UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

U.S. SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. ELEK STRAUB, ANDRAS BALOGH, and TÁMAS MORVAI, Defendants.	Case No. 11-Civ-9645 (RJS)

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM IN OPPOSITION TO THE DEFENDANTS' JOINT MOTION TO DISMISS THE COMPLAINT

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Plaintiff, the U.S. Securities and Exchange Commission ("SEC"), responds as follows to the joint motion to dismiss the complaint submitted by defendants Elek Straub, Andras Balogh, and Támas Morvai (collectively, "defendants").

PRELIMINARY STATEMENT

The three defendants were corporate executives of Magyar Telekom, Plc. ("Magyar"), a Hungarian telecommunications company and a subsidiary of Deutsche Telekom, AG ("Deutsche Telekom"). Both Magyar and Deutsche Telekom were publicly-traded and filed their financial statements with the SEC during the relevant time period. The complaint alleges that the defendants perpetrated a scheme to bribe government officials in Macedonia in order to secure business for Magyar in that country, and, as part of their bribery scheme, the defendants falsified the company's books and records, circumvented internal controls, lied to auditors, and caused the company to file inaccurate quarterly and annual reports with the SEC.

The defendants move to dismiss the complaint, arguing that (1) the Court lacks personal jurisdiction; (2) the SEC's claims are time-barred; (3) the complaint fails to allege facts supporting the SEC's anti-bribery claims; and (4) the complaint fails to allege facts supporting the SEC's lying to auditors claims. The Court should deny the motion on all four grounds.

First, the defendants are subject to personal jurisdiction because their conduct caused foreseeable consequences in the United States. The complaint alleges that the defendants orchestrated a bribery scheme in Macedonia; that they concealed their bribes through the use of sham contracts and falsified books and records; that they lied to Magyar's auditors by signing false annual and quarterly certifications; and that their actions caused Magyar to file annual and quarterly reports with the SEC in the United States that misrepresented the company's financial statements and included false Sarbanes-Oxley certifications.

Second, the complaint was timely filed within the statute of limitations set forth at 28 U.S.C. § 2462. That provision expressly states that the limitations period does not begin to run until the defendants are "found within the United States." The defendants acknowledge in their brief that they have remained outside of the United States since their commission of this scheme. Thus, the statute of limitations period has not begun to run as to them. In any event, claims for equitable relief are not subject to the limitations period of Section 2462, which by its terms applies only to "penalties."

Third, the complaint pleads all facts necessary to support every element of every claim against the defendants.[1] The defendants met the "interstate commerce" prong of Exchange Act Section 30A, 15 U.S.C. § 78dd-1, by sending, in furtherance of their bribery scheme, electronic mail messages that were routed through servers located in the United States. Because the use of interstate commerce is a jurisdictional element, the Exchange Act does not require that defendants know, let alone "corruptly" intend, that their messages would reach the United States. The complaint sufficiently identifies the foreign officials whom the defendants bribed; Section 30A does not require that the officials be expressly named. And the complaint sufficiently identifies the specific false statements made by each defendant to Magyar's auditors and why those statements were material.

FACTUAL ALLEGATIONS

The complaint alleges that, in 2005 and 2006, defendants Straub, Balogh, and Morvai devised and engaged in a corrupt scheme to bribe Macedonian government and party officials.

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[1] The defendants' motion does not challenge the legal sufficiency of the SEC's third and fourth claims for relief, alleging violations of Sections 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B), and 78m(b)(5)); and Rule 13b2-1 (17 C.F.R. § 240.13b2-1) promulgated thereunder.

Comp. ¶¶ 18-19. In return for €4.875 million in secret, under-the-table payments, Magyar received competitive advantages in the Macedonian telecommunications market. *Id*. The payments were routed through a third-party intermediary by means of a series of sham marketing and consulting contracts. *Id*. As part and parcel of the scheme, the defendants falsified the books and records of Magyar, circumvented the company's internal accounting controls, lied to the company's auditors, and caused the company to file erroneous annual and quarterly reports with the SEC in the United States.[2]

1. The Scheme to Bribe Government Officials in Macedonia

Magyar is the largest telecommunications company in Hungary. *Id.* at ¶ 14. It operates subsidiaries in Macedonia, Montenegro, and other countries. *Id*. In Macedonia, Magyar operates through Makedonski Telekommunikacii A.D. Skopje ("MakTel"), the former state-owned telecommunications services provider in that country. *Id.* at ¶ 15. MakTel is jointly owned by Magyar and the Macedonian government. *Id*.

In early 2005, the Macedonian Parliament enacted a new Electronic Communications Law, which liberalized the telecommunications market and threatened Magyar's business. *Id.* at ¶ 20. The law authorized the licensing of a third mobile telephone operator, which would have created a new direct competitor for MakTel. *Id.* The law also increased frequency fees and imposed other regulatory burdens on MakTel. *Id*. In response, Straub, Balogh, and Morvai hatched a scheme to negotiate a deal with officials in Macedonia's coalition government. *Id.* at

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[2] The complaint alleges that the defendants engaged in two corrupt schemes, one in Macedonia and the other in Montenegro. As the SEC has previously advised the Court, the complaint's anti-bribery claims are based solely on the allegations involving Macedonia. To the extent that the defendants challenge the factual sufficiency of the complaint, those contentions focus almost entirely on Macedonia. Accordingly, the SEC's statement of facts focuses principally on the Macedonia allegations.

