solely on a company's contacts with the United States to establish personal jurisdiction over its officers, but must instead establish personal jurisdiction based on an officer's individual conduct.<sup>21</sup> One way the SEC can get over this hurdle is to show that the foreign officer was the primary participant in the corporation's contacts with the United States.

For example, in *SEC v. Carrillo*,<sup>22</sup> the U.S. Court of Appeals for the Eleventh Circuit upheld the extension of personal jurisdiction over a Costa Rican corporation and its officers, which fraudulently offered and sold unregistered securities to U.S. residents. The court concluded that "by virtue of their control over the

operations and involvement in the company's contacts with the United States," the officers were the primary participants in the contacts with the U.S.<sup>23</sup> Specifically, the court found that one or both of the officers initiated each of the following contacts: (1) placing advertisements and arranging for articles about the securities in two airlines' in-flight magazines; (2) mailing offering materials and application forms directly to American investors; (3) maintaining bank accounts in the United States to receive payments from investors; and (4) mailing at least one stock certificate to a U.S. investor. Thus, companies and their officers that cause securities to be offered and sold in the United States are likely to be subject to a U.S. court's jurisdiction because these actions constitute the necessary minimum contacts required by due process.

### *False Reporting*

Similarly, if the defendant signs a filing with the SEC that contains false information, it would be hard to argue that the person could not have foreseen that such a statement would have an effect in the U.S. More difficult are situations where a foreign-based defendant transmits fraudulent financial information to the United States but is unaware that the information will be communicated to the SEC. In many of these cases, the SEC reaches a settlement with the defendant. If a contested case is filed, the defendants often default and the question of jurisdiction is never challenged. A good example of this arose in *SEC v. Waring*,<sup>24</sup> in which the court granted the SEC's request for default judgment against Greg Waring and Craig Treloar.<sup>25</sup> Waring and Treloar, both Australian nationals, were senior officers of the Australian subsidiary of CorrPro Companies, Inc. (CorrPro), a U.S. public corporation. These individuals held positions that were equivalent to a CEO and a CFO, respectively.

The SEC alleged that CorrPro Australia falsified its accounting records and inflated its net income and assets in order to meet the financial targets set by its parent company. CorrPro then incorporated the false numbers from CorrPro Australia into its financial statements. CorrPro's discovery of the defendants' fraud led to a restatement of CorrPro's financial statements and a sharp decline in its stock price. The SEC's unchallenged theory of jurisdiction was that the defendants had purposefully directed their activities towards U.S. investors because they knew that by supplying false financial records for CorrPro Australia to CorrPro, the parent company's true financial condition would be misstated. Because the defendants did not contest the SEC's assertions, the sufficiency and scope of their contacts in the U.S. were not explored or litigated. As such, the case provides little insight about whether personal jurisdiction existed, although it does provide a good example of the SEC's perception of its ability to sue foreign nationals.

Actions by private litigants also provide some useful guidance in this area. In *In re Endotronics, Inc.*,<sup>26</sup> a court considered a Japanese corporation's motion to dismiss on jurisdictional grounds a third party complaint filed by Peat, Marwick, Main & Company (PMM), the U.S. accounting firm now known as KPMG. In the original complaint, the plaintiffs accused PMM of aiding and abetting fraud, which led to the artificial inflation of Endotronics, Inc.'s stock. PMM's third party complaint claimed that Yamaha made false representations of facts upon which it reasonably relied in its endorsement of Endotronics' financial statements. Specifically, PMM claimed that Yamaha confirmed its purchase of equipment from Endotronics in Minnesota for which Yamaha owed over \$800 million and that the equipment in question continued to be held in Minnesota at its request.<sup>27</sup>

In its motion to dismiss, Yamaha admitted that it furnished the false information but denied that it had any communications or contact with PMM. Yamaha claimed that it provided the information solely to Peat Marwick Minato (PMM Tokyo), a Japanese accounting firm, which was legally separate and unrelated to PMM. The court, however, was not persuaded by Yamaha's argument and found that the representations made by Yamaha to PMM Tokyo were specifically intended to reach PMM. The court found evidence of Yamaha's "specific intent" in its awareness that PMM requested confirmations of the sales and storage of the equipment and that PMM would use this information in its audit of Endotronic's financial statements.<sup>28</sup> Consequently, Yamaha knew its actions would affect Endotronic's public financial disclosures. The court opined that since the information provided was material and the representations Yamaha made were false, Yamaha must have known that its misrepresentations would have a detrimental effect on PMM and that this harm would manifest itself in the United States.<sup>29</sup>

In another private suit, investors commenced a consolidated securities fraud action arising out of Royal Ahold's \$1.1 billion restatement of earnings and \$24.8 billion reduction in revenue against the Dutch company, its American subsidiaries, auditors, underwriters, and foreign-based individuals, including its CEO, Executive Vice President/CFO, Chairman of the Supervisory Board, a member of the Supervisory Board, and a member of its Executive Board.<sup>30</sup> The individuals all moved to dismiss the action for lack of personal jurisdiction, citing their residence outside of the United States and their employment by a foreign corporation based in the Netherlands.

