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In Seeking Documents Abroad, Does the SEC's Reach Exceed Its Grasp?

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The globalization of markets has led to an increasing number of international disputes over the applicability of domestic laws to individuals and corporations located abroad. In two previous columns, we examined issues relating to extradition of individuals and the various laws and policies affecting extradition determinations.[1] In this column, we examine less provocative but no less complex issues relating to what essentially amounts to the extradition of documents: the ability of the Securities and Exchange Commission (SEC) to compel U.S. corporations to produce corporate documents located abroad.

Many aspects of the SEC's jurisdiction are currently being tested in a number of forums. In *Morrison v. National Australia Bank*, the U.S. Supreme Court issued a landscape-shifting opinion that set limits on the reach of Section 10(b) claims over foreign securities transactions.[2] In the Southern District of New York, two recent opinions reached divergent results in addressing the limits of the SEC's personal jurisdiction over foreign individuals.[3] In the case of *SEC v. Deloitte Touche Tohmatsu CPA*, (*Deloitte Tohmatsu*) in the District of Columbia, another issue is coming to a head.[4] The decision pending on a motion by the SEC in *Deloitte Tohmatsu* will for the first time address certain aspects of the SEC's authority to compel production of foreign documents. Depending on the outcome, the opinion will be cited either by the SEC or by international corporate defendants in federal courts throughout the country.

'Deloitte Tohmatsu' Dispute

Deloitte Touche Tohmatsu CPA Ltd. (DTTC) is a limited liability corporation headquartered in Shanghai. DTTC is an audit and professional service firm with its operations located primarily in Shanghai. It is registered in the United States as a public accounting firm. It is part of the Deloitte network, which is a large and diffuse group of independent legal entities located throughout the world. These entities are organized under UK-based Deloitte Touche Tohmatsu Limited (DTTL). In the United States, Deloitte LLP is a member of DTTL.[5]

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In 2007, DTTC began auditing Longtop Financial Technologies Ltd., a software corporation incorporated in the Cayman Islands but with its operations located in China. Longtop's American depository shares traded on the New York Stock Exchange. In 2010, DTTC's audits revealed potential fraud at Longtop, and in May 2011 DTTC performed a noisy withdrawal. Its resignation letter, which detailed potential indicia of fraud, was filed by Longtop in an SEC Form 6-K. The SEC thereafter also began an investigation into Longtop and eventually delisted its shares.[6] The SEC commenced an administrative action against Longtop on Nov. 10, 2011.[7]

Prior to commencing its administrative action, the SEC filed the *Deloitte Tohmatsu* action in the District of Columbia seeking an order to show cause to compel DTTC to produce its audit work papers regarding Longtop. Both sides have briefed the motion and a decision is pending.

The dispute involves many issues. The primary concern for DTTC is that China has laws prohibiting the sort of disclosure the SEC is seeking and China's securities regulator, the China Securities Regulatory Commission (CSRC), has expressly forbidden DTTC from producing its Longtop work papers to the SEC. Apparently, violations of Chinese disclosure laws are punishable by imprisonment. DTTC argues that it has complied fully with its obligations under U.S. securities laws and that it is essentially stuck in a dispute between regulators in two countries. It accuses the SEC of knowing this and failing to work out a solution with the CSRC through diplomatic channels.[8] Although some of these issues are specific to a dispute involving China, the core issue—the extent of the SEC's authority to compel production of documents located abroad—can potentially affect any U.S. corporation with business interests located abroad.