¶ 21. In return for bribes, the officials would see to it that the law's impact on MakTel was mitigated. *Id*.

a. The Protocol of Cooperation

Magyar's Macedonian subsidiaries retained an intermediary, a Greek "lobbying consultant," to negotiate with government officials. *Id.* at ¶ 22. The negotiations, which took place in April and May 2005, resulted in a secret agreement -- a "Protocol of Cooperation." *Id*. Under the Protocol of Cooperation, senior Macedonian government officials agreed to ensure that the government would delay or block the creation of a third mobile telephone business and exempt MakTel from the increased frequency fee. *Id.* In return, the government of Macedonia would receive a €95 million dividend payment from MakTel, and the officials behind the deal would receive undisclosed bribe payments. *Id.*

In May 2005, two virtually identical versions of the Protocol of Cooperation were executed, one with officials of the ruling party and the other with members of the ethnic Albanian minority party, which was part of the coalition government and controlled the key telecommunications regulatory agencies. *Id.* at ¶ 27. Straub, Balogh, and Morvai acknowledged among themselves that the minority political party would "torpedo [or 'wreck'] the agreement within 2 months if [they did not] pay" bribes to the minority officials. *Id*. The two Protocols of Cooperation were signed by defendants Straub and Balogh. *Id.* at ¶¶ 23, 30.

Part of the payoff to the minority party was Magyar's creation of a patronage opportunity. Under the terms of a Letter of Intent executed by defendant Straub, Magyar would, through another Macedonian subsidiary, construct a mobile telecommunications infrastructure in a neighboring country. The minority political party would have the right to designate the

operator of the new telecommunications business, which would be built on Magyar's network backbone. *Id.* at ¶ 29.

To prevent public disclosure of the secret deal, the only executed original copies of the Protocols of Cooperation were retained by the Greek intermediary. *Id.* at ¶¶ 24, 30. No signed copies were retained in Magyar's files. *Id*. The existence and purpose of the agreement were kept secret within the company, known only to Straub, Balogh, Morvai, and a few others**.** *Id*.

b. The Payment of Bribes Through Sham Contracts

In order to induce the officials in the ruling and minority parties to enter into the Protocols of Cooperation, the defendants offered to pay up to €10 million in bribes, in three installments, to senior Macedonian government officials. *Id.* at ¶ 26. The first installment, totaling €4.875 million, was made to the government officials through the Greek intermediary under sham "success fee based" contracts for "consulting" or "marketing" services. *Id*. The contracts served no legitimate business purpose, and no bona fide services were rendered under them. *Id.* at ¶ 32. The contracts were intended instead to function as a channel for the corrupt payments. *Id*. In communications among themselves, Straub, Balogh, and Morvai referred to the routing of payments through such sham contracts using the code "logistics." *Id*.

In email messages and memoranda, the defendants discussed how to handle the "logistics" of the corrupt payments. *Id*. In June 2005, Balogh proposed to "structure" the payments as "success fee based" contracts. *Id.* at ¶ 31. Balogh volunteered to "be present when signing the contracts or [to] meet[] with the representatives of both sides and inform[] them about the source of the money." *Id*. The defendants also discussed how the bribe payments should be allocated. *Id.* at ¶ 28. In handling payments to the minority party, Balogh proposed: "[W]e could pay, for instance EUR 2 million, one million each to a Macedonian and an Albanian

consulting firm . . . or we could pay the Albanians only one million each in two installments." *Id*. In June 2005, Balogh requested that the Greek intermediary provide the defendants with "feedback, after the transaction, from high level representatives of both sides acknowledging that they received what we promised." *Id.* at ¶ 34.

The sham consulting and marketing contracts through which the bribes were paid served no legitimate business purpose and concealed the fact that the contract payments were in fact intended to be used as bribes. *Id.* at ¶ 35. The phony contracts were supported by false performance certificates or fabricated evidence of performance. *Id*. And in many cases, the contracts were purportedly success-based, but were backdated and entered into after the contingencies had already been satisfied. *Id*.

The defendants structured the sham contracts to circumvent Magyar's internal controls. *Id.* at ¶ 36. The amount of the payments called for were consistently set just below thresholds that would have required Board approval. *Id.* In some cases, the contracts and performance certificates were re-executed to name different contracting parties as a means to avoid "attract[ing] too much attention." *Id.*

Magyar ultimately received the benefits promised in the Protocol of Cooperation. As a result of the corrupt payments, the Macedonian government delayed the introduction of a third mobile telephone competitor until 2007, when a new administration came into power. *Id.* at ¶ 38. The government also reduced the frequency fee tariffs imposed on MakTel. *Id.*

c. Use of Interstate Commerce

Electronic mail messages in furtherance of the scheme, including those transmitting drafts of the Protocol of Cooperation and Letter of Intent, and copies of sham consulting contracts, were transmitted through the instrumentalities of United States interstate commerce.

Id. at ¶ 39. The electronic mail messages originated in Europe, but were routed through and stored on network servers in the United States. *Id*. Several such messages were sent or received by defendant Balogh. *Id*.

d. The Defendants Destroyed Evidence.

When Magyar's auditors raised questions about the sham contracts, leading to an internal investigation within the company, Balogh and Morvai destroyed, and attempted to destroy, evidence of the bribery scheme. In February 2006, Balogh and Morvai attempted to "wipe" (i.e., permanently erase) from their computers copies of documents that memorialized elements of the bribery scheme. *Id.* at ¶ 21. Balogh also tried to erase from his computer the memorandum in which he volunteered to "be present when signing the contracts" and advise officials from the majority and minority parties "about the source of the money" they would receive. *Id.* at ¶ 31.

