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This is the second of a two part article. Part I of the article appeared in the Fall 2005 edition of *The International Lawyer.* Part I examined the development of the infrastructure by which international regulators share information and react to cross-border developments. Part I also examined the interplay between international agreements and domestic legislation governing execution of these agreements at the local level. Part II of the article, which includes a discussion of U.S. legal proceedings involving cross border regulatory issues and jurisdiction, Sarbanes-Oxley, and anti-money laundering initiatives, appears below.

I. U.S. Court Action

A. U.S. Court Assertion of Jurisdiction Over Assets

1. *SEC v. Heden*

In *SEC v. Heden,*[1] the U.S. District Court for the Southern District of New York held that there was no doubt that the assets of a relief defendant in an insider trading case could be frozen, but only to the extent that such assets represented profits from the alleged insider trading.[2] The *Heden* court held that, unlike a preliminary injunction enjoining violations of securities laws, an asset freeze requires the Securities and Exchange Commission (SEC) to show only that it is likely to succeed on the merits or that "'there is a basis to infer that the appellants traded on inside information.'"[3] The SEC is not required to show risk of irreparable injury, as a private litigant would be.[4] But the court also held that it is inappropriate to freeze the assets of a relief defendant, as opposed to a defendant, to the extent such assets

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1. SEC v. Heden, 51 F. Supp. 2d 296, 298 (S.D.N.Y. 1999).
2. *Id.* at 301.
3. *Id.* at 298 (quoting SEC v. Unifund SAL, 910 F.2d 1028, 1041 (2d Cir. 1990)).
4. *Id.*

represent the principal amount invested, rather than profits, finding that in such case the relief defendant has a legitimate claim to the assets.[5]

2. *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*

Whether an asset freeze in advance of judgment would withstand challenge under the laws of various nations or when considered by the European Council of Human Rights is an open question. Moreover, whether U.S. courts will issue broad asset freeze orders in advance of judgment is perhaps less certain than it once was in light of the U.S. Supreme Court's decision in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*[6] In *Grupo Mexicano*, certain holders of unsecured notes issued by Grupo Mexicano de Desarrollo, S.A. brought an action against the company based on its failure to make scheduled payments on the notes. The holders sought a preliminary injunction restraining the company from transferring its assets pending resolution of their claims. The district court issued the preliminary injunction and the U.S. Court of Appeals for the Second Circuit affirmed. But the Supreme Court reversed the lower courts' decisions, focusing on the history of equitable relief and the nature of the relief requested.

Specifically, the Court noted that the equity powers of U.S. courts were generally fixed at the time of the Judiciary Act of 1789 and that, at that time, the "well-established general rule was that a judgment fixing the debt was necessary before a court in equity would interfere with the debtor's use of his property."[7] In the absence of an enactment by Congress modifying that rule, the Court found no authority for granting the requested relief.[8] However, *Grupo Mexicano* may be distinguishable from asset freeze cases brought by the SEC on a number of grounds. In particular, *Grupo Mexicano* involved an action by private litigants for money damages, rather than by an agency serving a public purpose.[9] Moreover, the *Grupo Mexicano* litigants were general unsecured creditors of the debtor, and the Court expressly noted that the bankruptcy and fraudulent conveyance laws were developed to protect such parties.[10] Such laws are not applicable and therefore provide no protection in cases where the SEC seeks the preliminary relief of an asset freeze in, for example, an insider trading case.

3. *SEC v. Euro Security Fund, S.D.N.Y. Civil Action 98 Civ. 7347, DLC 6/18/01.*

In this case, a Swiss broker trading through a Luxembourg account was charged with insider trading in the United States. His assets were frozen by a federal judge in New York. In the context of asset freezes, the case is significant for the immediacy of the reaction from U.S. authorities, and the willingness of U.S. courts to freeze the assets of foreign nationals trading through foreign accounts.

A former stockbroker at the Swiss office of a New York brokerage agreed on June 18, 2001 to settle a civil action brought by the SEC alleging insider trading violations. Giovanni

5. *Id.* at 301-02.

6. Grupo Mexicano de Desarrolo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999).

7. *Id.*

8. *Id.* at 322.

9. *See id.* at 326 (quoting United States v. First Nat'l City Bank, 379 U.S. 378, 383 (1965) in noting that "courts of equity will 'go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved'").

10. *Id.* at 322.

Piacitelli agreed to pay over $350,000 in settlement.[11] This was in addition to over $11 million in disgorgement and penalties obtained previously from co-defendants in the case and in related litigation.[12] The SEC's complaint alleged that Mr. Piacitelli purchased 10,000 shares of Elsag Bailey Process Automatiou N.V. while in possession of material, nonpublic information concerning Asea Brown Boveri Ltd.'s October 14, 1998 tender offer for Elsag Bailey.[13] The alleged purchase took place through an account at Banco Del Gottardo in Luxembourg one day before the tender offer was announced. While the SEC alleged that Piacitelli's potential profits were $164,375 on this purchase, he never accessed the money because the SEC filed an emergency action on October 19, 1998, and Judge Denise Cote entered an order freezing assets that same day.

As part of the settlement, Mr. Piacitelli agreed to be barred from future securities law violations. He also agreed to disgorge $164,375 in profits and $1,740 in commissions from the Elsag trades to pay prejudgment interest and a civil penalty of $164,375.

B. Cognizability of Foreign Money Judgments

In addition to using the power to freeze the assets of foreign nationals on the basis of alleged extra-territorial conduct, U.S. courts have demonstrated a willingness to assist foreign regulatory authorities in their efforts to collect foreign money judgments based on securities enforcement actions.

1. *Alberta Securities Commission v. Ryckman*

The Arizona Court of Appeals affirmed a lower court decision that a money judgment entered in a Canadian court in favor of the Alberta Securities Commission (ASC) against a Canadian businessman now living in Arizona was properly domesticated in Arizona.[14]

The money judgment at issue stemmed from the ruling of an ASC hearing panel that Lawrence Ryckman had engaged in market manipulation by purchasing and selling shares of Wesgroup Corp. in order to artificially boost the share price. Following the ruling, the ASC filed with the Alberta court a certified order assessing investigative costs of $492,640.14 against Mr. Ryckman. One week later, the parties reached a settlement under which the ASC would accept $250,000 as full payment for investigative costs, provided that Mr. Ryckman pay that sum no later than May 16, 1996. Ultimately, Mr. Ryckman paid only $7,500 in 1996.[15] In March 1999, the ASC filed in Maricopa County Superior Court seeking a judgment against Mr. Ryckman and his wife based on the judgment of the Court of the Queen's Bench of Alberta.

The Court of Appeals noted that "Canadian judgments have long been viewed as cognizable in courts of the United States," and that "[n]either Ryckman's allegations concerning the ASC administrative proceedings nor anything else he presents tends to establish that the judicial system of Alberta is one that 'does not provide impartial tribunals or procedures compatible with due process of law.'"[16]

11. SEC v. Euro Sec. Fund, SEC Litigation Release No.17045, 2001 SEC LEXIS 1195 (June 21, 2001).
12. *Id.*
13. *Id.*
14. Alberta Sec. Comm'n v. Ryckman, 30 P.3d 121 (Ariz. Ct. App. 2001).
15. *Id.* at 124.
16. *Id.* at 126.

C. Production of Evidence; Conflict with Foreign Laws

U.S. courts have held that a defendant generally may not refuse to comply with discovery requirements in a U.S. action on the basis that compliance would violate foreign laws. The rationale behind this general rule is that a party who does business internationally, thereby subjecting himself to conflicting laws, must bear the burden of such conflict. Where a party can show that production of evidence would violate a foreign law, U.S. courts have sometimes undertaken a comity analysis, in which the courts have balanced the hardships to the relevant jurisdictions depending on whether the evidence is produced.

A case in the U.S. District Court for the Southern District of New York illustrates this principle. In *SEC v. Euro Security Fund*, the SEC brought an insider trading action against certain institutions and individuals, some of whom were foreign nationals.[17] The defendants failed to respond to numerous discovery requests and ultimately failed to comply with discovery orders entered by the court, arguing in part that the production of the requested materials could violate Swiss laws. The court held that it is "well established that a court has the power to impose discovery under the Federal Rules of Civil Procedure when it has personal jurisdiction over the foreign party."[18] The court further held that, contrary to the defendants' arguments, the Hague Convention is not the only means of obtaining evidence from a foreign party.[19] As for the defendants' argument that compliance with the discovery orders could violate Swiss law, the court found that it was up to the defendants to produce evidence that a specific Swiss law would be violated and that they had failed to make such a showing. Absent such evidence, the court refused to undertake a comity analysis.[20] Finally, the court noted that even if it were to apply a comity analysis, the United States has a "keen interest in its securities markets," and the defendants had not acted in good faith.[21] Although the interest of U.S. courts in enforcing securities laws will not always trump the interests of other jurisdictions, courts have generally acknowledged that the protection of the securities markets is of great importance to the United States.

The SEC has recognized the need for discretion in exercising its power to obtain information pursuant to broad cooperation arrangements with foreign regulators. In some cases, regulators may not need to obtain certain evidence, even though it is within their power to do so. For example, in *SEC v. Certain Purchasers of the Call Options of Duracell International, Inc.*, in order to prevent removal of funds from the jurisdiction, the U.S. District Court for the Southern District of New York imposed a freeze on the proceeds of the sale of call options without requiring certain unknown purchasers of a Bahamian account to be identified.[22] By stopping at the level of the managers of the account, the SEC was able to achieve its objectives without requiring disclosure of the account's beneficial owners. Similarly, in *SEC v. One or More Unknown Purchasers of Call Options and Common Stock of USCS International, Inc.*, the Southern District of New York entered a preliminary injunction freezing

17. SEC v. Euro Sec. Fund, No. 98 Civ. 7347, 1999 U.S. Dist. LEXIS 4046 (S.D.N.Y. Apr. 1, 1999).

18. *Id.* at *7 (quoting Societe Nationale Industrielle Aerospatiale v. United States Dist. Court, 482 U.S. 522, 553 n.4 (1987)).

19. *Id.*

20. *Id.* at *9.

21. *Id.* at *10-11.

22. SEC v. Certain Purchasers of the Call Options of Duracell Int'l, Inc., No. 96 Civ. 7017 (SAS), 1996 U.S. Dist. LEXIS 14425 (S.D.N.Y. Oct. 2, 1996).

approximately $2 million of the defendants' assets without requiring them to be identified.[23] The defendants ultimately identified themselves only after the injunction was entered.[24] Whether U.S. District Courts will issue such broad freeze orders in the future in light of *Grupo Mexicano* remains to be seen.

D. Subject Matter Jurisdiction

The SEC's jurisdiction in cases where conduct occurs in the United States has in the past been virtually unlimited. In several recent cases, however, U.S. courts have considered whether assertion of subject matter jurisdiction is appropriate in actions alleging violations of U.S. federal securities laws under certain circumstances. The courts in these cases recognized that the United States has a strong interest in regulating its securities markets and that U.S. courts have historically taken a broad view of jurisdictional issues in securities cases. But each of the courts ultimately concluded that in some cases there is no U.S. interest significant enough to justify an assertion of jurisdiction. As a result, important limitations have been established on the extension of jurisdiction under U.S. securities laws. As the Tenth Circuit stated in one of the *Lloyd's* cases, discussed in further detail below, "[w]e cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."[25]

1. *Banque Paribas Case*

In June 1998, the Court of Appeals for the Second Circuit decided the most recent in a series of cases[26] addressing the assertion of subject matter jurisdiction under U.S. federal securities laws. In *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, the court found that the provisions of the Securities Act did not reach the transactions at issue because although the buyer was in the United States when he made certain of his purchases, neither the buyer, the seller, nor the issuer was a U.S. person and the presence of one of the parties in the United States was fortuitous and personal.[27] There was therefore no material interest for the U.S. courts to protect.[28] The Second Circuit's conclusion makes clear that, although the United States will not permit itself to serve as a base for fraud, neither will it serve as a jurisdictional haven for all securities transactions.

Alan Carr, a Canadian citizen, was the sole owner of Europe and Overseas Commodity Traders, S.A. (EOC), a Panamanian corporation. EOC maintained a non-discretionary investment account at Banque Paribas in London. In 1993, John Arida, an account manager at Paribas in its London office, informed Carr that EOC had accumulated a large amount of cash in its account and offered to recommend an investment opportunity. At that time,

23. SEC v. One or More Unknown Purchasers of Call Options and Common Stock of USCS Int'l, Inc., SEC Litigation Release No. 16044, 68 SEC Docket 3047 (Jan. 26, 1999).

24. *Id.*

25. Riley v. Kingsley Underwriting Agencies, Ltd., 969 F.2d 953, 957 (10th Cir. 1992), *cert. denied*, 506 U.S. 1021 (1992).

26. *See* Itoba Ltd. v. Lep Group PLC, 54 F.3d 118 (2d Cir. 1995), *cert. denied*, 516 U.S. 1044 (1996); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

27. Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 126 (2d. Cir. 1998), *cert. denied*, 525 U.S. 1139 (1999).

28. *Id.*

Carr was planning to leave for a vacation in Florida. Arida ultimately went on to recommend that EOC invest in Paribas Global Bond Futures Fund, S.A., a Luxembourg corporation (the Fund). Although the parties disputed whether the first discussions regarding the Fund and the first buy order took place before or after Carr arrived in Florida, it is undisputed that certain correspondence took place by telephone and by facsimile once Carr was in Florida, and that at least six buy orders originated from Carr's vacation home there.[29] EOC alleged that (1) the defendants made fraudulent misrepresentations about the Fund and such misrepresentations were repeated on each occasion that EOC purchased shares and (2) the Fund sold unregistered securities in the United States in violation of the Securities Act.

The issue addressed by the Second Circuit was whether telephone calls and facsimiles to a person in the United States provide enough of a connection to the United States to implicate both the registration and fraud provisions of U.S. securities laws and to give subject matter jurisdiction over such matters to U.S. courts. The lower court had granted the defendants' motion to dismiss for lack of subject matter jurisdiction, reasoning that the contact was initiated offshore, the purchaser's agent was in the United States solely for personal reasons, and the parties involved were non-U.S. entities.[30] In affirming the lower court's dismissal, the Second Circuit reviewed the registration issue and the fraud claim separately.

Initially, the court noted that the extra-territorial reach of the federal securities laws, in particular the antifraud provisions, was well established. Numerous courts have recognized that "Congress would not want the United States to become a base for fraudulent activity harming foreign investors, or 'conduct' . . . and that Congress would want to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States, or 'effects.'"[31]

With respect to the fraud claim, the court found that the conduct and effects tests clearly applied to the issue, stating that "[t]elephone calls and facsimiles conveying offers to sell securities and investment information could be characterized as either conduct or effects in the United States."[32] But the court found that no U.S. interest was affected by the transaction and that there was no U.S. entity to protect.[33] In other words, there was no effect in the United States. The court said that under the conduct test the case was more difficult. Activity in the United States did directly cause harm to EOC.[34] But the court held that "a series of calls to a transient foreign national in the United States is not enough to establish jurisdiction under the conduct test without some additional factor . . . ."[35] Therefore, the court concluded that it was not appropriate to extend jurisdiction to EOC's fraud claims.