SEC Authority to Compel

In *Deloitte Tohmatsu*, the SEC notes that it has the authority to issue subpoenas under Section 21(b) of Securities Exchange Act of 1934 (Exchange Act) and Section 19(c) of the Securities Act of 1933 (Securities Act). The SEC can also seek to compel production under Section 21(c) of the Exchange Act and Section 22(b) of the Securities Act.[9]

DTTC counters by arguing that Sections 21(b) of the Exchange Act and 19(c) of the Securities Act both limit the SEC's authority by stating only that documents or evidence "may be required from any place in the United States"; in other words, the SEC may not require production of materials located outside the United States. According to DTTC, the best proof of this limitation was the need for the enactment in 2002 of Section 106 of the Sarbanes-Oxley Act.[10] Section 106 states that if a foreign accounting firm provides service upon which a registered public accounting firm relies, the foreign

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accounting firm is deemed to have consented to the SEC's authority to subpoena and compel production of its work papers. Ergo, according to DTTC, the SEC did not have this authority before under Sections 21(b) of the Exchange Act and 19(c) of the Securities Act.[11]

DTTC next notes that the Dodd-Frank Act amended the Sarbanes-Oxley provision to include what DTTC calls a safe harbor provision. This provision, codified in 15 U.S.C. §7216(f), states that the SEC "may allow a foreign public accounting firm that is subject to this section to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission or the Board." According to DTTC, this provision was specifically added for cases like *Deloitte Tohmatsu*, where compulsion of production of documents abroad might violate foreign laws. DTTC argues that this provision anticipates that the SEC will attempt to resolve such disputes by working directly with foreign securities regulators. For good measure, DTTC also cites the watershed *Morrison* opinion for the proposition that legislation only applies within the United States unless it specifically states an intention for extraterritorial application.[12]

Both sides, however, have to contend with textual hurdles. The safe harbor provision upon which DTTC relies certainly authorizes the SEC to permit a foreign accounting firm to satisfy its obligation through a foreign securities regulator. Yet, the safe harbor provision does not require it. Instead, Section 7216(f) states that the SEC "may" permit such a resolution, which is very different than the magic word "shall." To date, no court has issued an opinion interpreting Section 7216(f).

For its part, the SEC chooses not to fight on such limited ground. Instead, the SEC stakes a wider claim by arguing that Section 7216 is irrelevant. According to the SEC, its basic authority to subpoena materials under Sections 21(b) of the Exchange Act and 19(c) of the Securities Act covers the materials sought from DTTC. The SEC argues that the language in Sections 21(b) and 19(c) that DTTC calls "limiting"—that materials "may be required from any place in the United States"—refers only to the place where production must be made. The SEC contends that where a subpoena is validly issued and served, this "limiting language" requires only that responsive documents must be produced within the United States.[13]

The SEC and DTTC in *Deloitte Tohmatsu* also engage in numerous sub-arguments over issues such as whether acceptance by DTTC's U.S. counsel of service of the subpoena essentially waived any extraterritorial challenge, and whether DTTC's U.S. counsel actually controlled the materials requested. Courts have previously touched on these and similar issues in older cases mostly involving other federal agencies, but relevant authorities are scarce and no recent opinion directly addresses the nuanced arguments advanced in *Deloitte Tohmatsu*.

The SEC contends that this is simply because the issue is long-settled, but DTTC advances plausible arguments to distinguish prior cases. DTTC also points to *FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson*, an intriguing U.S. Court of Appeals for the D.C. Circuit opinion where the court seemed to indicate that a party challenging the method of service of a federal agency's subpoena would also be able to challenge the agency's authority to compel production of documents located abroad.[14] The D.C. Circuit did not indicate which way it would have ruled, but seemed perplexed as to why the argument was not made.

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Conclusion

The issues in *Deloitte Tohmatsu* do not lend themselves to simple resolution. The SEC rightly argues that courts in many scenarios have ordered production of documents located abroad. Indeed, it is not uncommon for parties resisting discovery demands to argue that production of documents located abroad may violate foreign law. Foreign banking institutions have made such claims for years. Resolution of the issues often turns on the comity analysis articulated in *Société Nationale Industrielle Aérospatiale v. U.S. Dist. Court*.[15]

Globalization of markets and regulation suggest that U.S. courts may be more receptive to the arguments against production raised by DTTC—notably the specific objection made by the Chinese securities regulators and the apparent failure of the SEC to pursue alternative means. Moreover, the watershed *Morrison* case has created an environment in which courts are likely to take a fresh look at challenges to the applicability of securities laws and their enforcement by the SEC, particularly where, as in *Deloitte Tohmatsu*, the precedent upon which the parties rely is older, factually distinguishable and frankly somewhat murky. Indeed, a March 13, 2013, oral argument on the SEC's application apparently lasted three hours and a decision remains pending.[16]