2. The Defendants Falsified Magyar's Books and Records and Made False Statements to Auditors.

By virtue of their roles in the bribery scheme, defendants Straub, Balogh, and Morvai knowingly caused the books and records of Magyar to be rendered false. *Id.* at ¶¶ 40, 65-67. The €4.875 million paid to Macedonian government officials were booked falsely as legitimate operating expenses, such as "consulting or marketing services." *Id.* at ¶¶ 6, 67. Straub, Balogh, and Morvai knew that the booking of these payments was false. *Id.* at ¶ 66. The supporting contracts and performance certificates were fictitious. *Id.* at ¶ 35.

As senior corporate officials, *Id.* at ¶¶ 11-13, Straub, Balogh, and Morvai were also charged with making certifications to Magyar's auditors regarding the accuracy of the company's financial statements and the adequacy of its internal controls. *Id.* at ¶¶ 63-64. All three defendants falsified their certifications in connection with the company's 2005 financial statements. *Id.* at ¶ 62.

Between July 2005 and January 2006, Straub signed management representation letters to Magyar's auditors certifying that (1) "all financial records and related data" had been made available to the auditors; (2) he was "not aware of any . . . transactions . . . not fairly described and properly recorded in the financial and accounting records underlying the financial statements"; and (3) he was "not aware of any violations or possible violations of laws or regulations." *Id.* at ¶ 63. All these statements were false. *Id.*

Defendants Balogh and Morvai signed management sub-representation letters to Magyar's auditors for quarterly and annual reporting periods in 2005. *Id.* at ¶ 64. Each letter certified that "all material information" relating to his area of the company "was disclosed accurately and in full (actuals and accruals) and in agreement with the subject matter of the management representation letter." *Id.* These statements were equally false. *Id.*

The statements were false because the defendants failed to disclose the existence of the Protocols of Cooperation, the Letter of Intent to the minority political party, or the scheme to bribe Macedonian government and party officials. *Id.* at ¶ 68. The statements were false because payments under sham contracts had been booked as legitimate expenses. *Id.* at ¶¶ 66-67. The statements were also false because the defendants had authorized and failed to disclose a second set of phony contracts, *Id.* at ¶¶ 47-49, 53-58, in connection with a separate corrupt scheme, *Id.* at ¶¶ 41-47, 69, in Montenegro. Had Magyar's auditors known these facts, they would not have accepted the defendants' representations, nor would they have provided an unqualified audit opinion to accompany Magyar's annual report, filed with the SEC on Form 20-F. *Id.* at ¶ 70.

3. The Defendants' Contacts with the United States

Straub, Balogh, and Morvai were senior executive officers, *Id.* at ¶¶ 11-13, of Magyar, a public company that was registered with the SEC in the United States and whose securities traded on the New York Stock Exchange. *Id.* at ¶ 14. As a registrant, Magyar filed annual and quarterly reports, along with other filings, with the SEC. *See* 15 U.S.C. § 78m(a). All of Magyar's filings were made available to and relied upon by analysts and investors in the United States.

Each of the defendants played a critical role in the content and preparation of Magyar's SEC filings. As Chairman and CEO, defendant Straub was effectively the "public face" that Magyar presented to the United States capital markets. Straub signed Magyar's FY 2004 annual report on Form 20-F, which was filed with the SEC on May 11, 2005.[3] Ex. 1. In connection with the 2004 report, Straub signed Sarbanes-Oxley certifications representing, among other things, that he had disclosed to Magyar's auditors and the audit committee "[a]ll significant deficiencies and material weaknesses" in Magyar's internal controls and "any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting." *Id*. Straub signed his May 11, 2005, certifications simultaneously with his negotiation of the Macedonia bribe scheme and only two weeks before he and Balogh signed the secret Protocols of Cooperation. Comp. ¶¶ 22-23.

During the pendency of the bribery scheme, Magyar filed six quarterly reports on Form 6-K with the SEC. Ex. 1. Straub signed one of these reports on August 10, 2006. *Id*. All six quarterly reports contained an extensive discussion and analysis of Magyar's business operations

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[3] The allegations here regarding Magyar's annual and quarterly SEC filings go beyond the four corners of the SEC's complaint. However, as the defendants note, Def. Br. at 12 n.9, the Court may take judicial notice of relevant public sources, such as required SEC filings. *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991).

under the heading, "Elek Straub, Chairman and CEO commented: . . . ." *Id*. Defendant Straub's personalized quarterly commentary typically included a discussion of Magyar's operations in Macedonia and Montenegro. *Id*. As noted above, in connection with every quarterly SEC filing, Straub signed a management representation letter to Magyar's auditors. Comp. ¶ 63. On July 3, 2006, when Magyar announced that its 2005 annual report would be delayed by the internal investigation of the conduct forming the basis of this lawsuit, it was defendant Straub who signed the Form 12b-25 SEC filing. Ex. 1.

The role that defendants Balogh and Morvai played in the preparation of Magyar's SEC filings was less conspicuous but equally critical. As noted above, in connection with each annual and quarterly SEC filing, Balogh and Morvai signed sub-certifications in support of the management representation letters provided to Magyar's auditors. Comp. ¶ 64. The auditors relied on the Magyar's management representation letters in providing their audit opinions. *Id.* at ¶ 70.

