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Expert Analysis

Competing Approaches to FCPA Enforcement: Recent Cases Diverge

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It happens very rarely. Two judges in the same federal district court simultaneously have SEC cases before them involving alleged violations of the Foreign Corrupt Practices Act (FCPA). In both cases, a defendant moves to dismiss on the face of the complaint, arguing, among other things, that the court lacks personal jurisdiction. In both cases, the defendant never set foot in the United States. One judge rules for the SEC. The other rules for the defendant. Although the second decision makes an effort to distinguish the first, the two opinions leave the reader at a loss to articulate a guiding principle that should apply to the jurisdictional question raised in both cases. Here is how this came to pass.

Personal Jurisdiction Prongs

On Dec. 29, 2011, the Securities and Exchange Commission initiated an action in the Southern District of New York, *SEC v. Elek Straub*. The complaint alleged that executives of a Hungarian telecommunications company named Magyar Telekom, Plc. engaged in a scheme to bribe public officials from both political parties in Macedonia's coalition government. The defendants filed a motion to dismiss the complaint arguing, among other things, that the court lacked personal jurisdiction over them. In a recent decision, U.S. District Judge Richard J. Sullivan denied the defendants' motion. *SEC v. Straub*, 2013 WL 466600 (S.D.N.Y. Feb. 8, 2013).

As Sullivan wrote, the personal jurisdiction issue has two prongs: Did the defendants have "minimal contacts" with the United States, and does the assertion of personal jurisdiction comport with principles of fair play and substantial justice?[1] Addressing the "minimal contacts" prong first, and relying on *In re Parmalat Sec. Litig.*, 376 F.Supp.2d 449, 455 (S.D.N.Y. 2005), the court looked to three factors in deciding the minimal contacts issue: (1) "whether the defendant's actions caused effects in the United States"; (2) "whether those effects were direct and foreseeable results of those actions"; and (3) "whether [the defendant] knew or had good reason to know that [his] conduct would have effects here." *Straub* at *6 (footnote omitted).

With regard to the first factor, the court found that the defendants' actions "caused effects in the United States" based on the fact that the defendants were alleged to have submitted false representation letters to Magyar's auditors,[2] who in turn, relied on those representations in providing an unqualified audit opinion to accompany Magyar's annual report to the SEC on Form 20-F. The defendants argued that the effects that the SEC had to allege were not just the auditors' submission of an unqualified audit opinion accompanying Magyar's annual report to the SEC, but also investors' reliance to their detriment on the allegedly false SEC filings. The court rejected this argument, holding that the "SEC does not bear the burden of alleging that investors relied to their detriment on the concealment of Defendants' bribery scheme." Id. at *8.[3]

With regard to the second factor, the court found that the effects in the United States that were caused by the defendants' actions were the "direct and foreseeable results" of the defendants' false representation letters to Magyar's auditors. As articulated by the court, this was an objective test. In other words, the court found that the SEC needed to allege and prove only that the false SEC filings were objectively foreseeable to anyone engaged in a bribery scheme of a company whose American Depositary Receipts (ADRs) were listed on the New York Stock Exchange.

As for the third factor, the court focused on the SEC's allegations regarding the defendants' state of mind, concluding that the SEC had adequately alleged that the defendants "knew or had good reason to know" that their false representation letter would have the necessary effects in the United States. Id. at *7. On this point, the court concluded that the defendants were "sophisticated actors who knew that Magyar listed ADRs on the NYSE and that the allegedly fraudulent financial reports would be filed with the SEC." Id. at *8.

In sum, a fair reading of the court's analysis is that the SEC had sufficiently alleged "minimal contacts" with the United States by showing that the defendants made false certifications to Magyar's auditors, knowing (or having reason to know) that Magyar's auditors would not have provided an unqualified audit opinion to accompany Magyar's annual report to the SEC if they had been aware of the sham contracts and the false certifications.

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A Different View

Now let's compare Sullivan's analysis of the minimal contacts requirement with Judge Shira Scheindlin's opinion 11 days later in *SEC*

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v. Sharef, 2013 WL 603135 (S.D.N.Y. Feb. 19, 2013). *Sharef* involved alleged bribes paid by Siemens Business Services (SBS) to Argentine politicians to obtain a $1 billion project to create national identity cards in Argentina (the DNI contract). Siemens Aktiengesellschaft (Siemens) and its Argentine affiliate, Siemens IT Services S.A. (SITS), submitted a bid in December 1996 and won the project in February 1998. A contract was entered into the following November.

After a change of government in Argentina in late 1999, the new president of Argentina, Fernando De la Rua, notified Siemens S.A. Argentina (Siemens Argentina) that the DNI contract would be terminated unless Siemens agreed to renegotiate its terms. The defendant Herbert Steffen, who had left Siemens Argentina in 1991, was asked by codefendant Uriel Sharef (a member of Siemens' Managing Board) to renegotiate the DNI contract on behalf of Siemens Argentina.

While those negotiations were underway, other Siemens managers also renegotiated the contract. This separate group informed Siemens that past and present Argentine officials were demanding a total of $27 million in corrupt payments to secure the entry of a decree by the new president reauthorizing the DNI contract. On Jan. 3, 2001, Siemens, through its operating group SBS, signed a $27 million sham consulting contract whose sole purpose was to funnel bribe payments to Argentine government officials without detection. The bribery scheme was not disclosed to the auditors of SBS, or to auditors of the company that owned SBS, Siemens.