Whatever the decision, it will undoubtedly be cited either by the SEC or by international corporate defendants in federal courts throughout the country, including New York. Depending on the result, the SEC could also seek further legislation to bolster its authority or clarify the applicability of the so-called safe harbor provision found in Section 7216(f). Regardless, the dispute in *Deloitte Tohmatsu* is one part of a litany of active disputes over the extraterritorial reach of U.S. securities laws and their enforcement by the SEC. Given the globalized marketplace, and the current trend toward closer regulation of financial firms, we can expect many more such disputes in the near future.

1. Nicholas M. De Feis and Philip C. Patterson, "Last Chance: Secretary of State's Discretion to Deny Extradition Requests," NYLJ, Jan. 30, 2013; Nicholas M. De Feis and Philip C. Patterson, "Citizenship a Good Defense Against Extradition—but Not in U.S.," NYLJ, Dec. 14, 2012.

2. 130 S. Ct. 2869, 177 L. Ed. 2d 535 (2010).

3. See *SEC v. Straub*, No. 11 CV 9645, 2013 U.S. Dist. Lexis 22447 (S.D.N.Y. Feb. 8, 2013); *SEC v. Sharef*, No. 11 CV 9073, 2013 U.S. Dist. Lexis 22392 (S.D.N.Y. Feb. 19, 2013); see also Lawrence S. Bader, "Competing Approaches to FCPA Enforcement: Recent Cases Diverge," NYLJ, April 5, 2013.

4. No. 11 MC 512 (GK) (DAR) (D.D.C. filed Sept. 8, 2011).

5. See "About Deloitte," available at http://www.deloitte.com/view/en_US/us/About/index.htm.

6. See Declaration of Lisa Deitch in Support of SEC Application for Order to Show Cause, Docket No. 1-2, No. 11 MC 512 (GK) (DAR) (D.D.C. filed Sept. 8, 2011).

7. *In the Matter of Longtop Financial Technologies*, SEC Admin. Proc. No. 3-14622, Exchange Act Release No. 65734 (Nov. 10, 2011).

8. See DTTC's Statement of Points and Authorities Opposing the SEC's Application for Order to Show Cause and Order Requiring Compliance with a Subpoena, Docket No. 23, No. 11 MC 512 (GK) (DAR) (D.D.C. filed Sept. 8, 2011) (DTTC Brief).

9. See SEC's Memorandum of Points and Authorities in Support of Application for Order to Show Cause and Order Requiring Compliance with a Subpoena, Docket No. 1-1, No. 11 MC 512 (GK) (DAR) ("SEC Brief") (citing 15 U.S.C. §78u(b), 15 U.S.C. §77s, 15 U.S.C. §78u(c) and 15 U.S.C. §77v(b), respectively).

10. 15 U.S.C. §7216.

11. See DTTC Brief, supra note 9, at 15-17.

12. See id. at 17-18.

13. See SEC's Reply Memorandum in Support of Its Application for Order Requiring Compliance with Subpoena, at 5, Docket No. 38, No. 11 MC 512 (GK) (DAR).

14. See SEC Brief at 5-11; DTTC Brief at 20-22 (citing *FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson*, 636 F.2d 1300 (D.C. Cir. 1980)).

15. 482 U.S. 522 (1987). The factors include (1) the importance to the litigation of the documents requested, (2) the degree of specificity of the request, (3) whether the documents originated in the United States, (4) the availability of alternative means of acquiring the documents, and (5) the extent to which noncompliance with the request would undermine important interests of the United States, or compliance with the request would undermine the important interests of the state where the documents are located.

16. See Mike Scarcella, "In Subpoena Spat with Deloitte, No Easy Day for SEC Lawyers," American Lawyer, March 14, 2013.