The defendants each played key roles not only in preparing Magyar's SEC filings, but in falsifying those filings as well. By conspiring to make bribe payments to government officials and then funnel those payments through a series of sham contracts, backed up by phony accounting entries, *Id*. at ¶¶ 2, 6, all three defendants took actions that they knew would taint the company's quarterly and annual financial statements and render the company's 2005 year-end Sarbanes-Oxley certifications false.

The corrupt payments that the defendants made could not have been booked as "bribes" on the company's general ledger without alerting Magyar's auditors. Indeed, the very purpose of using sham contracts was to conceal the payments as legitimate operating expenses, *Id.* at ¶ 32, with fictitious paperwork to back up the phony general ledger entries. The concealment of the

bribes was in this respect inextricably intertwined with the bribes themselves. At year-end and at the end of each affected quarter, Magyar therefore reported to the SEC operating expenses that were incorrect. Payments that were reported to the SEC as legitimate expenses were in truth illegal bribes. Magyar's erroneous financial results were consolidated into those of Deutsche Telekom, *Id.* at ¶ 15, thereby rendering the parent company's operating expenses, as reported to the SEC, equally incorrect. *Id.* at ¶ 40.

By falsifying Magyar's books and records, Straub, Balogh, and Morvai also knowingly caused the falsification of the company's 2005 Sarbanes-Oxley certifications. Section 906 of the Sarbanes-Oxley Act requires the Chief Executive and Chief Financial Officers of public companies to certify that every periodic SEC filing "fully complies with" the Exchange Act's books and records and internal controls provisions; and that the filing "fairly presents, in all material respects, the financial condition and results of operations of the issuer." 18 U.S.C. § 1350. Because Magyar's Form 20-F filing for 2005 contained operating expenses that were incorrectly reported, the certifications made to the SEC in that filing were equally false. By virtue of their positions, the defendants knew that Magyar had to make Sarbanes-Oxley certifications. As Chairman and CEO, defendant Straub would have signed the 2005 year-end certification himself had he not been removed from the company by then. Def. Br. at 12. Instead, the 2005 year-end certifications, containing the misrepresentations resulting from the defendants' secret conduct, were signed by the new CEO and CFO. Defendants Balogh and Morvai signed sub-certifications supporting those false certifications. Comp. ¶ 64. The defendants knew what Magyar's certifications would say when they were filed with the SEC, and they knew that their actions in covering up their corrupt bribe scheme would render those certifications false. Comp. ¶ 67.

STANDARD ON A MOTION TO DISMISS

Defendants' "burden on a motion to dismiss pursuant to Rule 12(b)(6) is indeed substantial, as '[i]t has been said that the motion to dismiss for failure to state a claim is disfavored and is seldom granted.'" *Compudyne Corp. v. Shane*, 453 F. Supp. 2d 807, 817 (S.D.N.Y. 2006). *Accord Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000). When evaluating a motion to dismiss, the facts in the complaint are presumed to be true and all factual inferences must be drawn in the plaintiff's favor and against the defendants. *ATSI Comm., Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007). The court's role is limited to "merely assess[ing] the legal feasibility of the complaint, not to assay[ing] the weight of the evidence which might be offered in support thereof." *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 176 (2d Cir. 2004). "At the pleading stage, then, '[t]he issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.'" *Id*. at 177 (quoting *York v. Ass'n of the Bar*, 286 F.3d 122, 125 (2d Cir. 2002)).

ARGUMENT

1. The Complaint Adequately Alleges That This Court Has Personal Jurisdiction Over the Defendants.

The defendants argue that the Court lacks personal jurisdiction over them, both under the Constitution and under New York's long-arm statute, set forth at N.Y. C.P.L.R. §§ 301 and 302. Both arguments are erroneous. The applicable long-arm provision is not the N.Y. C.P.L.R., but Section 27 of the Exchange Act, 15 U.S.C. § 78aa, which provides for nationwide service of process and has been construed in this Circuit to provide for personal jurisdiction to the fullest extent of the due process clause. In applying Section 27, courts have routinely held that foreign defendants who knowingly or foreseeably cause the falsification of filings with the SEC in the United States have subjected themselves to jurisdiction here.

a. Standard of Review for Determining Personal Jurisdiction

"Where, as here, no discovery has taken place, the plaintiff need make only a prima facie showing of jurisdiction by pleading in good faith . . . legally sufficient allegations of jurisdiction." *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 449, 452 (S.D.N.Y. 2005). All allegations must be construed in the light most favorable to the SEC "and all doubts resolved in [the SEC's] favor, notwithstanding controverting evidence." *Itoba Ltd. v. LEP Group PLC*, 930 F. Supp. 36, 40 (D. Conn. 1996). "Eventually personal jurisdiction must be established by a preponderance of the evidence, either at an evidentiary hearing or at trial." *A.I. Trade Fin., Inc. v. Petra Bank*, 989 F.2d 76, 79 (2d Cir. 1993).

Section 27 of the Exchange Act, 15 U.S.C. § 78aa, establishes the basis for personal jurisdiction in securities cases. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1340 (2d Cir. 1972); *Landry v. Price Waterhouse Chartered Accountants*, 715 F. Supp. 98, 101 (S.D.N.Y. 1989). Section 27 "permits the exercise of personal jurisdiction to the limit of the due process clause of the Fifth Amendment." *SEC v. Unifund SAL*, 910 F.2d 1028, 1033 (2d Cir. 1990) (citing *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 998 (2d Cir. 1975)). "Since . . . Congress meant [Section] 27 to extend personal jurisdiction to the full reach permitted by the due process clause, it is unnecessary to discuss the applicability of the [N.Y. C.P.L.R.], which could reach no further." *Leasco*, 468 F.2d at 1339.