The court determined that the conduct and effects tests also applied to the registration issue, but that the applicable standard would be different than that applied in cases of fraud.

29. *Id.* at 122.
30. *See id.*
31. *Id.* at 125 (citing Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983) and *Schoenbaum*, 405 F.2d at 206).
32. *Id.* at 128.
33. *Id.*
34. *Id.* at 129.
35. *Id.*

Specifically, the extent of the conduct or effects in the United States necessary to invoke U.S. jurisdiction over alleged violations of the Securities Act's registration provisions is greater than that required for fraud.[36] The court held that registration under U.S. securities laws should not be required for an offering with only incidental jurisdictional contacts. In this case, the actual purchaser was an offshore corporation with no place of business in the United States. Moreover, the presence of Carr in Florida was personal and fortuitous and not business-related. Under those circumstances, the court concluded that the nearly de minimus U.S. interest in the transactions prevented assertion of jurisdiction under the more limited conduct and effect standard applicable to the registration issue.[37]

It is worth noting that the court also recognized that the transactions at issue in this case were clearly subject to the regulatory jurisdiction of England.[38] The applicability of foreign laws and regulations, and the availability of adequate remedies thereunder, would also be important to the courts deciding the Lloyd's of London cases discussed below.

2. *Lloyd's of London Cases*

The Lloyd's of London cases[39] are a series of federal circuit court cases deciding the enforceability of forum selection and choice of law provisions in subscription documents that chose England and English law, respectively. The issue in the Lloyd's of London cases was quite simple: could Society & Council of Lloyd's (d/b/a Lloyd's of London) avoid the application of U.S. securities laws by requiring a U.S. person to subscribe in London to an offering, and to execute documentation which provided that English law would govern the transaction? In the Lloyd's cases, the U.S. plaintiffs contended that U.S. courts had jurisdiction over Lloyd's for its promotion in the United States of its insurance syndicates, despite the fact that (1) the United States plaintiffs traveled to London to execute the operative agreements and (2) the operative agreements provided that the governing law would be English law and that English courts would be the forum for disputes. The plaintiffs argued that, because the U.S. securities laws contained anti-waiver provisions,[40] they could seek the protections of such laws, notwithstanding the forum selection and choice of law provisions. Moreover, the plaintiffs argued that the transactions at issue in the Lloyd's cases had a substantial effect in the United States. The importance of the Lloyd's cases is that, like the Banque Paribas case, they establish limitations on the applicability of U.S. securities laws to transactions that are primarily extraterritorial.

36. *Id.* at 125-26.

37. *Id.* at 126.

38. *Id.* at 129.

39. *See, e.g.*, Lipcon v. Underwriters at Lloyd's, London, 148 F.3d 1285 (11th Cir. 1998), *cert. denied*, 525 U.S. 1093 (1999); Richards v. Lloyd's of London, 107 F.3d 1422 (9th Cir. 1997), *rev'd en banc*, 135 F.3d 1289 (9th Cir. 1998), *cert. denied*, 525 U.S. 943 (1998); Haynsworth v. Corp., 121 F.3d 956 (5th Cir. 1997), *cert. denied*, 523 U.S. 1072 (1998); Allen v. Lloyd's of London, 94 F.3d 923 (4th Cir. 1996), *mandamus denied sub nom*, In re Allen, 521 U.S. 1102 (1997); Shell v. Sturge, Ltd., 55 F.3d 1227 (6th Cir. 1995); Roby v. Corp. of Lloyd's, 996 F.2d 1353 (2d Cir. 1993), *cert. denied*, 510 U.S. 945 (1994); Bonny v. The Society of Lloyd's, 3 F.3d 156 (7th Cir. 1993), *cert. denied*, 510 U.S. 1113 (1994); and *Riley*, 969 F.2d 953.

40. The anti-waiver provisions of the U.S. securities laws render unenforceable any agreement that effectively eliminates compliance with such laws. The Securities Act provides that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the [Securities and Exchange] Commission shall be void." 15 U.S.C. § 77n (1997). The Securities Exchange Act contains a substantially identical provision. *See id.* § 78cc(a).

The alleged facts of the various Lloyd's cases are substantially the same. Between 1970 and 1993, seeking to increase its underwriting capacity, Lloyd's initiated a program in the United States to recruit Names, or members of its insurance underwriting syndicates. As part of its recruitment program, Lloyd's representatives traveled to the United States in order to offer investment contracts by which U.S. residents could become Names of Lloyd's.[41] Lloyd's employed the U.S. mail to provide printed information on its history and operations, and to send questionnaires, applications and agreements to potential Names residing in the United States. The information provided by Lloyd's to potential Names did not comply with the standards required of prospectuses by the SEC.[42] Essentially, the investment contracts offered by Lloyd's were securities but were not registered under either federal or state securities laws.[43]

In addition to meeting certain financial requirements,[44] a potential Name was also required to execute one or more contracts with Lloyd's: (1) the General Undertaking that contained a choice of forum clause (England)[45] and a choice of law clause (English);[46] (2) the Members' Agent's Agreement that contained choice of forum (England), arbitration, and choice of law clauses (English); and (3) the Managing Agent's Agreement that contained choice of forum (England), arbitration, and choice of law clauses (English).[47] In most of the Lloyd's cases, each individual was required to travel to London to execute these contracts.[48] The issue confronting the courts was whether the Choice Clauses were valid in light of the anti-waiver provisions of the U.S. securities laws.

With the exception of the Ninth Circuit's initial decision in *Richards v. Lloyd's of London*,[49] each of the federal circuit courts that decided the Lloyd's cases upheld the validity of the Choice Clauses. In *Richards*, the Ninth Circuit found that the Choice Clauses operated to effect the very waivers that the precise terms of the anti-waiver provisions are meant to prohibit and, accordingly, found the Choice Clauses to be void.[50] The court criticized the majority rule courts for enforcing judicial discretion to find and decide a policy issue in an area where Congress had already made the applicable policy decision.[51] Congress had specifically enacted anti-waiver provisions in the U.S. securities laws; therefore, the court reasoned, the anti-waiver provisions themselves render the Choices Clauses void. In addition,

41. *Richards*, 107 F.3d at 1424.

42. *Id.*

43. *Id.*

44. To become a Name, a person was required to demonstrate that he met a means test—that he had a net worth of approximately $170,000. *Roby*, 996 F.2d at 1357.

45. Paragraph 2.2 of the agreement stated that "[e]ach party hereto irrevocably agrees that the courts of England shall have exclusive jurisdiction to settle any dispute and/or controversy of whatsoever nature arising out of or relating to the Member's membership of, and/or underwriting of insurance business at Lloyd's . . . ." *Haynsworth*, 121 F.3d at 959.

46. Paragraph 2.1 of the agreement provided that "[t]he rights and obligations of the parties arising out of or relating to the Member's membership of, and/or underwriting of insurance business at, Lloyd's and any other matter referred to in this Undertaking, shall be governed by and construed in accordance with the laws of England." *Id.*

47. *Roby*, 996 F.2d at 1357-58.

48. *See, e.g.*, *Id.* at 1357; *Bonny*, 3 F.3d at 158. In *Richards*, however, the plaintiffs executed the General Undertaking in the United States. *Richards*, 107 F.3d at 1425.

49. *Richards*, 107 F.3d at 1422.

50. *Id.* at 1426.

51. *Id.*

the Ninth Circuit disagreed with the majority rule courts that the remedies available to the U.S. plaintiffs under English law were ample.[52]

However, in an en banc decision, the Ninth Circuit withdrew its initial *Richards* opinion and held that the Choice Clauses were indeed valid, thus resolving the conflict existing between the Ninth Circuit and the majority rule courts.[53] In upholding the validity of the Choice Clauses, the courts applied the reasonableness test developed by the Supreme Court in *The Bremen v. Zapata Off-Shore Co.* case.[54] Under *Bremen*, forum selection and choice of law clauses are presumptively valid where the underlying transaction is fundamentally international.[55] The presumption of validity may be overcome, however, by clearly showing that the clauses are unreasonable under the circumstances: (1) if their incorporation into the agreement was the result of fraud, undue influence or overwhelming bargaining power;[56] (2) if the selected forum is so "gravely difficult and inconvenient that [the plaintiff] will for all practical purposes be deprived of its day in court;"[57] (3) if the fundamental unfairness of the chosen law may deprive the plaintiff of a remedy;[58] or (4) if the clauses contravene a strong public policy of the forum state.[59]

The Lloyd's courts found that the U.S. plaintiffs were neither fraudulently induced into agreeing to the forum selection, choice of law, or arbitration clauses, nor were they inconvenienced by litigating in London since they initially found it convenient enough to travel there.[60] Rather, the courts deemed the real question to be whether, by allowing Lloyd's to avoid liability for putative violations of the U.S. securities laws, important U.S. policies aimed at prospectively protecting American investors by requiring full and fair disclosure from issuers would be contravened.[61] Unanimously, the courts determined that, in the circumstances of the Lloyd's cases, no such U.S. policy would be undermined. The Supreme Court recognized that uncertainty as to applicable law and the forum for disputes is likely to exist in transactions involving parties in two or more countries.[62] The ability to decide in advance on an acceptable forum for disputes is therefore an essential element of international commercial transactions, without which such transactions would lack predictability and orderliness.[63]

With respect to the application of U.S. securities laws in particular, the courts cautioned against a hasty expansion of jurisdiction to extraterritorial transactions. For example, while noting the important function of U.S. securities laws to protect investors in the U.S. markets, the Fifth Circuit warned in *Haynsworth v. Corp.*, that "[t]o insist on the application of American securities law where the laws of the parties' agreed-upon forum meet this concern

52. *Id.* at 1429-30.

53. *Richards*, 135 F.3d 1289.

54. Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972).

55. *See also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 516 (1974); Mitsubishi Motors, Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991), *on remand*, 934 F.2d 1091 (9th Cir. 1991).

56. *Bremen*, 407 U.S. at 14-15.

57. *Id.* at 18.

58. *Id.* at 12-13.

59. *Id.* at 15.

60. *See Bonny*, 3 F.3d at 160; *Roby*, 996 F.2d at 1363.

61. *See Bonny*, 3 F.3d at 161; *Roby*, 996 F.2d at 1364.

62. *Haynsworth*, 121 F.3d at 962 (citing *Scherk*, 417 U.S. at 516).

63. *See Richards*, 135 F.3d at 1293.

would be the very height of the parochialism that [] *Bremen* condemned."[64] Moreover, the courts concluded that English law provided the U.S. plaintiffs with substantive and just remedies.[65]

E. Personal Jurisdiction

1. *Personal Jurisdiction Over Foreign Broker Dealers*

a. Pinker v. Roche Holdings Ltd.

In *Pinker v. Roche Holdings Ltd.*, the Third Circuit clarified the standards for personal jurisdiction over foreign sellers of securities to American investors.[66] The Third Circuit joined five other circuits in holding that courts should apply a national contacts test in cases under the federal securities laws. The court applied the test and held that Roche Holdings Ltd. had sufficient contacts with the United States as a whole to warrant assertion of personal jurisdiction by plaintiffs.[67]

Pinker involved a securities fraud class action against Roche Holdings Ltd., a Swiss corporation with its principal place of business in Switzerland, that sponsored American Depository Receipts (ADRs) that were actively traded by American investors. Plaintiffs contended that they purchased ADRs at an artificially inflated price because of misrepresentations by the company regarding the competitiveness of the vitamin market at a time when the corporation's subsidiaries were engaged in a worldwide conspiracy to fix vitamin prices. The U.S. District Court dismissed the complaint.[68] One of the grounds for dismissal was lack of personal jurisdiction.[69]

The Third Circuit reversed.[70] The court held that in performing its due process, minimum contacts analysis, it could consider contacts with the United States as opposed to analyzing only state contacts.[71] The court referenced the nationwide service of process afforded under the securities laws as support for considering contacts with the United States as a whole as opposed to just the forum.[72] The court stated that "[w]e think that by sponsoring ADRs that are actively traded by American investors, Roche purposely availed itself of the American securities market and thereby evidenced the requisite minimum contacts with the United States to support the exercise of personal jurisdiction by a federal court."[73] Roche's ADRs were not traded on American exchanges and, as a result, Roche was not subject to the Exchange Act's reporting requirements. However, in compliance with SEC Rule 12g3-2(b), the company did have to provide materials it was required to prepare pursuant to regulations in its home country.