In its analysis, the court noted that personal jurisdiction over a corporate employee is not simply conferred by the contacts of the corporation to the forum. Rather, an employee's contact with the forum must be assessed on an individual basis.<sup>31</sup> The court also explained that it is appropriate for courts to assert personal jurisdiction over an individual who signed, approved, or signed off on the dissemination of particular forms filed with the SEC, forms which the relevant defendant knew or should have known would have been relied on by U.S. investors.<sup>32</sup> In this case, the CEO, VP/CFO and one of the members of the Executive Board<sup>33</sup> all signed documents on behalf of Royal Ahold that were ultimately filed with the SEC and the court found personal jurisdiction over these three individuals. Interestingly, before this decision, the CEO and the VP/CFO entered into settlement agreements with the SEC, consenting to judgments against them that permanently enjoined them from violating certain securities laws—thus not contesting the SEC's jurisdiction over them.<sup>34</sup> The last of the three, the member of the Executive Board, however, did not reach a settlement with the SEC.<sup>35</sup>

The court found that it lacked personal jurisdiction over the member of the Supervisory Board who was involved in the part of the scheme that involved solely foreign employees and foreign corporations, even though this facet of the ploy enabled Royal Ahold to artificially inflate the revenue that was ultimately reported in its false financial statements. Although the court concluded that these statements were incorporated in SEC filings relied on by American investors, it reasoned that the "U.S. [could] not be fairly characterized as the focal point of either [his] acts or the harm suffered because his allegedly fraudulent acts were directed towards the Netherlands, and globally, but not specifically toward the U.S."<sup>36</sup> Ironically, this individual also reached a settlement with the SEC by consenting to the entry of a cease and desist order against him.<sup>37</sup> In addition, the court also found that it lacked jurisdiction over the chairman of the Supervisory Board because there was no evidence he signed any SEC filings or personally participated in any fraudulent activities.<sup>38</sup>

On their face, these two cases seem somewhat unremarkable. After all, the courts seemingly engaged in the same jurisdictional analysis as numerous other courts have done countless times. However, what is instructive are the myriad of potential arguments that a foreign-based individual can successfully raise in challenging personal jurisdiction. From the case law, it appears that the key considerations are whether a foreign actor knew (or reasonably should have known) that his representations would be transmitted to the United States and whether he should have expected his actions to have a harmful effect in the United States. For foreigners who hold CEO, CFO or comptroller-like positions in a foreign subsidiary of a U.S. company that incorporates its subsidiary's financial information in its SEC filings, it would be difficult to argue that one does not know that representations are transmitted to the United States and incorporated into public filings. However, once the analysis is applied to a person further down the reporting chain, that person's knowledge of the use of the information he has supplied may be worth a jurisdictional challenge. If one could demonstrate a lack of awareness that information would be transmitted outside of the company, arguably, one could succeed in challenging personal jurisdiction. The person's position at the company and knowledge of the contents of U.S. companies' public filings would all have to be examined to determine the risk that a U.S. court would find that it has personal jurisdiction. The greater the employee's financial background or job responsibilities or knowledge of SEC filings, the greater the chance that jurisdiction would exist. A notable exception is illustrated by the *Royal Ahold* court's finding that it lacked personal jurisdiction over the Supervisory Board member. Even though his actions in a fraudulent scheme had a causal effect in the United States, the United States was not the focal point of either his acts or the harms caused. If a foreign actor, regardless of his fraudulent conduct or position in the company, can make a similar showing then, arguably, personal jurisdiction can be defeated.

### *Conclusion*

As with all cases involving personal jurisdiction challenges, whether an individual's contacts are sufficient is a very fact specific question. When analyzing whether a defendant had sufficient minimum contacts, a two part examination must occur: (1) whether there are clearly foreseeable effects within the United States and (2) whether the defendant could reasonably have anticipated his conduct would have affected U.S. shareholders or the U.S. public. If the answer to these questions is "yes," then it is highly unlikely that a challenge based on personal jurisdiction would be successful unless it can be shown that exercise of the court's jurisdiction would violate due process. Such a showing is often a very difficult proposition to advance because the interests of the SEC and the forum in the exercise of jurisdiction will justify even the serious burden placed on a foreign-based defendant. As discussed above in the various actions—insider trading, fraudulent schemes, and false reporting—these two primary questions are a good starting point for a foreign-based national to consider whether such a challenge would be successful when facing an action by the SEC.

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<sup>1</sup> See <http://www.sec.gov/about/whatwedo.shtml>.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> See, e.g., Sections 20 and 22 of the Securities Act and Sections 21 and 27 of the Exchange Act.

<sup>6</sup> See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 998 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975). Personal jurisdiction can be either specific or general jurisdiction. Specific jurisdiction is established when a defendant's contacts with the forum are related to the dispute at issue, while with general jurisdiction, the controversy can be unrelated to the defendant's contacts with the United States. This article will focus on situations where specific jurisdiction is sought because general jurisdiction does not exist.