The constitutional limit of the Court's jurisdiction under Section 27 is framed by the minimum contacts analysis set forth in *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945), and its progeny. *Hallwood Realty Partners, L.P. v. Gotham Partners L.P.*, 104 F. Supp. 2d 279, 283 (S.D.N.Y. 2000). Under Section 27, the Court's inquiry must focus on the defendants' contacts with the entire United States. "Second Circuit authority clearly establishes that the

constitutionality of in personam jurisdiction in federal question cases where Congress has provided for worldwide service is to be determined by national, rather than local, contacts." *SEC v. Softpoint, Inc.*, No. 95 Civ. 2951 (GEL), 2001 WL 43611, at *5 (S.D.N.Y. Jan. 18, 2001) (*citing Unifund*, 910 F.2d at 1033).

Personal jurisdiction under the due process clause depends upon "the relationship among the defendant, the forum, and the litigation." *Shaffer v. Heitner*, 433 U.S. 186, 204 (1977). A nonresident defendant need not be physically present in the forum in order for personal jurisdiction to exist. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985). Instead, the Court may exercise jurisdiction upon a showing that a defendant has purposefully directed his activities toward the residents of the forum state, or otherwise "purposefully avail[ed him]self of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson v. Denckla*, 357 U.S. 235, 253 (1958). Where, as here, the Court is exercising personal jurisdiction "in a suit arising out of or related to the defendants' contacts with the forum," the Court exercises "specific," as opposed to "general," jurisdiction. *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 414 n. 8 (1984).

A foreign defendant is deemed to have purposefully directed his activities at the United States sufficiently to create personal jurisdiction when he "performs an act that he knows or has good reason to know will have effects in the forum, and if the exercise of jurisdiction by that forum is not unreasonable." *Reingold v. Deloitte Haskins & Sells*, 599 F. Supp. 1241, 1259 (S.D.N.Y. 1984) (citing *Leasco*, 468 F.2d at 1341). "[I]n some cases, as with an intentional tort, the defendant might well fall within the forum's authority by reason of his attempt to obstruct its laws." *SEC v. Compania Internacional Financiera*, No. 11 Civ. 4904 (DLC), 2011 WL 3251813, at *5 (S.D.N.Y. Jul. 29, 2011) (quoting *J. McIntyre Machinery, Ltd. v. Nicastro*, 131

S.Ct. 2780, 2787 (2011)). Thus, where a defendant knowingly or foreseeably causes the falsification of an SEC filing, he will be subject to jurisdiction in the United States. In *SEC v. Stanard*, No. 06-cv-7736 (GEL) (S.D.N.Y. May 16, 2007) (unpublished transcript, attached as Ex. 2), the court denied a jurisdictional challenge by a Senior Vice President of an SEC-registered reinsurance company who engaged in sham transactions designed to "smooth" the company's earnings. *Id*. at 2-3. Because the defendant "conceived and implemented a strategy for entering a sham transaction and specifically intended that his work would result in false statements by [the reinsurer] in its publicly-filed financial statements in the United States," the defendant's actions rendered him subject to jurisdiction here. *Id*. at 3.

Once it has been decided that a defendant purposefully established minimum contacts within the forum State, these contacts may be considered in light of other factors to determine whether the assertion of personal jurisdiction would comport with "fair play and substantial justice." *Int'l Shoe*, 326 U.S. at 320. The factors to be considered are: "(1) the burden that the exercise of jurisdiction will impose on the defendant; (2) the interests of the forum state in adjudicating the case; (3) the plaintiff's interest in obtaining convenient and effective relief; (4) the interstate judicial system's interest in obtaining the most efficient resolution of the controversy; and (5) the shared interest of the states in furthering substantive social policies." *Metropolitan Life Ins. Co. v. Robertson-Ceco Corp.*, 84 F.3d 560, 568 (2d Cir. 1996).

"The burden is on the defendant to demonstrate that the assertion of jurisdiction in the forum will 'make litigation so gravely difficult and inconvenient that [he] unfairly is at a severe disadvantage in comparison to his opponent.'" *Softpoint*, 2001 WL 43611, at *5 (quoting *Burger King*, 471 U.S. at 478). "This prong of the inquiry rarely defeats jurisdiction where a defendant has sufficient forum contacts . . . and is largely academic in non-diversity cases brought under a

federal law that provides for nationwide service of process." *Id*. (citing *Asahi Metal Indus. Co. v. Super. Ct. of Cal., Solano Cnty.*, 480 U.S. 102, 116 (1987)). "In the last analysis, the question is whether the burden on [the defendants] of litigating this case in New York is so severe that the exercise of personal jurisdiction over [them] is arbitrary, shocks the conscience, or offends fundamental principles of ordered liberty, notwithstanding the strong federal interest in efficient and effective enforcement of the securities laws." *Hallwood Realty*, 104 F. Supp. 2d at 286-87.

b. Straub, Balogh, and Morvai Are Subject to Personal Jurisdiction Because They Directed Acts at the United States by Their Involvement in Falsifying Magyar's SEC Filings.