The Third Circuit took judicial notice of the fact that sponsored ADRs, such as Roche's "require the issuer to deposit shares with an American branch of a depositary and to enter

64. *See Haynsworth*, 121 F.3d at 967.
65. *See Bonny*, 3 F.3d at 161; *Roby*, 996 F.2d at 1366; *Haynsworth*, 121 F.3d at 966, 969.
66. Pinker v. Roche Holdings Ltd., 292 F.3d 361 (3d Cir. 2002).
67. *Id.*
68. *Id.*
69. The complaint was also dismissed for failure to adequately plead reliance. The Third Circuit also reversed this portion of the decision. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.* at 367.

a deposit agreement with the ADR holders defining the rights of the ADR holders and the corresponding duties of the issuer."[74] The court held that Roche's activities subjected it to U.S. jurisdiction.[75]

By sponsoring an ADR, therefore, Roche took affirmative steps purposefully directed at the American investor. "The aim of sponsoring an ADR after all, is to allow American investors to trade equities of a foreign corporation domestically. Roche, therefore, clearly took 'action'—sponsoring an ADR in a deliberate attempt to solicit American capital—'purposefully directed toward the [the United States].'"[76]

The court equated Roche's sponsorship of ADRs to an "active marketing of its equity interests to American investors,"[77] and held that "[a] foreign corporation that purposefully avails itself of the American securities market has adequate notice that it may be haled into an American court for fraudulently manipulating that market."[78]

In response to Roche's argument that it should not be subject to personal jurisdiction because the ADRs were not traded on an American exchange, the court noted that the complaint alleged Roche was traded on the over-the-counter market and the average daily trading volume of the Roche ADRs was about 25,000.[79]

b. Greenlight Capital, Inc. v. Greenlight (Switzerland)

Greenlight Capital, Inc. v. Greenlight (Switzerland) involved a trademark dispute between two investment advisory firms, both using the Greenlight name.[80] Greenlight (Switzerland) is a corporation organized under Swiss law and based in Geneva, Switzerland. Despite the fact that Greenlight (Switzerland) was a foreign company that claimed it had never had a place of business in New York or been licensed to do business in the jurisdiction, the court concluded that it had personal jurisdiction.[81] The court based its finding of jurisdiction on the company's securities transactions and on its beneficial ownership of substantial quantities of securities registered pursuant to the 1934 Securities Exchange Act.[82] The court held that "[i]t can certainly be said that Greenlight (Switzerland) transacts business in New York where, during a six-year period, as part of its regular business as an investment advisor . . . it has made repeated purchases of stock traded on the NASDAQ in sufficient volume to trigger the reporting requirements of Rule 13d-1."[83] The court held that the Greenlight (Switzerland) transactions "suffice to confer jurisdiction in this case where all of [plaintiff's] claims stem directly from this activity."[84]

74. *Id.* at 365.
75. *Id.*
76. *Id.* at 371 (internal citations omitted).
77. *Id.*
78. *Id.* at 372.
79. *Id.*
80. Greenlight Capital, Inc. v. Greenlight (Switzerland) S.A., No. 04 Civ. 3136(HB), 2005 U.S. Dist. LEXIS 2 (S.D.N.Y. Jan. 3, 2005).
81. *Id.*
82. *Id.*
83. *Id.* at *3.
84. *Id.*

2. *Personal Jurisdiction Over Foreign Individuals—SEC v. Alexander*

SEC v. Alexander illustrated that there are some lengths to which U.S. courts will not go in construing contacts sufficient to subject a defendant to personal jurisdiction in the United States.[85]

The U.S. District Court for the Southern District of New York ruled on August 14, 2001 that an Italian mother charged with insider trading based on a tip from her daughter, a corporate executive, did not have the minimum contacts with the United States to make personal jurisdiction fair and reasonable. The court dismissed Gianna Toffoli, a 65 year-old non-English speaking resident of Italy, from the SEC's civil suit. The court noted that the insider trading allegations at issue arose from a single transaction, initiated in Italy and involving the securities of an Italian company. The court said that Toffoli did not know that her stock sale would be accomplished by the sale of ADRs listed on the New York Stock Exchange (NYSE). The court also noted that the amount of loss avoided, $20,250, was far below the amount found to have been sufficient to support jurisdiction in previous cases.

The SEC alleged that Toffoli's daughter, the manager of public and investor relations at Italian eyewear company Luxottica Group S.p.A., tipped her about Luxottica's plans to make a tender offer for U.S. Shoe, which owned LensCrafters. U.S. Shoe was traded on the NYSE. When Luxottica did in fact make the offer, Luxottica's share price fell 20%. Toffoli avoided this loss by selling shares of Luxottica through her Italian bank. Luxottica's ADRs are registered with the SEC and traded on the NYSE.

The court explained that not every case where there is a causal connection between an action abroad and an ultimate injury to American investors has the minimum contacts necessary to show that the trader reasonably should have anticipated being haled into a U.S. court.[86]

On May 20, 2003, the court dismissed SEC charges against another defendant in the case.[87] Penelope Afouxenide was a relief defendant who allegedly received illegal profits from her husband's insider trading in U.S. Shoe prior to the Luxottica hostile tender offer. The court held that the "SEC's allegations . . . are not sufficient to demonstrate the requisite minimum contacts with the United States on the part of [d]efendant Afouxenide to support personal jurisdiction."[88] The court denied the motion of Afouxenide's husband, Constantine Spyropoulos, to dismiss on similar grounds.

In its suit, the SEC alleged that Spyropoulos received material nonpublic information concerning Luxottica's efforts to acquire U.S. Shoe from defendant Adrian Alexander who, in turn, had received the information from defendant Belli. The SEC alleged that Spyropoulos used Afouxenide's brokerage account to illegally purchase shares of U.S. Shoe Corp., then sold those shares after the tender offer announcement for a profit of $117,175. Defendants Afouxenide and Spyropoulos did not contest the trades occurred, but argued they did not violate U.S. securities laws.[89]

85. SEC v. Alexander, 160 F. Supp. 2d 642 (S.D.N.Y. 2001); SEC v. Alexander, No. 00 Civ. 7290 (LTS HPB), 2003 U.S. Dist. LEXIS 8503 (S.D.N.Y. May 20, 2003).

86. SEC v. Alexander, 160 F. Supp. 2d 642.

87. *Id.*

88. *Id.*

89. SEC v. Alexander, 2003 U.S. Dist. LEXIS 8503.

The defendants maintained that all of the U.S. Shoe trades were carried out in Greece by telephone through Politis, of the Greek brokerage firm Iris S.A., and executed using Afouxenide's brokerage account in Greece. The defendants asserted that both were Greek citizens, although Spyropoulos was also a U.S. citizen; they did not own any property in the United States; that they did not have any business contacts, bank accounts, or brokerage accounts in the United States; and that their trips to the United States were limited to trips to obtain medical treatment in 1991 and 1993, and to a family vacation in 2001.

In declining to dismiss charges against Spyropoulos, the court noted that his "alleged activity would have created a near certainty that shareholders in the United States would be adversely affected" and that "the trading at issue here was not insignificant."[90] With respect to Afouxenide, the Court noted that there were "no allegations that [d]efendant Afouxenide engaged in insider trading, or even that [she] traded securities at all."[91] The court observed that "[p]laintiff seeks only to have [d]efendant Afouxenide disgorge any alleged illegal profits earned through trading in the brokerage account maintained in her name."[92]

F. Forum Non Conveniens—DiRienzo v. Philip Services Corp.

In *DiRienzo*, the Second Circuit found that an action against Canadian corporation Philip Services was properly brought in the United States.[93] The court reversed a dismissal based on forum non conveniens, holding that where the corporation had conducted road shows in the United States, owned U.S. companies, derived profit from U.S. activities, and its shares were owned by U.S. investors, it was properly sued in U.S. courts.[94]

Plaintiffs, in a direct action and an uncertified class action, brought suit against the directors and officers of a Canadian corporation in bankruptcy and other defendants, alleging federal securities fraud and related state law claims. The fraud claims were based on allegedly fraudulent misrepresentations regarding the income and value of Philip during a three year period between 1995 and 1998. The U.S. District Court for the Southern District of New York dismissed both cases on the ground of forum non conveniens. The U.S. Court of Appeals for the Second Circuit reversed. The court concluded that the lower court erred in both actions by giving less deference to plaintiffs' choice of forum and by failing to accord proper significance to the choice of a U.S. forum by U.S. plaintiffs.[95] The court held that the lower court's analysis was infected by that court's failure to appreciate the significance of the interest of the United States in deciding these maters, which arose out of the sales of defendant foreign metal processing company's securities in the United States.[96]

The Court of Appeals noted that the defendant, Philip Services Corporation, had its principal offices in Hamilton, Ontario, but owned fifteen American companies and maintained facilities in twelve states. Its U.S. efforts generated 70 percent of its corporate revenue. To raise money, the company sold stock in both the United States and Canada. By

90. *Id.* at * 9.
91. *Id.* at * 10.
92. *Id.*
93. Dirienzo v. Philip Serv. Corp., 232 F.3d 49 (2d Cir. 2000).
94. *Id.*
95. *Id.*
96. *Id.*

the end of 1996, 60 percent of the company's seventy million shares were held by U.S. investors. The company promoted the stock via road shows, press releases, and filing financial reports with the SEC. When extensive litigation was commenced in different states and in Canada regarding the alleged securities fraud, the U.S. suits were transferred by the Judicial Panel on Multi-District Litigation to the U.S. District Court for the Southern District of New York.[97]

In analyzing the district court's forum non conveniens findings, the Court of Appeals held that the district court erred by finding that the local interest factor weighed heavily in favor of litigation in Ontario.[98] The court held that the district court "failed to acknowledge as a factual matter that many of the plaintiffs' securities transactions were conducted entirely in the United States, by Americans, in American dollars, on American stock exchanges."[99] In response to the district court's conclusion that "parties who choose to engage in international transactions . . . cannot expect always to bring their foreign opponents into a United States forum"—the court noted that the majority of plaintiffs had bought shares on the NYSE or National Association of Securities Dealers Automated Quotation system (NASDAQ) and relied on statements filed with the SEC.[100] The court distinguished the case from others in which it had affirmed forum non conveniens dismissals, noting *DiRienzo* "[does] not involve Americans who sought out involvement with a foreign forum. It was Philip who came to them by registering its stock on American exchanges, filing statements with the SEC, and conducting the bulk of its business—including multiple corporate acquisitions—in the United States."[101]

The court also recognized that "there is a strong public interest favoring access to American courts for those who use American securities markets. The fraud on the market theory itself illustrates investors' reliance on accurate and complete information. For securities markets to function efficiently, securities fraud law must be clear and enforceable."[102] Moreover, the United States has its own interest in enforcing its securities laws.

G. Substantive Rights—Fifth Amendment Assertions

The evolution of international assistance has created the anomalous circumstance that, notwithstanding the fact that assistance is sought in a U.S. civil case and no U.S. criminal case could arise, a defendant may face foreign prosecution based upon his testimony. The ability to invoke the Fifth Amendment to the U.S. Constitution was severely limited by the Supreme Court in such a case.

In *United States v. Balsys*, the Supreme Court declined to extend the Fifth Amendment's protection against self-incrimination to cases where the only threat of prosecution is by a foreign government.[103] Taken at its extreme, this limitation of rights under the Fifth Amendment may be quite significant and would seem out of harmony with cases holding that the right to counsel, and other rights, attach at the moment of confinement, even if the defen-

97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.* at 64.
102. *Id.* at 65.
103. United States v. Balsys, 524 U.S. 666 (1998).

dant is a foreign national charged in the United States. However, it is important to view the Court's ruling in the context of the facts of the case, which involved the investigation of Nazi war crimes. In *Balsys*, the Department of Justice subpoenaed Aloyzas Balsys, a resident alien and suspected Nazi war criminal, to testify about his wartime activities and his immigration to the United States. Balsys relied on the Fifth Amendment in refusing to respond to the Department of Justice's subpoena. In particular, he asserted his Fifth Amendment privilege against self-incrimination because he feared prosecution by Lithuania, Israel, and Germany in connection with the matters at issue. Significantly, Balsys could claim no fear of U.S. prosecution, as the statute of limitations had run on the charge of misrepresentation in his immigration application and there was no other basis for charges in the United States.[104]

The District Court granted the Department of Justice's petition to enforce the subpoena, but the Second Circuit vacated that ruling, holding that a witness with a real and substantial fear of prosecution by a foreign country may assert the Fifth Amendment privilege against self-incrimination, even if there is no valid fear of prosecution in the United States.[105] The Supreme Court granted certiorari in order to resolve a split among the circuit courts,[106] and held that concern solely with foreign prosecution is beyond the scope of the self-incrimination clause.

In making its decision, the Court focused on the issue of whether a criminal prosecution by a foreign government is a criminal case under the Fifth Amendment.[107] Concluding that it is not, the Court emphasized the potential consequences of an expansion of the clause to cover threat of foreign prosecution. Ordinarily, the Court reasoned, prosecution of criminals is not significantly hindered by assertion of the privilege against self-incrimination with respect to potential U.S. prosecution because U.S. prosecutors have the discretion to grant immunity, thereby removing the threat of prosecution and requiring parties to testify. But, the scope of the immunity must be as broad as the privilege in order to be effective. Because the United States clearly may not grant immunity from prosecution by foreign governments, the Court concluded that the likely result of an expansion of the privilege would be the loss of crucial testimony in U.S. criminal cases.[108]

Under the *Balsys* ruling, an individual subpoenaed in the United States with respect to securities transactions would not be able to assert the privilege against self-incrimination based solely on a fear of prosecution in another country, in the absence of a valid fear of prosecution in the United States.[109] Therefore, such person could be faced with a choice between contempt in the United States for refusing to respond to the subpoena, on one hand, and prosecution abroad, on the other. In light of the globalization of the markets and the participation by many individuals and firms in the securities markets of more than one country, the Court's decision could impact international securities law enforcement.

104. *Id.* at 670.

105. *Id.* at 672.

106. *See* United States v. Gecas, 120 F.3d 1419 (11th Cir. 1997) (holding that privilege can not be invoked based on fear of foreign prosecution); United States v. (Under Seal), 794 F.2d 920 (4th Cir. 1986); In re Parker, 411 F.2d 1067 (10th Cir. 1969); United States v. Balsys, 119 F.3d 122 (2d Cir. 1997) (allowing assertion of the privilege).

107. *Balsys*, 524 U.S. at 670-72.

108. *Id.* at 695-97.

109. *Id.*

It is important to note, however, that the Court left open the possibility of revisiting the issue in the future. Specifically, the Court recognized the importance of cooperative conduct between the United States and foreign governments in the enforcement of criminal laws.[110] Although the Court concluded that such cooperation does not at this time rise to a level that would justify expanding the privilege, the Court stated that

> [i]f it could be said that the United States and its allies had enacted substantially similar criminal codes aimed at prosecuting offenses of international character, and if it could be shown that the United States was granting immunity from domestic prosecution for the purpose of obtaining evidence to be delivered to other nations as prosecutors of a crime common to both countries, then an argument could be made that the Fifth Amendment should apply based on fear of foreign prosecution simply because that prosecution was not fairly characterized as distinctly "foreign."[111]

With increasing cooperation in the international enforcement of securities laws and the movement toward consensus on the substance of such laws, the opening left by the Court could prove significant in cases relating to securities law matters.

II. Recent SEC Assertions of Jurisdiction

A. Jurisdiction Over Foreign Broker-dealers

1. *Broker-dealers Controlled by U.S. Registered Broker-dealers: SEC v. Zahareas*

In *SEC v. Zahareas*, the Eighth Circuit clarified the definition of control under the Securities Exchange Act of 1934 and provided useful pointers for brokers seeking to provide finder and other services not requiring registration to U.S. based brokers.[112]

Defendant John Tuschner was the former president and CEO of Tuschner & Company, a securities broker-dealer registered with the SEC. The SEC alleged that Tuschner & Company "controlled" defendant Nicholas Zahareas in a series of transactions, thereby aiding and abetting Zahareas in becoming an associated person of a United States securities broker in violation of a barring order and federal securities law. Defendant Zahareas was a U.S. citizen previously barred from trading in U.S. securities by the SEC, and permanently enjoined from committing future violations of the federal securities antifraud provisions. He was the president and majority shareholder of defendant Euroamerican Securities, S.A., a brokerage and financial consulting firm doing business in Athens, Greece.

In 1996, Tuschner and Tuschner & Company reached an agreement with Zahareas whereby Zahareas would recruit Greek citizens to purchase certain securities in an initial public offering (IPO) for which Tuschner & Company was serving as underwriter. The agreement called for Zahareas to be paid a fee of 8 percent of the total revenues generated by the IPO. Tuschner testified that he considered the payment to be a foreign finders fee. This finders fee was paid into the account of Zahareas' wife in Greece.