One of the defendants in the *Sharef* case, Bernd Regendantz, was the CFO of SBS after February 2002. He allegedly approved the bribes and "signed quarterly and annual certifications pursuant to the Sarbanes-Oxley Act falsely representing the financial statements of SBS. These certifications were presented to auditors and SBS and Siemens in connection with the companies' quarterly and annual audits." Id. at *4 (footnotes omitted.)

The defendant, Herbert Steffen, moved to dismiss the complaint against him for lack of personal jurisdiction, and the court granted his motion. The allegations regarding Steffen were spare. It was alleged that in the 1980s and in 1991, Steffen had been CEO of Siemens SA Argentina, a wholly owned subsidiary of Siemens. From 1996 until his retirement in 2003, he was group president of Siemens Transportation Systems. The complaint alleged that in 2000, Steffen was recruited to help with the bribery scheme because of the connections he had in Argentina during his earlier tenure at Siemens Argentina.

The complaint in *Sharef* did not allege that Steffen participated in a cover-up of the bribes. Instead, other defendants allegedly were involved in the creation of fictitious documents to hide those bribes. Nor was there any allegation that Steffen had any knowledge of the quarterly and annual certifications submitted by Regendantz to auditors and SBS and Siemens in connection with the companies' quarterly reviews and annual audits. On these facts, Scheindlin ruled that the SEC had not sufficiently alleged that Steffen had minimal contacts with the United States.

In her opinion, Scheindlin specifically cited Sullivan's opinion in *Straub*, and distinguished that case on the grounds that in *Straub*, the defendant "orchestrated a bribery scheme directed at the Macedonian government *and* as part of the bribery scheme signed off on misleading management representations to the company's auditors and signed false SEC filings." Id. at *7 (emphasis in original). On close examination, however, these grounds to distinguish the *Straub* case appear flawed.

When it comes to the minimal contacts test, the 'Straub' and 'Sharef' opinions both address the issue of the extent of the connection between the defendant's conduct abroad and the company's false filing with the SEC.

Scheindlin was correct that the SEC did not allege that Steffen participated in the cover-up in Argentina; however, elsewhere in her opinion, Scheindlin argued that participating in the cover-up of a bribe is not enough to confer personal jurisdiction on a defendant who did not act in the United States: "illegal corporate behavior almost always requires cover ups, which to be successful must be reflected on financial statements. Thus, under the SEC's theory, every participant in illegal activity taken by a foreign company subject to U.S. securities laws would be subject to the jurisdiction of the U.S. courts no matter how attenuated their connection with the falsified financial statements. This would be akin to a tort-like foreseeability requirement, which has long been held to be insufficient." Id. (footnote omitted).

This quote raises interesting questions. How "attenuated" to the falsified financial statements must the defendant's acts be in order to defeat personal jurisdiction? Can the different results in *Straub* and *Sharef* be reconciled on the ground that the defendants in *Straub* made written certifications to Magyar's accountants, whereas the defendant in *Sharef* was not alleged to have communicated with Siemen's accounting firm? Given Scheindlin's rejection of a "tort-like foreseeablility requirement to satisfy the minimum contacts requirement of personal jurisdiction," it does not seem that it should matter whether the defendants simply participated in the bribery scheme or falsely denied to auditors the existence of such a scheme.

Scheindlin's final observation to distinguish *Straub*—that the defendants in *Straub* "signed false SEC filings"—does not apply to two of the three defendants. In the *Straub* case, the defendants Andras Balogh and Tamas Morvai only "signed management sub-representation letters for quarterly and annual reporting periods…" Id. at *7. There was no allegation that they signed any SEC filings.

Conclusion

When it comes to the minimal contacts test, the *Straub* and *Sharef* opinions both address the issue of the extent of the connection between the defendant's conduct abroad and the company's false filing with the SEC. Sullivan emphasized the defendants' participation in the cover-up and their representations to the companies' auditors. Scheindlin downplayed the importance of a defendant's participation in a cover-up, even though the defendant in that case had not been accused of participating in the cover-up.

Scheindlin wrote in her opinion: "…[T]he exercise of jurisdiction over foreign defendants based on the effect of their conduct on SEC filings is in need of a limiting principle." *Sharef* at * 7. However, the opinions in *Straub* and *Sharef* do not establish "a limiting principle" that can be applied in all FCPA cases. Instead, these opinions appear to emphasize different kinds of behavior in resolving the matter of personal jurisdiction. *Straub* emphasized the defendants' participation in the cover-up. *Sharef* emphasized the defendants' role (or no role) in preparing false financial statements.

In the end, therefore, the reader is left to wonder what future judges will emphasize in FCPA cases brought by the SEC on the issue of minimal contacts.[4]

1. The courts' discussion of the second prong will be discussed in a future article.

2. A review of the relevant SEC filings shows that Magyar's auditors were in Hungary.

3. The defendants also argued that the SEC had to allege and prove that the trading harm to investors as a result of the false SEC filing was "significant." Having ruled that the SEC need not prove that investors relied to their detriment on the false filing, the court had no trouble holding that the SEC did not have to prove that the investors' trading harm was "significant." Id. at *8.

4. Sullivan's decision also addressed at some length the issue of whether the statute of limitations is tolled in FCPA cases when the defendant is not present in the United States.

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