In actions brought under the securities laws, courts routinely uphold personal jurisdiction over foreign defendants whose actions abroad are directed at the United States by virtue of their involvement in falsifying financial statements filed with the SEC. As the court held in *Stanard:* "Where an executive of a foreign securities issuer, wherever located, participates in a fraud directed to deceiving United States shareholders in violation of federal regulations requiring disclosure of accurate information" he has caused consequences in the forum. *Stanard*, Tr. at 3. "SEC regulations would be meaningless as applied to foreign issuers of U.S.-traded securities if the United States courts lacked jurisdiction over executives abroad who violate those regulations." *Id*.

Judge Lynch's decision in *Stanard* is consistent with a long line of precedent in this and other courts. *See Parmalat*, 376 F. Supp. 2d at 454-55 (jurisdiction upheld over Italian auditor in connection with the misleading financial statements filed with the SEC); *Landry*, 715 F. Supp. at 102 (jurisdiction upheld over a Canadian board member who orchestrated a fraudulent corporate acquisition resulting in misleading financial statements filed with the SEC); *Reingold*, 599 F. Supp. at 1259 (jurisdiction upheld over Australian auditor of fraudulent registration

statement); *In re CINAR Corp. Sec. Litig.*, 186 F. Supp. 2d 279, 305-06 (E.D.N.Y. 2002) (jurisdiction upheld over Canadian general counsel for signing a fraudulent registration statement); *In re Royal Dutch/Shell Transport Sec. Litig.*, 380 F. Supp. 2d 509, 551 (D.N.J. 2005) (jurisdiction upheld over British corporate official who signed SEC filings containing misleading statements about petroleum reserves); *Derensis v. Coopers & Lybrand Chartered Accountants*, 930 F. Supp. 1003, 1014 (D.N.J. 1996) (jurisdiction upheld over Canadian corporate officers who approved financial statements that overstated the inventory of a gold mining company); *Itoba*, 930 F. Supp. at 40-41 (jurisdiction upheld over British board chairman who approved a fraudulent Form 20-F filing with the SEC).

The defendants' conduct in falsifying Magyar's books and records, and thereby causing the Magyar's annual and quarterly filings with the SEC to be rendered false falls squarely within this line of cases. An essential part of the defendants' scheme to pay some €4.875 million in bribes was the concealment of the bribes through the use of sham contracts, phony supporting documents, false accounting entries, circumvented internal controls, and false certifications to auditors. By these actions, the defendants caused the quarterly and year-end reports that Magyar filed with the SEC in the United States, along with the accompanying Sarbanes-Oxley certifications, to be rendered false.

Nor were the defendants mere passive observers in the preparation of Magyar's false SEC filings. Defendant Straub was Magyar's public face to the SEC and the United States capital markets. Straub signed Maygar's 2004 annual report and at least one quarterly report. Ex. 1. Every quarterly report quoted Straub by name and at length in its discussion and analysis of the company's business. *Id*. And all three defendants signed quarterly sub-certifications for Magyar's auditors attesting to the accuracy of Magyar's books and records and the integrity of

its financial controls within those defendants' areas of responsibility. Comp. ¶¶ 63, 64. A jury may reasonably find that each of these defendants took concrete steps to falsify Magyar's books and records regarding the bribes, circumvent its internal controls, and then ensure that the resulting misstated financial results and false Sarbanes-Oxley certifications would be filed with the SEC in the United States.[4]

The defendants argue that the *corpus* of their corrupt scheme was exclusively foreign, and that any impact on the United States was too incidental to support jurisdiction. Def. Br. at 14. This contention misconceives both the statutory framework of the FCPA and the essence of the SEC's allegations. When Congress passed the FCPA in 1978, the Act's provisions included not only prohibitions against bribery, but also the books and records, internal controls, and lying to auditors requirements set forth at Exchange Act Sections 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5). 15 U.S.C. §§ 78m(b)(2)(A), (b)(2)(B), and (b)(5). Congress recognized that bribery cannot thrive in an organization without the accompanying efforts to conceal corrupt payments, bypass internal controls, and mislead auditors. As a result, Congress intended from the start that these FCPA enforcement provisions would operate in a unified manner. The Senate Report made this clear.

> The accounting standards in S. 305 are intended to operate in tandem with the criminalization provisions of the bill to deter corporate bribery. S. 305 expresses a public policy which encompasses a unified approach to the matter of corporate bribery.

S. Rep. No. 95-114 at 7 (1977) *reprinted in* 1977 U.S.C.C.A.N. 4098, 4104-05.

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[4] The SEC does not rely on the use of electronic mail messages by defendant Balogh, transmitted through the means or instrumentalities of interstate commerce, Comp. ¶ 39, as a basis for the Court's personal jurisdiction over the defendants. The transmission of those messages through servers in the United States does, however, satisfy the "interstate commerce" element of the SEC's bribery charges under 15 U.S.C. § 78dd-1. *See infra* at Section 3.a.

Consistent with the enforcement framework envisaged by Congress, the SEC did not charge the defendants *only* with bribing government officials in Macedonia. The SEC charged Straub, Balogh, and Morvai with a larger, more comprehensive bribery scheme that included covering up their bribes by falsifying Magyar's books and records, circumventing its internal controls, and lying to its auditors. The bribes themselves may have taken place outside this country (as is true almost by definition in FCPA cases), but the concealment of those bribes -- which was both integral to the scheme and essential for its success -- was directed at the United States in the form of Magyar's SEC filings, which the defendants each had a hand in falsifying. The *corpus* of the defendants' violations, therefore, is not limited to Macedonia but extends to the United States as well.