110. *Id.* at 698.

111. *Id.* In his dissenting opinion, Justice Breyer, with whom Justice Ginsburg joined, also stressed the concept of "cooperative internationalism." In particular, he emphasized that in recent decades, the United States has "dramatically increased its level of cooperation with foreign governments to combat crime." *Id.* at 714. In support, he cited the numerous mutual legal assistance treaties, extradition treaties and the similar agreements the United States has entered into with foreign governments. *Id.*

112. SEC v. Zahareas, 272 F.3d 1102 (8th Cir. 2001).

Following the IPO, Zahareas established Euroamerican Securities and continued to refer Greek investors to Tuschner & Company. Tuschner & Company supplied Zahareas with the paperwork necessary to open an account, which he completed and returned. All paperwork to establish accounts and engage in trading came from Tuschner & Company. During the course of the parties' relationship, Tuschner & Company authorized its trader to accept orders directly from Zahareas. Zahareas received monthly reports noting the trades in which Euroamerican was involved and the commission due Euroamerican. Euroamerican received 75 percent of the gross charges to each customer as compensation.

In September 1997, Tuschner testified before the SEC that he had ceased doing business with Zahareas and Euroamerican. However, as of December 1997, the Greek accounts had not been formally transferred away from Euroamerican, nor had the customers been notified of any termination of relationship between Tuschner & Company and Zahareas.

The U.S. District Court for the District of Minnesota found that Zahareas associated with Tuschner & Company and that Tuschner aided and abetted in the association.[113] The court issued a preliminary injunction enjoining the association.[114] After the preliminary injunction was affirmed on appeal, the parties brought cross motions for summary judgment. The district court granted the SEC's motion for summary judgment and for permanent injunction with regard to defendant Tuschner.[115] The court found that Zahareas, a banned agent, was controlled by Tuschner and was an associated person, that Mr. Tuschner was aware of the ban, and that he therefore violated the Securities Exchange Act of 1934.[116]

The Eighth Circuit reversed the district's court's grant of the SEC's motion for summary judgment holding him liable under § 20(e) of the Securities Exchange Act of 1934.[117] The court concluded that the SEC failed to show that Zahareas was controlled by Tuschner under the plain language of 15 U.S.C. sec. 78c(a)(18).[118] The court remanded for entry of judgment in favor of Tuschner.

The court held that the "dispositive issue is whether Zahareas was 'controlled by' Tuschner."[119] Under 15 U.S.C. § 78c(a)(18), an associated person is defined as

> [a]ny partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer . . . .[120]

The court noted that Zahareas was not an employee of Tuschner, and that Zahareas controlled his own employees and performed his own consulting work with his own clients.[121] The court refused to accept the district court's holding that Zahereas was a controlled person simply because Tuschner & Company controlled access to shares of the IPO, stating that "[t]o hold that a refused buyer becomes an 'associated person,' whenever an

113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* at 1105.
120. 15 U.S.C. § 78(c)(A)(18).
121. *Zahareas*, 272 F.3d at 1106.

underwriter does not sell to that buyer, would expand the scope of liability under sec. 78c(a)(18) beyond recognition."[122]

Nor did the court agree with the district court's finding that Tuschner controlled the means and manner of performance of Zahareas by virtue of the fact that Tuschner provided paperwork to Zahareas for Greek investors to complete.[123] The Eighth Circuit noted that the SEC "has pointed to no precedent in which providing and verifying paperwork amounts to 'control' under § 78c(a)(18)."[124]

Finally, the Eighth Circuit disagreed with the district court's acceptance of the SEC's alternate theory that Zahareas was a Tuschner & Company representative in all but name, holding that the district court "departed significantly from the express scope of the Congressional statute" in finding that the term associated person was equivalent to a registered representative.[125]

In responding to the SEC's argument that the court should employ a general policy analysis, the Eight Circuit recognized that "[f]or over [sixty] years, Congress has carefully limited the federal securities laws to the domestic shores of the United States."[126] The court noted that "[d]espite being granted some authority by the statute, the SEC never enacted a rule or regulation applicable to transactions with foreign brokers such as those between Tuschner and Zahareas."[127] The court explicitly referenced 54 Fed. Reg. 30,013-30,016 as an example of the SEC's adherence to a territorial approach.[128] In the Release, the SEC states that it "uses a territorial approach in applying the broker-dealer registration requirements to the international operations of broker-dealers. Under this approach, all broker-dealers physically operating within the United States . . . would be required to register as broker-dealers."[129]

The court noted that the territorial approach was "based at least in part on avoiding the jurisdictional entanglement between United States securities laws and European securities dealers."[130] The court stated that

> [h]ere, Zahareas's customers were all European; Zahareas made no sale to an American customer. The transaction with Tuschner was at arms-length. Indeed, European financial consultants and securities brokers would be quite surprised to learn that they were "controlled by" an American broker simply by selling an IPO using the broker's forms. Moreover, the SEC all but ignores the European and Greek securities laws in pursuit of its novel application of United States laws.[131]

The SEC filed a Petition for Rehearing and for Rehearing en Banc, which was denied on February 6, 2002.[132]

122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. Registration Requirements for Foreign Broker Dealers, Exchange Act Release No. 34-27017 (July 18, 1989).
129. *Id.*
130. *Zahareas*, 272 F.3d at 1107.
131. *Id.*
132. SEC v. Tuschner, No. 00-3047, 2002 U.S. App. LEXIS 1813, at *1 (8th Cir. Feb. 6, 2002).

2. *Jurisdiction over Foreign Broker-dealers for Sale of Unregistered Securities: State Bank of India and Citibank*

On November 19, 2001, the SEC issued a cease and desist order against the State Bank of India (SBI) and Citibank, N.A.[133] SBI and Citibank consented to entry of the Order directing both SBI and Citibank to cease violating §§ 5(a) and (c) of the Securities Act. The Order was issued pursuant to the finding that SBI and Citibank violated federal securities laws by selling Resurgent India Bonds (RIBs) in the United States without filing a registration statement with the SEC.

The Order finds that between August 5, 1998 and August 24, 1998 SBI directly, and through the marketing efforts of a subsidiary and Citibank, raised approximately $532 million in the United States by selling RIBs to non-resident Indians and entities owned or controlled by non-resident Indians. Of that amount, Citibank sold approximately $160 million of the bonds.

SBI is the largest commercial bank in India, with offices in five major U.S. cities. In July 1998, SBI entered into agreements with Citibank and others to act as brokers to seek subscriptions from eligible investors in the United States and abroad.[134] Also in July 1998, SBI appointed collecting banks including SBI New York and Citibank, to act as regional centers where applications would be collected, processed, and forwarded to SBI.[135]

In SBI's preoffering announcement, the RIBs were described as five-year denominated instruments carrying interest rates as high as 8 percent, transferable outside of India, and giftable within India. The announcement stated that only non-resident Indians and their affiliates could purchase the RIBs and that the offering would be used mainly for infrastructure development in India.

In the United States, SBI and Citibank's Non-Resident Indian Services division conducted marketing, specifically targeting about one million non-resident Indians living in the United States, many of whom were also U.S. citizens.[136] Marketing efforts included mass mailings and cold calls. The marketing campaign featured the name Resurgent India Bond and frequently used the terms "bonds" and "investments" and other terms commonly associated with securities offerings.[137] Citibank's marketing materials also touted similarities between RIBs and government bonds.

The Order found that RIBs are securities and that SBI and Citibank violated §§ 5(a) and (c) of the Securities Act by offering and selling the RIBs when the offering of such securities was not registered with the SEC, and ordered that the companies cease and desist from committing such violations.[138]

B. Jurisdiction over Foreign Issuers and Nationals for Violation of U.S. Antifraud and Disclosure Standards

The ease of global dissemination of information in the internet age has led to an increased concern on the part of U.S. authorities regarding the impact on U.S. investors of statements

133. Press Release, SEC, State Bank of India and Citibank, N.A. Settle SEC Charges Involving An Unregistered Securities Offering (Nov. 19, 2001), *available at* http://www.sec.gov/news/headlines/bankofindia.htm.
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.*

made by foreign issuers. Courts have been willing to interpret the conduct and effects test broadly enough to encompass actions against foreign issuers in this context. Two cases, *In the Matter of Eric John Watson* and *In the Matter of E. ON AG* demonstrate the SEC's efforts to expand its reach in this area.

1. *In the Matter of Eric John Watson*[139]

This matter is noteworthy because the SEC asserted jurisdiction over foreign activity by a foreign employee of a foreign subsidiary where the parent corporation was traded on the U.S. markets. This matter resulted in the issuance of a consent order requiring Watson to cease and desist from violating § 10(b) and Rule 10b-5 of the Exchange Act.[140] The SEC alleged that Mr. Watson, a New Zealand citizen, misled U.S. Office Products (USOP) in connection with the company's 1997 acquisition of McCollam Printers, Ltd., a New Zealand company. USOP was listed on the NASDAQ at the time of the conduct in question. Watson was the CEO of Blue Star Group, Ltd., a subsidiary of USOP located in New Zealand, and President of USOP's International Division.

The SEC alleged that Watson targeted McCollam Printers as a potential acquisition for USOP without disclosing that he had purchased shares of McCollam, or that he and two associates were continuing to purchase. Using nominee and foreign accounts, Watson and his associates purchased over two million shares of McCollam that they then sold after the announcement that USOP had offered to purchase McCollam. The purchases and the sales all took place in New Zealand. The group realized profits of approximately $533,000. The SEC found that Watson's actions had the effect of defrauding USOP and its shareholders.

2. *In the Matter of E. ON AG*

In this matter, the SEC asserted jurisdiction over a foreign private issuer of securities in the United States for misleading foreign conduct in connection with the German company's denials of ongoing merger negotiations.[141] These denials were disseminated in Germany and in the United States. The SEC took the position that where a foreign issuer avails itself of U.S. markets, it must adhere to U.S. securities laws, regardless of laws of the issuer's residence.

The SEC alleged that during July and August of 1999, senior management of the German industrial holding company E. ON AG directed the release of press information denying merger negotiations. Contrary to the press releases, significant merger negotiations were ongoing and the merger was ultimately finalized. At the time the misleading press releases were issued, the company was known as Veba AG. The information was disseminated in Germany and in the United States, where Veba AG's ADRs traded on the NYSE. The SEC alleged that Veba AG expected that U.S. investors would learn of its denials of ongoing merger negotiations.

Veba AG claimed that it had issued the press releases because it was concerned that it would not be able to gain support for the merger from government and labor entities if news of the negotiations was spread. In rejecting Veba AG's position, the SEC articulated

139. Mr. Mann represented Watson in connection with this proceeding.

140. In re Matter of Eric John Watson, Exchange Act Release No. 34-44934, 76 SEC Docket 100 (Oct. 15, 2001).

141. In re Matter of E. ON AG, Exchange Act Release No. 34-43372, 73 SEC Docket 974 (Sept. 28, 2000).

its view as to disclosure practices for foreign issuers where there is a divergence or conflict between the securities laws of the issuer's residence and the United States:

> [t]he Commission recognizes that disclosure practices and laws regarding the existence of merger negotiations may differ in other jurisdictions. Where jurisdictional requirements are met, however, there is no safe harbor for foreign issuers from violations of the antifraud provisions of the U.S. federal securities laws. . . . When a foreign issuer voluntarily avails itself of the opportunities in the U.S. capital markets, it must adhere to the U.S. federal securities laws.[142]

3. *S.E.C. v. TV Azteca S.A. de C.V., Azteca Holdings, S.A. de C.V., Ricardo Salinas Pliego, Pedro Padilla Longoria, and Luis Echarte Fernandez*

The SEC brought civil fraud charges against Azteca S.A. de C.V. (TV Azteca), a Mexican issuer with ADRs trading on the NYSE; its parent company, Azteca Holdings, S.A. de C.V.; and three current and former TV Azteca officers and directors.[143] The SEC alleged that the defendants took elaborate steps to conceal a related party transaction engaged in by Ricardo Salinas Pliego, the chairman of the board of directors and controlling shareholder of TV Azteca since 1993. Salinas was also the CEO and chairman of the board of directors of Azteca Holdings from 1997 until April 2004. The SEC also alleged that Salinas and Pedro Padilla Longoria sold millions of dollars of TV Azteca stock while Salinas' alleged self-dealing went undisclosed.

The TV Azteca matter is the first foreign issuer case that highlights two significant aspects of Sarbanes-Oxley in the enforcement context. First, when the company disregarded the advice of counsel regarding U.S. law, the U.S. counsel resigned pursuant to § 307 of the Sarbanes-Oxly Act. Second, in this case along with the Hollinger matter discussed below, the SEC is seeking, in part, an order barring director/officer defendants of this foreign issuer from serving as officers or directors of any publicly-held company with securities trading in the United States. The SEC is seeking the bar against Salinas and Padilla.[144] Salinas is the controlling shareholder of TV Azteca. The Salinas family indirectly owns and controls Azteca Holdings, which beneficially owns 55 percent of the outstanding stock of TV Azteca and as a result, it appears, irrespective of the bar has and would continue to have control of the company.

The question posed by the case is, notwithstanding the fact that the conduct, if it occurred in the United States, would draw the same pleas by the SEC for sanctions, are the sanctions responsive here? Second, given the fact that the shareholders are predominantly Mexican and that the board of directors is elected pursuant to Mexican law, can the United States preempt Mexican law and bar a person from serving as an officer or director of a foreign private issuer? If not, are there more appropriate and reasonable remedies that both redress the wrong and protect U.S. investors? These same issues apply to the SEC's action against Conrad Black, F. David Radler, and Hollinger, Inc., discussed below. Note that due to his status as the controlling shareholder, Salinas could still take action that was detrimental to U.S. investors, but outside the purview of the SEC.

142. *Id.*
143. S.E.C. v. TV Azteca S.A. de C.V., SEC Litigation Release No. 19022, 84 SEC Docket 52283 (Jan. 4, 2005).
144. *Id.*

The self-dealing alleged by the SEC relates to the purchase of debt owed by a TV Azteca subsidiary to a third party.[145] Salinas was a director of the subsidiary and president of the subsidiary during the relevant time period. The SEC alleged that a company secretly co-owned by Salinas purchased from a third party at a steep discount approximately $325 million of indebtedness owed by the subsidiary to the third party. According to the complaint, at the time Salinas purchased the indebtedness, he was aware that the subsidiary was in negotiations with another telephone company that would provide cash to the subsidiary sufficient to pay off the full amount of the indebtedness that Salinas had purchased at a discount. Three months after the purchase of the indebtedness, Salinas profited by $109 million upon the subsidiary's repayment of the debt at full value.