<sup>7</sup> *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). As already noted, the second part of the due process test is determining the reasonableness of the exercise of jurisdiction. This is typically satisfied because the interests of the SEC and the forum in the exercise of jurisdiction will justify even the serious burden placed on a foreign-based defendant. See *Asahi Metal Indus. Co. v. Superior Court of California*, 480 U.S. 102 (1987). Consequently, this article will focus its analysis on the first part of the due process test—minimum contacts.

<sup>8</sup> See *Republic of Panama v. BCCI Holdings (Luxembourg) S.A.*, 119 F.3d 935, 946-47 (11th Cir. 1997); *DeJames v. Magnificence Carriers, Inc.*, 654 F.2d 280, 284 (3d Cir. 1981).

<sup>9</sup> See *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980).

<sup>10</sup> See *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1340 (2d Cir. 1972).

<sup>11</sup> *Berch*, 519 F.2d at 1000. See later discussion on *In re Royal Ahold NV Sec. & ERISA Litig.*, 351 F.Supp.2d 334 (D. Md. 2004), which illustrates an insufficient casual connection to establish the court's jurisdiction over one of the individual defendants.

<sup>12</sup> 910 F.2d 1028, 1033 (2d Cir. 1990).

<sup>13</sup> The two companies involved in this appeal were Unifund and Tamanaco. Unifund is an investment company incorporated and based in Lebanon while Tamanaco is an investment company incorporated in Panama. The other named defendants did not challenge personal jurisdiction.

<sup>14</sup> *Id.*

<sup>15</sup> It is worth noting that the court, while finding due process satisfied, made clear that it was “not ruling that the use of a branch office of a United States brokerage firm automatically suffices to support personal jurisdiction.” *Id.*

<sup>16</sup> No. 98-CV-7347 (S.D.N.Y. Feb. 17, 1999).

<sup>17</sup> In this matter, the portfolio manager/corporate secretary and the president of Euro Securities Fund (Euro), an investment entity with a mailing address in Switzerland, challenged the court's jurisdiction over them. These two individuals were the only officers of Euro, and each had played a role in the insider trading, which involved using the Euro account at a Swiss office of a U.S. broker dealer.

<sup>18</sup> 160 F.Supp.2d 642 (S.D.N.Y. 2001).

<sup>19</sup> *Id.* at 657.

<sup>20</sup> The defendant's status as the non-English speaking 65-year-old mother of the tipster, undoubtedly, lent credibility to her claim of ignorance of how the trade would be executed. In a companion case to this action, that court noted that courts look primarily to the nature of the market activity and not its quantitative impact when evaluating whether a defendant has minimum contacts with a forum. See *SEC v. Alexander*, No. 00-CV-7290 (S.D.N.Y. May 20, 2003). Consequently, a trade involving a smaller volume and lesser value does not ensure that the court will not exercise its jurisdiction based on a lack of minimum contacts.

<sup>21</sup> *Charas v. Sand Tech. Sys. Int'l, Inc.*, No. 90-CV-5638 (S.D.N.Y. Oct. 7, 1992).

<sup>22</sup> 115 F.3d 1540 (11th Cir. 1997).

<sup>23</sup> *Id.* at 1547-49.

<sup>24</sup> No. 03-CV-2030 (N.D. Ohio Apr. 2, 2004).

<sup>25</sup> The SEC alleged violations of Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder.

<sup>26</sup> No. 87-CV-130 (D. Minn. Aug. 16, 1988).

<sup>27</sup> *Id.* at \*1.

<sup>28</sup> *Id.* at \*3.

<sup>29</sup> Interestingly, the court also rejected Yamaha's argument that defending itself in the suit would be a burden because Yamaha, like any other non-resident defendant, could hire local counsel to defend its interests in the United States. A factor contributing to the lack of burden was that Yamaha had previously appeared in a Minnesota court to defend itself.

<sup>30</sup> *In re Royal Ahold NV Sec. & ERISA Litig.*, 351 F.Supp.2d 334 (D. Md. 2004).

<sup>31</sup> *Id.* at 351 (citing *Calder v. Jones*, 465 U.S. 783, 790 (1984)).

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<sup>32</sup> See *In re CINAR Corp. Sec. Litig.*, 186 F.Supp.2d 279 (E.D.N.Y. 2002) (finding jurisdiction based solely on signing of Registration Statement); *Itoha Ltd. v. LEP Group PLC*, 930 F.Supp 36 (D. Conn. 1996).

<sup>33</sup> This defendant signed the Form 6-K, which plaintiffs alleged contained false and misleading financial results.

<sup>34</sup> SEC Lit. Release No. LR-18929 (Oct. 13, 2004).

<sup>35</sup> *Id.* The SEC did not pursue penalties in the enforcement actions against any of these officers at the request of Dutch authorities who were conducting their own criminal investigation and who were concerned about possible double jeopardy issues under Dutch law. *Id.*

<sup>36</sup> 351 F.Supp.2d at 354. The court also concluded that it lacked personal jurisdiction over the other member of the Supervisory Board because there was no allegation that he had any direct personal involvement in acts directed towards the United States.

<sup>37</sup> See SEC Lit. Release, *supra* note 34.

<sup>38</sup> 351 F.Supp.2d at 354-55.