The SEC's charges here all "arise out of or relate to" the defendants' contacts with the forum, as required for the Court's exercise of specific jurisdiction. *Helicopteros*, 466 U.S. at 414, n.8. The defendants' actions in falsifying Magyar's books and records, circumventing internal controls, and lying to auditors all fed directly into the preparation of the company's erroneous quarterly and annual reports with the SEC. Each of those reports included line items for operating expenses that purported to represent legitimate costs of operations, but were, at least in part, illegal bribe payments. And the financial statements in each of those reports were either audited or reviewed by outside auditors that relied upon the false management representations and sub-representations that the defendants signed. The SEC's bribery charges "relate to" the defendants' jurisdictional contacts as well. As discussed above, and as reflected in the FCPA's statutory scheme, the defendants' actions in paying bribes and covering up those bribes constituted a single, unified course of conduct, with a common nucleus of operative fact.

See SEC v. Carrillo, 115 F.3d 1540, 1544 (11th Cir. 1997) (contacts are "related to" the cause of action where "each of the contacts was a step by which the . . . scheme was carried out").

Defendants argue that if the Court exercises jurisdiction over them, it would automatically imply that "any individual director, officer, or employee of an issuer in any FCPA case" would also be subject to jurisdiction. Def. Br. at 10. The defendants' concern is overblown. In denying the defendants' motion, the Court need not explore every conceivable set of facts under which an individual defendant may be sued in the United States. It is sufficient that *these* defendants, in *this* case, personally orchestrated a bribery scheme, personally concealed their bribes through the use of sham contracts, thus falsifying Magyar's books and records, personally signed false statements to auditors, and personally had active roles in preparing and falsifying Magyar's SEC filings. On these facts, the Court may properly find that these defendants "purposefully directed" their conduct at this forum.

The defendants contend that the Court should decline to exercise jurisdiction because the SEC has not adequately pled that investors relied to their detriment on the SEC filings that the defendants corrupted. Def. Br. at 11-12. This argument entirely misconceives the SEC's burden. When they falsified Magyar's books and records in order to conceal their bribe scheme, the defendants would have known that the company's resulting erroneous financial statements would be filed with the SEC and made available to investors in the United States. That is sufficient to allege that the defendants purposefully directed their actions at the United States. The SEC does not bear the burden of further alleging that investors relied to their detriment on the concealment of Magyar's bribery. The SEC is not required to prove reliance in its enforcement actions. *SEC v. KPMG LLP*, 412 F. Supp. 2d 349, 375 (S.D.N.Y. 2006). With or without demonstrated investor harm, the SEC has the authority to enforce the FCPA's books and

records, internal controls, and lying to auditors provisions against defendants who cause erroneous quarterly and annual reports to be filed here.

The defendants cite *Morrison v. National Australia Bank Ltd.*, 130 S.Ct. 2869 (2010), and a series of insider trading cases[5] for the proposition that the SEC may not assert jurisdiction unless the defendants' actions had a "direct or significant impact" on the trading in Magyar's ADRs. Def. Br. at 16. The *Morrison* decision is not even remotely on point because it did not address personal jurisdiction. Instead, *Morrison* construed the permissible extraterritorial reach of Exchange Act Section 10(b). 15 U.S.C. § 78j(b). *Morrison*, 130 S.Ct. at 2877 ("[T]o ask what conduct § 10(b) reaches . . . is a merits question.").

Insofar as they are relevant, the insider trading cases defendants cite support, rather than undermine, the exercise of jurisdiction here. In two of the three cases, the courts found that foreign investors who traded based on insider information in United States securities markets *did* purposefully avail themselves of the privilege of conducting activities in the forum. *Unifund*, 910 F.2d at 1033; *Euro Security*, 1999 WL 76801, at *3. The only cited instance in which the court found the jurisdictional contacts to be insufficient was in *Alexander*, 160 F. Supp. 2d at 655-57, where the defendant was an elderly Italian woman who placed a single order with her Italian broker to sell shares in an Italian company and who had no idea that the shares would be traded through the company's American Depository Receipts on the New York Stock Exchange. *Id*. Here, the defendants' liability is not premised on harm to other investors; it is based on the filing of defective quarterly and annual reports with the SEC. And in contrast to the defendant in *Alexander*, defendants Straub, Balogh, and Morvai were sophisticated corporate executives who

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[5] *SEC v. Unifund SAL*, 910 F.2d 1028, 1033 (2d Cir. 1990); *SEC v. Euro Security Fund, Coim SA*, No. 98 Civ. 7347, 1999 WL 76801 (S.D.N.Y. Feb. 17, 1999); *SEC v. Alexander*, 160 F. Supp. 2d 642, 655-57 (S.D.N.Y. 2001).

were fully aware that the SEC filings they had rendered inaccurate would be lodged with a regulatory authority in the United States.

c. The Exercise of Personal Jurisdiction Over the Defendants is Reasonable.

Defendants contend that even if they have established sufficient minimum contacts with the United States, it would be "unreasonable" to exercise jurisdiction over them. Def. Br. at 7-8. This argument must be rejected as well. As Judge Lynch held in *Softpoint*, "This prong of the inquiry rarely defeats jurisdiction . . . and is largely academic in non-diversity cases brought under a federal law which provides for nationwide service of process." *Softpoint*, 2001 WL 43611, at *5. The reasons are straightforward. Congress in Section 27 recognized that the United States has a compelling interest in the enforcement of the federal securities laws. *Hallwood Realty*, 104 F. Supp. 2d at 286. And unlike a private diversity action, there is no alternative forum available to the government. If the SEC cannot proceed against the defendants in the federal courts of the United States, then the defendants will effectively have been immunized for the securities violations with which they are charged. Whatever the inconvenience of defending themselves in the United States, it does not "shock the conscience" for the defendants to answer the SEC's charges here.