According to the complaint, TV Azteca and its management failed to disclose, and in some instances falsely denied Salinas' involvement in the transactions. The SEC alleged that, while TV Azteca disclosed the transactions, it did not reveal that Salinas was involved in the debt purchase and profited from the purchase, despite advice from U.S. counsel that the transactions were material, reportable conditions under U.S. federal securities laws. U.S. counsel ultimately informed TV Azteca that it was resigning consistent with its obligations under § 307 of the Sarbanes-Oxley Act.

The SEC also alleged that Salinas, Padilla, and Luis Echarte intentionally withheld information from, and lied to the directors of TV Azteca about Salinas' connection to the transactions and that Salinas and Padilla fraudulently executed false Sarbanes-Oxley certifications. In the complaint, the SEC cites to an email sent by Echarte to Salinas and Padilla following a December 2003 New York Times article discussing the resignation of counsel. In the email, Echarte notes that "'[t]he damage is done and the situation that we didn't want to explain openly is now in the hands of the public.'"[146] TV Azteca issued a press release in January 2004, confirming that Salinas owned half of the third party purchaser of the indebtedness.

In the SEC litigation release, the head of enforcement for the SEC's Fort Worth, Texas office noted the cooperation between the SEC and the Comision Nacional Bancaria y de Valores, stating that "[e]nhanced global cooperation among securities regulators has significantly changed the ways in which the SEC investigates and prosecutes conduct that crosses international borders . . . geographic boundaries will not serve to protect those who seek to defraud investors."[147]

4. *SEC v. Conrad Black; F. David Radler; and Hollinger, Inc.*

The SEC filed an enforcement action against Hollinger International's former Chairman and CEO, Conrad Black, former Deputy Chairman and COO, F. David Radler, and Hollinger, Inc., a Canadian public holding company controlled by Black.[148] Black is a British citizen with residences in London, England, Palm Beach, Florida, and Toronto, Canada. According to the complaint, Black's personal holding company, the Conrad Black Capital Corporation, owns 65.1 percent of the Ravelson Corporation Limited, a private Canadian

145. *Id.*

146. *Id.*

147. Press Release, SEC, SEC Charges TV Azteca And Its Chairman—Ricardo Salinas Pliego—with Fraudulent Scheme to Conceal Salinas' $109 Million Windfall Through Related Party Transactions (Jan. 4, 2005), *available at* http://www.sec.gov/news/press/2005-1.htm.

148. SEC v. Black, SEC Litigation Release No. 18969, 84 SEC Docket 675 (Nov. 15, 2004).

corporation that directly and indirectly owns approximately 78 percent of Hollinger, Inc.'s stock. Black is the Chairman and CEO of Ravelson.

In its complaint, the SEC alleges that Black and Radler, along with Hollinger, Inc., fraudulently diverted assets from Hollinger International, Inc. and concealed their self-dealing from shareholders. Hollinger International, Inc. is a U.S. public company and a subsidiary of Hollinger, Inc.

The SEC complaint alleges that Black, Radler, and Hollinger, Inc. defrauded shareholders by engaging in a series of related party transactions by which Black and Radler diverted to themselves, other corporate insiders, and Hollinger, Inc. approximately $85 million of the proceeds from Hollinger International's sale of newspaper publications through what were described as non-competition payments. In addition, Black and Radler allegedly caused the sale of certain newspaper publications at below-market prices to another privately-held company owned and controlled by them, including the sale of one publication for $1.

According to the complaint, Black authorized the investment of $2.5 million of Hollinger International's funds in a venture capital fund, with which he and two other directors of Hollinger International were affiliated, without obtaining approval from the Audit Committee for the investment.

The complaint alleges that Black and Radler misled Hollinger International's Audit Committee regarding the related party transactions and misrepresented and failed to state material facts regarding the transactions in Hollinger International's filings with the Commission.

The SEC sought an injunction from future violations of the U.S. federal securities laws; disgorgement; civil penalties; a bar against Black and Radler from serving as an officer or director of a public company; and the imposition of a voting trust upon the shares of Hollinger International held directly or indirectly by Black and Hollinger, Inc.[149]

The attempt to impose a voting trust on the shares of Hollinger International held directly or indirectly by Black and Hollinger, Inc. represents another approach to the issue raised in TV Azteca, wherein a controlling shareholder could still act to the detriment of investors despite being barred from acting as an officer or director. Query, why did the SEC seek the imposition of a voting trust on the shares of Hollinger International held by Black and Hollinger, Inc., but not the shares of TV Azteca held by Salinas? Was it because Hollinger International is a U.S. public company? Was it because Hollinger, Inc. is a Canadian company? What standards does the SEC apply in deciding what is the appropriate remedy?

5. *SEC v. Koninklijke Ahold N.V. (Royal Ahold); SEC v. A. Michiel Meurs and Cees van der Hoeven; SEC v. Johannes Gerhardus Andreae; In the matter of Ture Roland Fahlin*

The SEC filed a complaint alleging fraud and other federal securities violations on October 13, 2004. Named in the complaint were Royal Ahold, a Dutch company, and three of its former top executives.[150] In addition, the SEC brought an administrative proceeding against a former member of Royal Ahold's supervisory board and audit committee.[151]

149. *Id.*

150. SEC v. Koninklijke Ahold N.V. (Royal Ahold), SEC Litigation Release No. 18929, 83 SEC Docket 2976 (Oct. 13, 2004).

151. *Id.*

In its complaint, the SEC alleged that U.S. Foodservice, Royal Ahold's wholly-owned U.S. subsidiary, fraudulently inflated promotional allowances and that Royal Ahold improperly consolidated joint ventures through fraudulent side letters. According to the SEC, these actions, along with other accounting errors and irregularities, caused Royal Ahold's net income, operating income, and net sales to be materially overstated from 2000 through 2002.[152]

The complaint alleged that U.S. Foodservice overstated promotional allowances by at least $700 million for 2001 and 2002 and that U.S. Foodservice executives provided or assisted in providing Royal Ahold's independent auditors with false and misleading information regarding the allowances. According to the SEC, the U.S. Foodservice executives persuaded personnel at major vendors to falsely confirm overstated promotional allowances to the auditors in connection with year-end audits.[153]

With respect to the improperly consolidated joint ventures, the SEC alleged that Royal Ahold fully consolidated several joint ventures in its financial statements despite owning no more than 50 percent of the voting shares and despite the fact that the joint venture agreements called for joint control by Royal Ahold and the other partners. Royal Ahold provided its auditors with side letters to the joint venture agreements which purported to verify that Royal Ahold controlled the joint ventures. However, after executing the side letters, Royal Ahold executed additional side letters that rescinded the earlier side letters.

According to the SEC, A. Michiel Meurs signed all but one of the side letters regarding control and rescission. The complaint alleged that he knew that auditors were relying on the letters regarding control but were unaware of the letters regarding rescission.

The SEC alleged that Cees van der Hoeven cosigned one of the rescission letters and was at least reckless in not knowing the auditors were unaware of its existence.

The SEC alleged that Johannes Gerhardus Andreae signed the side letters regarding control and rescission for ICA, Royal Ahold's Scandinavian joint venture, and knowingly or recklessly concealed the existence of the rescission letter from the auditors. Ture Roland Fahlin signed side letters on behalf of one of Royal Ahold's partners in one of the joint ventures. He then became a member of Royal Ahold's supervisory and audit committee and learned that the auditors were relying on side letters such as the one he had signed regarding control, yet he took no action.

In settling the matter while neither admitting nor denying the allegations in the complaint, Royal Ahold consented to an order enjoining it from future securities laws violations.[154] Van der Hoeven and Meurs agreed to be similarly enjoined and to be barred from serving as an officer or director of a public company.[155] Fahlin consented to an order directing him to cease and desist from causing any violations of the U.S. federal securities laws.[156] Andreae has not settled.[157]

The SEC noted in its litigation release that it did not seek penalties in this matter because the Dutch Public Prosecutor's Office requested that the Commission refrain from seeking

152. In connection with the U.S. Foodservice allegations, the SEC filed a complaint on July 27, 2004 against Michael Resnick, Mark P. Kaiser, Timothy J. Lee, and William Carter. SEC v. Resnick, SEC Litigation Release No. 18797, 83 SEC Docket 1412 (July 27 2004).

153. *See* SEC Litigation Release No. 18929, 83 SEC Docket 2976.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

penalties because of potential double jeopardy concerns under Dutch law.[158] In addition, the SEC noted the company's cooperation with regulators, proactive investigative approach, and prompt remedial actions.[159]

6. *SEC v. Royal Dutch Petroleum Company; "Shell" Transport and Trading Company, p.l.c.*

On August 24, 2004, the SEC reached a settlement with Royal Dutch Petroleum Company and Shell Transport and Trading Company, p.l.c. in connection with the alleged overstatement of reported proved hydrocarbon reserves.[160] Royal Dutch Petroleum Company is a Dutch corporation with its headquarters in the Netherlands and Shell Transport and Trading Company is an English corporation headquartered in London.

Shell agreed to consent to a cease-and-desist order finding violations of the antifraud, internal controls, record-keeping, and reporting provisions of the U.S. federal securities laws and by disgorging $1 million and paying a $120 million penalty.[161] In addition, Shell agreed to commit an additional $5 million to develop and implement a comprehensive internal compliance program.[162] In agreeing to the settlement, Shell neither admitted nor denied the factual allegations of the SEC complaint.

The SEC complaint alleged that Shell overstated proved reserves reported in 2002 by 4.47 billion barrels of oil equivalent, and that Shell overstated the standardized measure of future cash flows by approximately $6.6 billion.

According to the SEC, for the years 1998 through 2002, Shell materially misstated its reserves replacement ratio, an important performance indicator.

The SEC alleged that Shell's overstatement of proved reserves, and its delay in correcting the overstatement were the result of its desire to create and maintain the appearance of a strong reserves replacement ratio; the failure of its internal reserves estimation and reporting guidelines to conform to SEC requirements; and the lack of effective internal controls over the reserves estimation and reporting process. The SEC also alleged that Shell rejected warnings regarding the overstatement of the reserves and attempted to manage potential exposure by delaying the de-booking of improperly recorded proved reserves until new proved reserves were found to offset the impact of the de-booking.

7. *SEC v. A.C.L.N., Ltd.; Abderrazak "Aldo" Labiad; Joseph J.H. Bisschops; Alex de Ridder; Pearlrose Holdings International S.A.; Emerald See Marine, Inc.; Scott Investments S.A.; BDO International (Cyprus); Minas Ioannoud; and Christakis Ionnau (Defendants); and Scandinavian Car Carriers A/S; Pandora Shipping, S.A.; Sergui, Ltd; Westbound Developments Corp.; Maverick Commercial, Inc.; and DCC Limited (Relief Defendants)*

This matter involved the filing of a civil injunctive action in the U.S. District Court for the Southern District of New York against ACLN, Ltd., a Cyprus corporation operating from Antwerp, Belgium that shipped used cars to North and East Africa.[163] ACLN's com-

158. *Id.*
159. *Id.*
160. SEC v. Royal Dutch Petroleum Co., SEC Litigation Release No. 18844, 83 SEC Docket 1984 (Aug. 24, 2004).
161. *Id.*
162. *Id.*
163. SEC v. A.C.L.N., Ltd., SEC Litigation Release No. 17776, 2002 SEC LEXIS 2552 (Oct. 8, 2002); SEC v. A.C.L.N., Ltd., SEC Litigation Release No. 18888, 83 SEC Docket 2358 (Sept. 16, 2004).

mon stock was traded on the NASDAQ National Market System and on the NYSE until March 18, 2002, when it was de-listed following an SEC trading suspension.[164]

The SEC's complaint alleged that those that controlled ACLN—the company's former President Abderrazak "Aldo" Labiad, the company's former CEO Joseph J.H. Bisschops, and the company's former COO Alex de Ridder, used the company to perpetrate a financial fraud that resulted in losses of hundreds of millions of dollars to U.S. investors. The complaint also named three offshore corporations through which the Commission claims the three engaged in improper stock transactions, the company's former auditors, BDO International, two BDO Cyprus partners,[165] and six relief defendants. The complaint alleged that from 1998 through 2001, Labiad, Bisschops and de Ridder caused ACLN to misrepresent its revenues and income, fabricate a new car sales operation that never existed, and claim ownership of assets that did not exist or that it did not own. The SEC claimed that ACLN did not own the largest physical asset on its balance sheet, a car-carrier vessel, and that it significantly inflated the value of the vessel. The complaint cites the company's financial statements for the nine month period ending September 30, 2001 as an example of misrepresentation, claiming that ACLN claimed to have bank deposits of over $117 million at a time when its actual balance was less than $2 million.

The SEC alleged that BDO International (Cyprus), the company's auditors, furthered the scheme "by failing to conduct even the most basic audit procedures that would have detected ACLN's financial fraud and forgery of bank account statements."[166]

According to the SEC, Labiad, Bisschops, and de Ridder sold over $80 million in ACLN stock at inflated prices as a result of the scheme.

On September 13, 2004, the SEC entered into a settlement agreement with defendants ACLN, Labiad, and relief defendant Scandinavian Car Carriers requiring the disgorgement of approximately $27.6 million from various accounts frozen in Europe.[167] The court's order requires that Labiad disgorge the equivalent of $332,222 held in bank accounts in Monaco; that ACLN disgorge approximately $3.3 million that the SEC repatriated from the Netherlands to the U.S. in 2003; and that Scandinavian Car Carriers disgorge approximately $24 million from its bank account in Denmark.[168]

Pursuant to the settlement, Labiad consented to an order permanently barring him from acting as an officer or director of any public company whose securities are registered with the Commission, and enjoining him from future violations of the U.S. federal securities laws.[169] ACLN consented to an order enjoining it from future violations of the U.S. federal securities laws, and consented to the entry of a Commission order revoking the registration of its securities.[170]

164. *See* SEC Litigation Release No. 17776, 2002 SEC LEXIS 2552.

165. BDO International and the two audit partners at BDO Cyprus entered into a settlement agreement with the SEC. This agreement is reviewed in the section of this outline discussing the SEC's assertion of jurisdiction over foreign auditors. *See infra* discussion Part II.D.2.

166. *See*SEC Litigation Release No. 18888, 83 SEC Docket 2358.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

The SEC worked with agencies of several governments in investigating this matter, and in freezing approximately $45 million in bank accounts in Denmark, the Netherlands, Luxembourg, and Monaco.[171]

8. *SEC v. Lernout & Hauspie Speech Products, N.V., Civ. No. 02CV01992 (D.D.C.).*

The SEC filed a civil injunctive action against Lernout & Hauspie Speech Products, N.V. (L&H), which was headquartered in Ieper, Belgium and in Massachusetts.[172] L&H traded on NASDAQ and NASDAQ Europe. On February 28, 2003, the U.S. District Court for the District of Columbia entered the permanent injunction, thereby enjoining L&H from violating the antifraud, reporting, books and records, and internal controls provisions of the federal securities laws.[173] In its complaint, the SEC alleged that L&H, which operated as a developer, licensor, and provider of speech and language technologies, engaged in fraudulent schemes designed to inflate its reported revenue and income. According to the SEC, these fraudulent schemes lead to the end of L&H as an operating company and the loss of at least $8.6 billion in market capitalization, affecting investors in Belgium, the United States, and elsewhere. The company filed for bankruptcy reorganization in the United States and Belgium and is currently in liquidation proceedings in both jurisdictions.

The SEC's complaint details a list of alleged misconduct, including:

- Improperly recognizing over $60 million in revenue from transactions with two Belgian entities that were formed for the specific purpose of engaging in transactions with L&H so that L&H could recognize revenue from its own research and development activities. L&H subsequently acquired the two companies on terms that repaid the amounts the companies had paid to L&H, plus a substantial profit. The SEC characterized these transactions as disguised loans that should not have been recognized as revenue.
- Creating a series of Language Development Companies that the company then treated as new customers. According to the SEC, L&H established the private companies and secured funding for them. Many of the companies were incorporated in Singapore, although there were not actual operations there. The managing director of many of the Singapore companies was a Belgian national associated with L&H. L&H allegedly claimed over $100 million in revenue from licensing fees and prepaid royalties it claimed were obtained from these customers. The company did not disclose the true nature of these companies, nor did L&H disclose the fact that funds obtained from these companies were subject to material conditions imposing significant liabilities on L&H.

171. In its announcement of the action, the SEC acknowledged the assistance of, inter alia: INTERPOL; the Belgian Judicial Authorities, including the Office of the Investigating Judge, Antwerp Court, the Prosecuting Officer for Financial Crimes—Antwerp, and the Belgian Federal Police—Money Laundering Unit—Antwerp; the Danish Financial Supervisory Authority; the Danish Ministry of Justicy; the Danish Public Prosecutor for Serious Economic Crime; the Luxembourg Commission de Surveillance du Secteur Financier; the Tribunal de Premiere Instance de Monaco; the Banking, Insurance, and Securities Commission of Norway; the Netherlands Authority for the Financial Markets; the Netherlands Public Prosecution Service, Criminal Assets Deprivation Bureau; and the United Kingdom Financial Services Authority.

172. SEC v. Lernout & Hauspie Speech Prods., N.V., SEC Litigation Release No. 17782, 2002 SEC LEXIS 2573 (Oct. 10, 2002); SEC v. Lernout & Hauspie Speech Prods., N.V, SEC Litigation Release No. 18014, 79 SEC Docket 2206 (Mar. 4, 2003).

173. *See* SEC Litigation Release No. 18014, 79 SEC Docket 2206.

- Improperly recognizing approximately $175 million in sales revenue between September 1999 and June 2000 from its Korean sales operations. The sales recognized by the company were allegedly subject to written and oral side agreements that did not appear in the contract files. Some of these side agreements provided that L&H would not collect licensing fees unless the customer generated sufficient revenue from the L&H software to cover the fees. L&H then engaged in a series of transactions with Korean banks designed to hide the uncollectible receivables by making it appear that the receivables had been factored to the banks on a non-recourse basis when in fact side agreements with the banks provided that L&H secured the debts. The SEC characterized these agreements as "fully secured loans from the banks to L&H Korea, rather than sales of receivables from L&H Korea to the banks."[174]
- Paying down its own receivables by arranging for third parties to purchase the licensing agreements from original customers. The third parties received loans collateralized by L&H Korea but not reflected on the company's books, and used the proceeds to pay L&H Korea through the original customers.

In pursuing the L&H matter, the SEC worked with the Belgian Ministry of Justice pursuant to the provisions of the Mutual Legal Assistance Treaty in effect between the United States and Belgium, and with the Jersey Attorney General.

On March 4, 2003, L&H consented to the entry of an order revoking the registration of its common stock.[175] In its Order, the Commission found that L&H included materially false and misleading information in its financial statements and its Annual Reports for the calendar years 1996 through 1999 and in its Quarterly Reports for the first quarters of 2000.[176]

9. *SEC v. Vivendi Universal, S.A., Jean-Marie Messier, and Guillaume Hannezo*

On December 24, 2003, the SEC filed a settled enforcement action against Vivendi Universal, S.A., its former CEO, Jean-Marie Messier, and its former CFO, Guillame Hannezo.[177] Vivendi is a French company with its corporate headquarters in Paris. Its ADRs trade on the NYSE. Messier is a French citizen who resides in New York, New York. Hannezo is a French citizen who resides in Paris, France, but resided in New York, New York from mid-2001 through at least July 2002. Pursuant to the settlement, Vivendi agreed to a $50 million penalty and Messier agreed to relinquish his claim to a EUR 21 million severance package he negotiated prior to his resignation from Vivendi.[178] In addition, Messier and Hannezo agreed to pay disgorgement and civil penalties that totaled approximately $1.26 million. Messier and Hannezo consented to officer and director bars of ten and five years, respectively.[179]

In its complaint, the SEC alleges that Vivendi, Messier, and Hannezo violated federal securities laws by disguising Vivendi's cash flow and liquidity problems; improperly adjusting accounting reserves to meet EBITDA (Earnings before Interest, Taxes, Depreciation

174. *See* SEC Litigation Release No. 17782, 2002 SEC LEXIS 2573.
175. *See* SEC Litigation Release No. 18014, 79 SEC Docket 2206.
176. *Id.*
177. SEC v. Vivendi Universal, S.A., SEC Litigation Release No. 18523, 81 SEC Docket 3043 (Dec. 24, 2003).
178. *Id.*
179. *Id.*

and Amortization) targets; and failing to disclose material financial commitments. The SEC complaint alleges the following specific conduct:

- During 2001 and the first half of 2002, Vivendi issued misleading statements that falsely portrayed Vivendi's liquidity and cash flow as excellent and strong. These statements were authorized by Messier, Hannezo, and other senior executives.
- In order to meet earnings targets, Vivendi made improper accounting adjustments that raised EBITDA by approximately EUR 59 million during the second quarter of 2001 and by EUR 10 million during the third quarter of 2001.
- Vivendi failed to disclose future financial commitments regarding two of its subsidiaries. The Commission alleged that had Vivendi disclosed the commitments in its SEC filings and in meetings with analysts, questions would have been raised about the company's ability to meet its cash needs.
- Vivendi, Messier, and Hannezo failed to timely disclose all of the material facts about the company's investment in a fund that purchased a 2 percent stake in a Polish telecommunications company in which Vivendi already held a 49 percent stake.

This case marked the first successful litigation pursuant to § 1103 of the Sarbanes-Oxley Act of 2002. The SEC moved the District Court to order Vivendi to place the funds in escrow and the court granted the motion on September 24, 2003.[180] In its litigation release, the SEC acknowledged the assistance of the Autorite' des Marches Financiers, formerly the Commission des Operations de Bourse.[181]

10. *SEC v. Parmalat Finanziaria S.p.A.*

In December 2003, the SEC charged Parmalat Finanziaria S.p.A. with securities fraud.[182] In its complaint, the SEC alleged that from August through November 2003, Parmalat fraudulently offered $100 million of unsecured Senior Guaranteed Notes to U.S. investors by materially overstating the company's assets and materially understating its liabilities. The offering failed after Parmalat's auditors raised questions about certain Parmalat accounts. In support of its allegations, the SEC cited Parmalat's December 19, 2003 press release, in which the company acknowledged that the assets in its 2002 audited financial statements were overstated by at least approximately $4.9 billion. The SEC further alleged that Parmalat falsely stated to U.S. investors that it had used excess cash balances to repurchase corporate debt securities worth approximately $3.6 billion when in fact the excess cash balances did not exist.

On July 28, 2004, the SEC filed an amended complaint. Parmalat consented, without admitting or denying the allegations in the complaint, to the entry of a final judgment settling the matter.[183] In its amended complaint, the SEC alleged that Parmalat used a variety of strategies, such as entering into fictitious loan agreements, assigning debt and uncollectible receivables to nominee entities, using nominees to disguise inter-company loans, and falsely describing the sale of certain receivables, that caused the company to overstate its level of cash and marketable securities by approximately EUR 3.95 billion ($4.9

180. *Id.*

181. *Id.*

182. SEC v. Parmalat Finanziaria S.p.A., SEC Litigation Release No. 18527, 81 SEC Docket 3143 (Dec. 30, 2003).

183. *Id.*

billion) and to understate its debt by approximately EUR 7.9 billion. In addition, the SEC alleged that between 1997 and 2003, Parmalat transferred approximately EUR 350 million to businesses owned and operated by Tanzi family members.

In consenting to the settlement, Parmalat agreed to be permanently enjoined from violating § 10(b) of the Securities Exchange Act and Exchange Act Rule 10b-5, as well as § 17(a) of the Securities Act.[184] Parmalat also agreed to adopt changes to its corporate governance structure.[185] The changes agreed upon in the settlement include adopting by-laws providing for governance by a shareholder-elected board of directors, the majority of which will be independent and serve finite terms; delineating the duties of the board of directors in the by-laws; adopting a Code of Conduct for directors; adopting an insider-dealing Code of Conduct; and adopting a Code of Ethics.[186] In addition, the by-laws will require that the positions of chairman of the board of directors and managing director be held by two separate people. Finally, Parmalat consented to the continuing jurisdiction of the U.S. District Court to enforce the provisions.[187] In its Litigation Release, the SEC acknowledged the assistance of Consob.[188]

C. Insider Trading

Insider trading issues in many respects inaugurated the SEC's international enforcement initiatives. Over twenty years later, insider trading cases are still a force in the exploration of jurisdictional issues and the establishment of the SEC's evolving position regarding assertion of jurisdiction. The rise of complex international brokerage and banking systems promises that this area will continue its role as a primary motivator in the development of SEC policy as it pertains to jurisdiction. The examples below reflect some of the issues that arise in investigating and litigating such cases.

1. *SEC v. Jorge Eduardo Ballesteros Franco, et al.*

This matter relates to an insider trading action brought against eight Mexican nationals and the entities through which they traded. The SEC alleged that Jose Luis Ballesteros Franco, the former director of Nalco Chemical Company tipped his four sons and his brother about an impending merger between Nalco and a French company.[189] One of the sons then allegedly tipped Carlos Minvielle, who then tipped his father, Eugenio Minvielle. The defendants purchased a total of 260,000 Nalco shares, at the time worth approximately $9.8 million, prior to the merger.

The SEC alleged that the Ballesteros family utilized offshore trusts held in different names, as well as trustees located in the Isle of Jersey, along with offshore nominee companies, to execute the purchases. The Ballesteros family also used four different brokerage firms with accounts in both Switzerland and the United States.

On December 9, 2002, the U.S. District Court for the Southern District of New York entered a final judgment against Juan Pablo Ballesteros pursuant to a settlement between

184. *Id.*
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.*
189. SEC v. Franco, SEC Litigation Release No. 16991, 74 SEC Docket 2135 (May 8, 2001); SEC v. Franco, SEC Litigation Release No. 17035, 75 SEC Docket 459 (June 13, 2001).

Juan Ballesteros and the SEC.[190] The judgment ordered Juan Ballesteros to pay a penalty of $106,403.75.[191] He had previously paid an identical amount in disgorgement as well as prejudgment interest as part of an earlier settlement. He was convicted on February 27, 2002 of insider trading and was sentenced on June 4, 2002 to 15 months imprisonment, a $40,000 fine, and two years of supervised release.[192]

On October 21, 2003, the U.S. District Court for the Southern District of New York entered a final judgment against Jorge Eduardo Ballasteros, the former Chairman of Grupo Mexicano de Desarrollo, S.A.[193] Jorge Ballasteros was the brother of Jose Ballasteros Franco. The complaint in this matter alleged that, after receiving the tip from his brother regarding the impending merger, Jorge Ballesteros directed the purchase of 153,300 Nalco shares through two offshore companies, Gianni Enterprises Limited and Sagitton Limited that were owned by family trusts. The Commission alleged that after the June 28, 1999 public announcement concerning the merger, Jorge Ballesteros directed that the Nalco stock be sold, resulting in illegal profits of $2,271,109.

The final judgment was entered pursuant to a settlement between Jorge Ballasteros and the SEC.[194] Without admitting or denying the allegations in the Commission's complaint, Jorge Ballesteros consented to the entry of the judgment that directed him to pay a penalty of $2,573,875.[195] In light of the settlements with Jorge Ballasteros and with the estate of Jose Ballesteros, the Commission filed a notice voluntarily dismissing its claims against the corporate and trust vehicles through which Jorge Ballesteros traded.

In a related matter, the SEC filed a civil injunctive action against another Mexican businessman and a company owned by his family in the British Virgin Islands.[196] In *SEC v. Pablo Escandon Cusi and Lori LTD.*, the SEC alleged that Pablo Escandon was also tipped by Jose Ballesteros as to the Nalco merger.[197] The complaint alleges that Escandon, the Chairman and CEO of Nadro S.A. de C.V., Mexico's second largest pharmaceutical distributor, purchased 50,000 shares of Nalco stock through the brokerage account of Lori Ltd., a company owned by the Escandon family and incorporated in the British Virgin Islands. After the merger was announced, Escandon and Lori Ltd. sold their shares and realized a profit of $776,725.

The parties entered into a settlement agreement whereby Escandon and Lori Ltd. consented to pay a total of $1,716,546, representing disgorgement of $776,725, prejudgment interest in the amount of $163,096, and a penalty of $776,725.[198] In the course of its investigation, the SEC received assistance from, inter alia, the Swiss Federal Office of Justice and the Isle of Jersey Financial Services Commission.

The SEC has also reached a settlement agreement in *SEC v. Hugo Salvador Villa Manzo and Multinvestments, Inc.*[199] The SEC had alleged that Hugo Salvador Villa, the Chairman

190. SEC v. Walsh, SEC Litigation Release No. 17896, 2002 SEC LEXIS 3193 (Dec. 17, 2002).

191. *Id.*

192. *See* SEC Litigation Release No. 16991, 74 SEC Docket 2135.

193. SEC v. Franco, SEC Litigation Release No 18441, 81 SEC Docket 1703 (Nov. 3, 2003).

194. *Id.*

195. *Id.*

196. SEC v. Pablo Escandon Cusi and Lori Ltd., SEC Litigation Release No. 17356, 2002 SEC LEXIS 319 (Feb. 7, 2002).

197. *Id.*

198. *Id.*

199. SEC v. Manzo, SEC Litigation Release No. 17485, 77 SEC Docket 1356 (Apr. 24, 2002).

and part owner of a Mexican public company that indirectly owns Multinvestments, Inc., directed Multinvestments to purchase 50,000 shares of Nalco based on a tip from Jose Ballesteros. Multinvestments realized approximately $558,750 from the transaction. Pursuant to the settlement, the court entered an order enjoining Villa from future violations of the antifraud provisions of the securities laws, and also ordered Villa and Multinvestments, Inc. to pay $1,503,471.83 representing $558,750 in disgorgement, $106,596.83 in prejudgment interest and a civil penalty of $838,125.[200] Villa also settled a related administrative proceeding with the SEC. The settlement agreement bars him from associating with any broker dealer or investment adviser.[201]

2. *SEC v. Alejandro Duclaud Gonzalez de Castilla, et al.*

The defendants in this matter were Mexican nationals with access to offshore accounts. The SEC alleged that the individuals and the offshore entities through which they traded had engaged in insider trading related to the purchase of CompUSA, Inc. stock prior to the announcement of Grupo Sanborns, S.A. de C.V.'s acquisition of CompUSA.[202] The lead defendant, Alejandro Duclaud, was a partner in a law firm that represented Grupo Sanborns in the negotiations leading up to the acquisition. The defendant, along with family members, purchased approximately 750,000 shares of CompUSA prior to the announcement of the acquisition, and sold those shares shortly after the announcement. The defendants allegedly realized approximately $4 million in profits from the transactions. An interesting aspect of this case is that while the U.S. District Court for the Southern District of New York granted the SEC's request for a preliminary injunction freezing the assets of the defendants in an amount equal to four times the alleged profits of the scheme; it denied the request for a preliminary injunction against future violations of the federal securities laws. The court relied on the fact that the defendants lived abroad and used off-shore trading accounts in making its finding that there was a danger that the defendants might transfer assets beyond the jurisdiction of the United States absent the preliminary injunction.[203]

On February 8, 2002, Judge Robert Sweet granted defendants' motion for summary judgment as to the SEC's allegations of securities law violations related to the purchase of CompUSA stock.[204] The court did permit the SEC to add claims related to the purchase of stock of another company.[205] In granting the motion for summary judgment, the court found that there was no evidence that the defendants had come into possession of material non-public information and that there existed widespread public speculation regarding the acquisition of CompUSA prior to the purchases by the defendants. The court also found that the SEC failed to establish the existence of a tipper and therefore could establish neither a duty to a tipper nor a breach of such duty.

In granting the SEC's motion to amend its complaint, the court found that the motion to amend would result in a new cause of action based on purchases related to SBC Communications Inc.'s acquisition of an interest in Prodigy, but that the allegations based on

200. *Id.*

201. *Id.*

202. SEC v. Gonzalez de Castilla, SEC Litigation Release No. 16997, 2001 SEC LEXIS 890 (May 11, 2001).

203. SEC v. Gonzalez de Castilla, 145 F. Supp. 2d 402 (S.D.N.Y. 2001).

204. *Id.*

205. SEC v. Gonzalez de Castilla, 184 F. Supp. 2d 365 (S.D.N.Y. 2002).

the purchases of stock in El Globo, Inc. would not constitute a separate cause of action.[206] The court found that the allegations and evidence before it established that

> (i) El Globo stock trades on the Mexican Bolsa; (ii) the defendants who are alleged to have traded in the stock are all Mexican citizens residing in Mexico; and (iii) the El Globo transaction took place entirely in Mexico, is governed by Mexican law, and is subject to the jurisdiction of the Mexican authorities.[207]

The court therefore found that there was no basis for subject matter jurisdiction. The court stated that the allegations related to El Globo "do not constitute the basis for a cause of action but simply, potentially . . . evidence of intent" under the Federal Rules of Evidence."[208]

On December 19, 2002, the SEC entered into a settlement agreement with Alejandro Duclaud Gonzalez de Castilla, Rodrigo Igartua Baranda, and their respective offshore trusts with regard to the Prodigy trades. According to the amended complaint, Duclaud's firm represented Prodigy's owner in the SBC transaction. Duclaud allegedly tipped his friend, Ignacio Guerrero Pesqueira,[209] and his brother-in-law, Igartua, about the impending purchase by SBC of a large interest in Prodigy. The complaint alleges that in the month preceding the November 22, 1999 announcement of SBC's purchase, Guerrero and Igartua purchased 59,100 shares of Prodigy through offshore trusts, then sold the shares at a substantial profit and transferred $148,300 to Duclaud's offshore trust as a kickback.[210]

Pursuant to the settlement agreement, the defendants consented to the judgments without admitting or denying the allegations. The court permanently enjoined the defendants from violating the antifraud provisions of the federal securities laws and ordered Duclaud to pay $182,895 in disgorgement and prejudgment interest, as well as a $57,105 civil penalty.[211] Igartua was ordered to pay $25,375 in disgorgement and interest, as well as a $7,925 penalty.[212]

3. *SEC v. Levy*

This matter involved an action against six Panamanian residents who allegedly purchased the stock of iDial Networks, Inc. while in the possession of material nonpublic information concerning iDial's August 23, 2003 merger with GlobalNet, Inc.[213]

In its complaint, the SEC alleged that Leon Levy and Yanni Abecassis were present as consultants to iDial at iDial-GlobalNet merger negotiations in Panama. After obtaining material, nonpublic information, Levy allegedly opened a brokerage account with a Texas-based broker and purchased 12,500,000 shares of iDial. According to the SEC, Levy and Abecassis then tipped friends and family members, who combined to purchase an additional 24,050,000 shares of iDial prior to the announcement of the merger.

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206. *Id.*
207. *Id.* at 381.
208. *Id.* at 382.
209. Guerrero settled his matter with the SEC in May of 2001. *See* SEC Litigation Release No. 16997, 2001 SEC LEXIS 890.
210. SEC v. Gonzalez de Castilla, SEC Litigation Release No. 17903, 2002 SEC LEXIS 3208 (Dec. 19, 2002).
211. *Id.*
212. *Id.*
213. SEC v. Levy, SEC Litigation Release No. 18584, 82 SEC Docket 927 (Feb. 20, 2004).

The SEC filed an emergency action on February 24, 2004, seeking an accounting; an asset freeze; an order prohibiting the destruction or alteration of documents; expedited discovery, and a repatriation order. The court granted the emergency relief.

D. Jurisdiction Over Foreign Auditors and Foreign Affiliates

1. *Auditor Independence—Moret Ernst & Young*

On June 27, 2002, the SEC announced a settled enforcement action against the Dutch accounting firm Moret Ernst & Young, now known as Ernst & Young Accountants, with regard to its relationship with a Dutch company.[214] This action is the first auditor independence case brought against a foreign audit firm. It also resulted in the first civil penalty imposed for an alleged auditor independence violation. The SEC censured the Dutch auditor for engaging in improper professional conduct within the meaning of Rule 102(e) of the SEC's Rules of Practice, and ordered it to take certain remedial steps to avoid future independence problems. In addition, the company agreed to pay a $400,000 civil penalty. Moret consented to the order without admitting or denying the SEC's findings.

The SEC's Order alleged that from 1995-1997, Moret audited financial statements of Baan Company, N.V., a business software company headquartered in the Netherlands whose stock was quoted on the NASDAQ National Market. According to the SEC, consultants affiliated with Moret had joint business relationships with Baan during this time, including projects designed for the Moret affiliates and Baan to jointly implement software products for third parties and to develop faster software implementation tools. The Moret affiliates and Baan also engaged in joint marketing efforts emphasizing their partnership, and Baan used Moret consultants as subcontractors and temporary employees in servicing Baan clients. The SEC alleged that Moret consultants billed Baan approximately $1.9 million from the joint business relationships during the period of 1995-1997. Baan disputed approximately $328,000 of this amount, which the SEC alleged further impaired Moret's independence as an auditor.[215]

In commenting on the fact that Moret was a foreign auditor, Paul Berger, an Associate Director of Enforcement at the SEC stated that "[a]uditor independence has no geographic limitations.... Regardless of location, auditors have a fundamental obligation to ensure their independence. Investors have a right to expect that any audit firm, foreign or domestic, has no improper business ties to its audit client."[216]

2. *In the Matter of BDO International, Minas Ioannou and Christakis Ioanno*

This matter related to the SEC's action against ACLN.[217] BDO International and the two audit partners named as respondents agreed to settle this matter.[218] Pursuant to the

214. *See* Press Release, SEC, SEC Censures Dutch Ernst & Young Firm and Orders it to Pay $400,000 Civil Penalty (June 27, 2002), *available at* www.sec.gov/news/press/2002-95.htm.

215. The SEC also alleged that Moret's U.S. affiliate, Ernst & Young, lacked independence from Baan and that Ernst & Young performed audit work with regard to Baan upon which Moret relied in its 1997 external audit of Baan. In re Moret Ernst & Young Accountants, Exchange Act Release No. 46130, 77 SEC Docket 2954 (June 27, 2002).

216. Press Release, SEC, SEC Censures Dutch Ernst & Young Firm and Orders it to Pay $400,000 Civil Penalty (June 27, 2002), *available at* http://www.sec.gov/news/press/2002-95.htm.

217. The case is discussed *supra* at Part II.B.7.

218. In re BDO International, Exchange Act Release No. 46880, 2002 SEC LEXIS 2989 (Nov. 21, 2002).

settlement agreement, the respondents neither admitted nor denied the SEC's allegations related to their conduct. The respondents consented to a judgment permanently enjoining them from committing or aiding and abetting violations of the U.S. securities laws and agreed to disgorgement of all audit and other fees received from ACLN.[219] Minas Ioannou and Christakis Ioannou were suspended from appearing before the SEC.

The complaint alleged that BDO International (Cyprus) was an accounting firm with its primary address in Cyprus. It is the Cyprus member firm of BDO International, a worldwide network of professional accounting and consulting firms. Minas Ioannou was then Managing Partner of BDO International (Cyprus) and the managing partner on the ACLN engagement. As such, he signed BDO International's audit reports with regard to ACLN. Christakis Ioannou was a certified accountant at the firm and the engagement manager on the ACLN engagement. The SEC alleged that neither had any training or experience in applying U.S. Generally Accepted Accounting Principles (GAAP) or U.S. Generally Accepted Auditing Standards (GAAS).

The complaint alleged that BDO International was not independent from ACLN, and that its audits of ACLN were not conducted in accordance with GAAS. Specifically, the SEC claimed that the entity that prepared ACLN's records was owned and managed by BDO International employees, including one who worked on the ACLN audit, and other family members of BDO International partners. In addition, the SEC alleged that the financial statements audited by BDO International were not prepared in conformity with GAAP. The SEC claimed that the audit reports were false and misleading with respect to statements regarding BDO International's independence and compliance with GAAS and the conformity of the ACLN financial statements with GAAP. The complaint alleged that the respondents knew or were reckless in not knowing that the audit reports were false and misleading, and that they did not independently verify information provided by ACLN. As a result, ACLN was able to submit false invoices and bank records, overstate the revenue from its used car business, and further overstate its revenue by relying on a new car sales line of business, accounting for over 50 percent of its revenue, that did not exist.

3. *In the Matter of Moore Stephens Chartered Accountants (United Kingdom) and Peter D. Stewart, FCA*

In an example of the potential for reciprocal discipline among regulators in auditor oversight cases, on May 5, 2004, the Investigation Committee of the Institute of Chartered Accountants in England and Wales (Institute) announced that Consent Orders had been issued against the firm of Moore Stephens Chartered Accountants (United Kingdom) and Peter D. Stewart, FCA a partner of Moore Stephens.[220] In its litigation release, the SEC described the action as the first known disciplinary action brought by the Institute based on a complaint by the Commission. The SEC described the Institute's action as the result of cross-border cooperation between the Commission and the Institute on this auditor oversight matter.[221]

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219. *Id.*

220. In re Moor Stephens Chartered Accountants (UK), SEC Litigation Release No. 18695, 82 SEC Docket 2894 (May 5, 2004).

221. *Id.*

In the Institute matter, Moore Stephens consented to an order of a severe reprimand, a fine of £35,750 and the payment of costs.[222] Stewart consented to an order that included a reprimand, a fine of £3,000, and costs.

The conduct giving rise to the disciplinary action, and upon which the SEC's own action was based, related to the issuance of a report on the consolidated financial statements of the Cronos Group,[223] for the year ending December 31, 1996, which stated that Moore Stephens Chartered Accountants had conducted its audit in accordance with GAAS in the United States, when, according to the SEC, this was not the case.

According to the SEC's litigation release regarding the U.S. enforcement action, Stewart, the engagement partner on the audit, and two other auditors engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[224] The SEC alleged that Moore Stephens UK became the auditors of Cronos after Arthur Andersen UK resigned when it failed to receive support for a $1.5 million disbursement by the company, was denied access to the results of a corporate investigation into related party transactions, and after Cronos' board refused to investigate the $1.5 million payment, forged and false confirmations, and other related party transactions.

The SEC alleged that John L. Harbor, another Moore Stephens auditor on the engagement, learned from Arthur Andersen what had caused it to resign, but subsequently received a different explanation as to what caused the resignation from Stefan Palatin, then the Chairman and CEO of the Cronos Group. Nevertheless, Moore Stephens UK accepted the engagement. The SEC alleged that Stewart and the other Moore Stephens UK accountants chose to accept management's representations regarding the issues that had caused Arthur Andersen's resignation and to audit around the issues rather than question them.

In agreement to settle the SEC matter, Stewart, Harbor, and another Moore Stephens accountant consented to the entry of an order pursuant to Rule 102(e) without admitting or denying the underlying factual allegations.[225] As part of the agreement, Stewart consented to an order barring him from appearing or practicing before the Commission; Harbor and the other Moore Stephens auditor were censured.[226]

III. The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (the Act) carries the promise of significant expansion of U.S. jurisdiction over U.S. and foreign private issuers in the U.S. market, as well as U.S. and foreign audit firms conducting audits for such issuers. The Act has resulted in massive rulemaking efforts by the SEC and the newly created Public Company Accounting Oversight Board (PCAOB).[227] The result of these efforts is a drastic transformation of the regulatory landscape with respect to antifraud measures and the manner in which the accounting profession is regulated.

222. *Id.*

223. According to the SEC, the Cronos Group was a Luxembourg holding company headquartered in England until 1999 and in San Francisco, California after 1999. *Id.* During the relevant time period, the Cronos Group was a foreign private issuer as defined by Exchange Act Rule 3b-4. *Id.*

224. *See* In re Stewart, SEC Litigation Release No. 46157, 77 SEC Docket 3087 (July 2, 2002).

225. *Id.*

226. *Id.*

227. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204.

A. Potential Impact on Non-U.S. Issuers

In addition to complaints from the international regulatory community regarding the expansion of jurisdiction resulting from the Act, the Act is causing non-issuers to reevaluate the desirability of participating in the world's largest capital market. While it is unlikely that the implementation of the Act will result in a mass exodus from the U.S. markets, some foreign issuers have indicated that the new regulations will cause them to reconsider listing on American exchanges.[228] The SEC continues to evaluate whether to grant exemptions to foreign issuers with regards to certain Act requirements that conflict with the local law of the issuer's home jurisdiction.[229] Some of the provisions of the Act that impact foreign issuers are listed below.

1. *CEO/CFO Certifications of Financial Reports*

Foreign issuers are subject to the provisions of the Act requiring, pursuant to § 906, that the CEO and CFO of companies filing reports on Form 20-F or Form 40-F with the SEC to certify in writing that the information in the report fairly presents, in all material respects, the financial condition and results of operations of the public company.[230]

In addition, § 302 of the Act requires that in each quarterly and annual report filed with the SEC, the CEO and CFO certify in writing that

- The officer has read the report;
- To the officer's knowledge, the report does not contain any untrue statement of material fact, or omission of material fact that would make the report misleading;
- The information in the report fairly presents, in all material respects, the financial condition and results of operations of the public company;
- The officer has participated in designing internal controls designed to prevent fraud;
- The officer has disclosed to the auditors and audit committee all significant deficiencies in internal controls and any fraud, whether material or not to the company's financial statements; and
- Whether there were significant changes in internal controls implemented after the officer's evaluation of the report.[231]

The Act provides for criminal sanctions for knowingly submitting a false certification.

2. *Prohibition of Loans to Directors and Executive Officers*

The loan prohibition remains applicable to foreign issuers. Public companies are prohibited from arranging for personal loans to any director or executive officer of the company, nor can it make material changes to existing loan agreements.[232]

228. *See, e.g.* Craig Karmin, *SEC's Exemption Gets Some Praise*, Wall St. J., Jan. 13, 2003, at C16 (reporting that "German auto maker Porsche AG announced that it was no longer considering a listing on the New York Stock Exchange, citing conflicts with Sarbanes-Oxley").

229. As of the publication of this outline, the SEC has proposed a number of modifications to the law where there were conflicts with rules in foreign jurisdictions. The proposals are subject to a 30-day comment period and could be altered before becoming final.

230. Sarbanes-Oxley Act § 906.

231. *Id.* § 302.

232. *Id.* § 402.

3. *Reimbursement of Bonuses and Profits*

Foreign issuers are subject to the provisions of the Act requiring the CEO and CFO of public companies to forfeit any bonuses or other compensation, incentive or equity based, and any profits from the sales of the securities of the public company by the officer, received during the twelve month period following the issuance of a financial report, if the company was required to issue a restatement of those financial results due to misconduct.[233]

4. *Independent Audit Committees*

In reaction to complaints from the international community, the SEC has exempted foreign issuers from the Act's requirement that companies are required to have audit committees comprised entirely of independent directors.[234] The requirement was modified to include a provision that the requirement applies where provided for by local law in order to address situations where employee representatives may be required to serve on the audit committee. In addition, the concerns of international regulators and issuers were addressed by permitting shareholders to appoint outside auditors for foreign companies. The Act requires that, for domestic companies, the independent directors appoint the auditor.

5. *Enhanced Criminal Penalties*

Foreign issuers, as well as their officers and directors, are subject to the enhanced criminal penalties of the Act.

6. *Regulation G—Use of non-GAAP Measures*

The SEC exempted foreign issuers from the requirement in the Act that companies explain financial information that does not conform to U.S. GAAP. Absent the exemption, foreign issuers, such as U.K. companies applying U.K. GAAP, would have been required to include in their financial statements a reconciliation of the information in the statements with the information that would have appeared in the statements had the company followed U.S. GAAP. The SEC described the exemption as follows:

> Regulation G will provide a limited exception for foreign private issuers where (1) the securities of the issuer are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States; (2) the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with generally accepted accounting principles in the United States; and (3) the disclosure is made by or on behalf of the issuer outside the United States, or is included in a written communication that is released by or on behalf of the issuer outside the United States.[235]

B. Impact on Issuers of the Requirements Imposed on Foreign Audit Firms and Foreign Affiliates of U.S. Audit Firms

As discussed below, accounting firms are required to attempt to obtain client waivers that will remove any foreign legal impediment to a foreign accounting firm providing the PCAOB consent with respect to disclosure of a client's information. This requirement

233. *Id.* § 304.
234. *Id.* § 301.
235. Press Release, SEC, SEC Adopts Rules on Provisions of Sarbanes-Oxley Act (Jan. 15, 2003), *available at* www.sec.gov/news/press/2003-6.htm.

impacts U.S. multinationals with foreign subsidiaries as well as foreign private issuers audited by U.S. firms. Issuers should understand that they will be approached by accounting firms requesting such waivers. It is important that issuers understand the purpose of the consents and the protections an issuer may be waiving in the particular jurisdiction.

From the perspective of the issuer, the new requirements raise significant issues on several fronts, including data protection, confidentiality, and whether the issuer has the power to execute an effective waiver in some jurisdictions. Notwithstanding these concerns, the PCAOB requirements for auditors appear to be relatively absolute. There is no explicit exception based on legal impediments in foreign jurisdictions. Issuers will need to carefully analyze the information provided to auditors to insure compliance with local regulations as well as compliance with requirements imposed by auditors in connection with obtaining the audit opinions necessary for SEC filings. In this regard, it is interesting to note that while issuers themselves are not required to consent to production of documents and information to the SEC, the Act has created for all practical purposes, an indirect requirement.

C. Potential Impact on Foreign Audit Firms and Foreign Affiliates of U.S. Audit Firms

The requirements of the Act will change virtually every aspect of the auditor/client and auditor/affiliate relationship. The provisions of relevant portions of the Act are noted below:

1. *Applicability to Certain Foreign Firms*

a. Firms Preparing Audit Opinions

Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer is subject to the Act in the same manner as a public accounting firm that is organized and operates under the laws of the United States.[236] This includes the requirement that the firm register with the PCAOB. In addition, the PCAOB is empowered to determine that a foreign public accounting firm, or a class of firms, that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that is necessary or appropriate to subject the foreign public accounting firm to the requirements of the Act and related SEC and Board rules.

b. Associated Persons

Section 102 of the Act provides that a registering accounting firm must obtain consents from associated persons of the registering firm. The required consent includes an agreement by the associated person to provide testimony and documents upon request by the PCAOB.[237] The PCAOB Rules provide that, in circumstances where non-U.S. laws preclude the firm from providing certain information or consents, the firm may submit a legal opinion to that effect in lieu of providing the information as part of the PCAOB registration application.[238]

236. Sarbanes-Oxley Act § 106.

237. *Id.* § 102.

238. *See* Public Company Accounting Oversight Board's Rule 2105, Conflicting Non-U.S. Laws (June 9, 2004), *available at* http://www.pcaobus.org/Rules/Rules_of_the_Board/. Note that § 106 of the Sarbane-Oxley Act does not contain a similar exception.

2. *Production of Audit Work Papers*

As noted above, the production of client information and audit work papers may be illegal in some jurisdictions, regardless of whether the audit firm obtains a client's consent.

a. Consent to Production

i. Consent by foreign firms. Section 106 of the Act deems certain foreign accounting firms to have consented to the production of their audit work papers for the PCAOB or the SEC in connection with any investigation, and to be subject to federal court jurisdiction for enforcement of any request to produce those papers, if the firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report.[239]

ii. Consent by domestic firms. A registered public accounting firm that relies upon the opinion of a foreign public accounting firm in issuing all or part of any audit report or any opinion contained in an audit report is deemed:

- To have consented to supplying the audit work papers of that foreign public accounting firm in response to a request for production by the Board or the SEC; and
- To have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.[240]

b. Maintenance of Audit Documentation

Section 103(a)(2)(A)(i) of the Act, requires that the PCAOB adopt a standard that registered public accounting firms "prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report."[241] Consistent with that provision, the PCAOB has issued Auditing Standard No. 3—Audit Documentation. The stated purpose of the Rule is to enhance oversight by enabling a full and fair recreation of the entire audit. Part 18 of Auditing Standard No. 3 requires that audit documentation supporting the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms), must be retained by or be accessible to the office issuing the auditor's report. The initial version of the proposed rule would have required that non-U.S. audit work papers for audits of U.S. issuers be shipped to the United States. The final rule instead followed the Proposed Amendment to Interim Auditing Standards and would require that auditors at the U.S. firm's office that is signing the audit opinion retain or have access to the audit documentation so that it can review, inter alia, the documentation of other auditors, including affiliated firms, who audit a subsidiary, an affiliate, or a division of the SEC issuer.

D. Continuing Challenges

U.S. and foreign regulators continue to negotiate regarding potential exemptions and modifications to the Act's provisions with respect to foreign audit firms. In the event that

239. Sarbanes-Oxley Act § 106.
240. *Id.*
241. *Id.* at § 103.

these negotiations do not lead to a mutually satisfactory implementation of the Act, foreign audit firms, and indirectly foreign issuers, face the possibility that the lack of cooperation in asserting global standards could lead to a morass of intersecting and sometimes contradictory regulation.

IV. Anti-Money Laundering: The USA-Patriot Act

Cross border accounts beget cross border funds transfers that in turn implicate anti-money laundering regulation. Anti-money laundering regulation has drastically altered the way firms do business. For example, where in the past a firm might have thought little of establishing extraterritorial accounts and transferring funds to and from different jurisdictions for a variety of business purposes, a firm must now carefully analyze such transfers for compliance with its regulatory obligations.

As a result, firms are revisiting virtually every component of how accounts are opened and reviewed to improve the chances that inappropriate business is turned away and that suspicious activity is uncovered. With respect to foreign clients, the Office of Foreign Assets Control (OFAC) review will only be the beginning of a process of due diligence, not the end. Similarly, the risks associated with opening and maintaining an account for a client located outside of the United States will no longer be limited to potential foreign prosecution, but now may be more likely to include close scrutiny, if not worse, from regulators and enforcement authorities in the United States.

The USA-Patriot Act requires financial institutions, including broker-dealers and unregistered investment companies, to implement anti-money laundering compliance procedures. The regulatory obligations described below are applicable to the United States, but provide insight into the concerns of the regulatory community at large.

A. Anti-Money Laundering Compliance Procedures

- Establish and implement policies, procedures and internal controls reasonably designed to address the risk factors with regard to money laundering associated with the company's business;
- Provide for independent testing for compliance to be conducted by company personnel or by a qualified outside party, which should result in a written report;
- Designate a person or persons responsible for implementing and monitoring the operations and internal controls of the program; and
- Provide ongoing training for appropriate persons.

B. Client Account Procedures

1. *Opening New Accounts: General Customer Due Diligence*

Know your customer requirements constitute the core component of a company's commitment to deterring money laundering. This generally means obtaining reasonable information about both clients and beneficial owners and performing reasonable follow up diligence. This information should include, at a minimum:

- The identity of the client and beneficial owner of the account;
- The nature of the client's and beneficial owner's business;

- The source of the client's and beneficial owner's assets; and
- The intended purpose of the client's and beneficial owner's transactions.

2. *Doing Business with Persons Located Outside of the United States*

In addition to the sales and solicitation and cross border trading issues discussed above, foreign accounts, including accounts for persons who are not U.S. citizens and accounts for clients who are located outside of the United States, implicate anti-money laundering concerns. Companies should implement policies and procedures designed to address the requirements implicated by circumstances such as the following:

- Opening an account for a non-U.S. citizen or a person with a foreign address.
- Maintaining an account when a client moves to a foreign country or from one foreign country to another.
- Maintaining an account that conducts transactions in one or more jurisdictions included in the OFAC or Non-Cooperative Countries and Territories Lists.
- Maintaining an account that conducts transactions involving a foreign shell bank or correspondent account.
- Transactions by senior foreign political figures or their close associates

C. Ongoing Reviews of Client Accounts

A company's vigilance regarding money laundering does not end once an account is opened. The company must continue to review existing accounts to identify changes in circumstance such as the following:

- A change in the identity of the client or beneficial owner of the account;
- A change in the circumstances or source of assets of the client or beneficial owner;
- A change in the method of investment or payment;
- Whether the account appears to be serving the purpose for which the client and/or beneficial owner stated it was intended; and
- Whether there have been any suspicious developments regarding the client, beneficial owner, account or any transaction such that further review might be appropriate.

D. Suspicious Activity Reporting

Financial institutions[242] located in the United States are required to file Suspicious Activity Reports (SARs). If a company is required to file SARs, the company should establish

242. The USA-Patriot Act defines "financial institutions" as including: an insured bank; a commercial bank or a trust company; private bankers; an agency or branch of a foreign bank in the United States; any credit union; a thrift institution; a broker or dealer registered with the SEC under the Securities Exchange Act of 1934; a broker or dealer in securities or commodities whether or not registered; an investment banker or investment company; a currency exchange; an issuer, redeemer or cashier of traveler's checks, checks, money orders or similar instruments; an operator of a credit card system; an insurance company; a dealer in precious metals, stones or jewels; a pawnbroker; a loan or finance company; a travel agency; a licensed sender of money or any other person who engages as a business in the transmission of funds, formally or informally; a telegraph company; a business engaged in vehicle sales; persons involved in real estate closings and settlements; the United States Postal Service; an agency of the federal or any state or local government carrying out a duty or power of business described in the definition of a "financial institution"; a state-licensed or Indian casino with annual gaming revenue of more than $1,000,000; and certain other businesses designated by Treasury. USA Patriot Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

procedures for filing and educating its employees as part of the anti-money laundering compliance program.

V. Conclusion

The dynamic nature of the global securities markets has required regulators and courts to assess the effectiveness of existing regulatory schemes, and to develop new and creative measures to enhance market integrity and protect investors. Securities regulators will undoubtedly continue to explore their authority to investigate violations of the federal securities laws both by agreement and in foreign courts as the global markets expand and develop. Unquestionably, as world markets have evolved, the success of U.S. regulators in achieving effective cooperation with foreign counterparts is chiefly related to the evolution of laws similar to our own in countries around the world. In fact, assistance now is sought from the SEC as often as the SEC seeks it. The greatest challenge for regulators will be to keep pace with rapidly evolving markets and dramatic advances in technology.

Ironically, the expansion of regulation of markets worldwide and better cooperation is resulting in a limitation of the power of U.S. regulators to act as *parens patrie* for the global marketplace. For the first time, U.S. courts have begun to reevaluate the expansive interpretation of U.S. jurisdiction. This limitation on the assertion of authority by the United States reflects the understanding that in some circumstances, regulators in another jurisdiction may have a greater interest in enforcement against securities law violators and, more importantly, that sufficient regulatory protection exists in those jurisdictions to justify the reluctance of the SEC and the U.S. courts to become involved. The recent enactment of the Sarbanes-Oxley Act constitutes an attempt to return to the *parens patrie* role, but its reception by the international community may cause U.S. regulators to reevaluate its practical implementation.