2. The Commission's Claims Are Not Time Barred.

The defendants next argue that the SEC's claims are barred by the five-year catch-all limitations period set forth in 28 U.S.C. § 2462. Def. Br. at 17-20. This argument fails under the plain language of Section 2462, which provides that the limitations period does not run unless the defendant "is found within the United States" within the five-year period. The defendants concede on the first page of their brief that they "are Hungarian nationals who have resided and worked outside the United States during the entire time period alleged in the complaint, 2005-06, and

continue to do so." Def. Br. at 1. Further, the defendants' argument that the SEC's claims for equitable relief are punitive, and thus subject to the five-year limitation of Section 2462, has been rejected by the overwhelming weight of authority in this circuit and elsewhere.

a. Standard of Review for Statute of Limitations

Statute of limitations is an affirmative defense, and the defendants bear the burden of proof on this element. Fed. R. Civ. P. 8(c). On a motion to dismiss under Rule 12(b)(6), a claim may be dismissed as time-barred only if the factual allegations in the complaint clearly show that the claim is untimely. *Harris v. City of New York*, 186 F.3d 243, 250 (2d Cir. 1999).

b. The Statute of Limitations in Section 2462 Did Not Run as to the Defendants, None of Whom Were Found Within the United States.

The Exchange Act does not contain a limitations period. Therefore, to the extent the SEC's claims are subject to a statute of limitations, the catch-all period in 28 U.S.C. § 2462 applies. *SEC v. Kelly*, 663 F. Supp. 2d 276, 288 (S.D.N.Y. 2009). The statute provides:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, *within the same period, the offender or the property is found within the United States* in order that proper service may be made thereon.

28 U.S.C. § 2462 (emphasis added). The Supreme Court directs that "statutes of limitations sought to be applied to bar rights of the Government must receive a strict construction in favor of the Government." *Badaracco v. Comm'r Internal Revenue*, 464 U.S. 386, 391 (1984) (quoting *E.I. Dupont de Nemours & Co. v. Davis*, 264 U.S. 456, 462 (1924)).

Applying the plain language of Section 2462, it is clear that the defendants' statute of limitations argument fails. The five-year limitations period runs only "if, within the same period, the offender . . . is found within the United States." 28 U.S.C. § 2462. The defendants concede

that at no time during the limitations period were they "found" in this country. *See* Def. Br. at 1. The Court's inquiry should end with the plain language of the statute. *See United States v. Gayle*, 342 F.3d 89, 92 (2d Cir. 2003) (if the statutory terms are unambiguous, the inquiry generally ends there, and the statute is construed according to its plain meaning). Applying the plain language of Section 2462 here, the defendants cannot argue that the limitations period of Section 2462 -- which is strictly construed in favor of the government -- has even started to run against them.

Ignoring the plain language of Section 2462, the defendants contend that the "if found within the United States" clause "relates only to the ability to serve the defendant with process." Def. Br. at 19. In other words, the defendants argue that the five-year limitation should run against them if they are *either* "found within the United States" *or* subject to service of process in Hungary. But this plainly is not how the statute reads. The defendants' interpretation improperly conflates the tolling provision's *operative language* ("if, within the same period, the offender . . . is found within the United States") with the *statement of purpose* that follows it ("in order that proper service may be made").[6]

The operative clause, "if found within the United States," has been present in Section 2462 and predecessor statutes since 1839. Act of Feb. 28, 1839, ch. 36, §4, 5 Stat. 322 (Ex. 3). The clause was understood from the start to toll the limitations period for defendants outside the country. *See United States v. Brown*, 24 F.Cas. 1263 (D.Ma. 1873) (holding that the 1839 tolling provision did not apply in a criminal prosecution for an assault at sea but would prevent the statute from running in a civil action for money penalties). Since that time, Congress revisited the tolling

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[6] The Supreme Court rejected this precise interpretive error in *District of Columbia v. Heller*, 554 U.S. 570, 577 (2008), when it construed the Second Amendment to the Constitution. Like Section 2462, the Second Amendment "is naturally divided into two parts: its prefatory clause and its operative clause. The former does not limit the latter grammatically, but rather announces a purpose." *Id*. An explanatory clause may "resolve an ambiguity in the operative clause. . . . But apart from that clarifying function, does not limit or expand the scope of the operative clause." *Id*.

provision twice, in 1940 and again in 1948.[7] Each time, Congress revised and modernized the statute's phrasing, but left the substance of the tolling provision intact, thus reaffirming its judgment that the provision served a valuable public policy.

Congress' decision to toll the limitations period of Section 2462 for overseas defendants is in no way "extraordinary" or "unprecedented." Def. Br. at 20. A parallel tolling provision exists, for example, under the Internal Revenue Code at 26 U.S.C. § 6531.[8] That provision has been tested and repeatedly upheld as constitutional, enforceable, and unambiguous. *See United States v. Edkins*, 421 Fed. App'x. 511, 514 (6th Cir. 2010) ("As authorized by 26 U.S.C. § 6531, the court excludes this time outside of the country from the statute of limitations calculation, rendering the indictment timely."); *United States v. Ohle*, 678 F. Supp. 2d 215, 230 (S.D.N.Y. 2010) (citing *United States v. Myerson*, 368 F.2d 393, 395 (2d Cir. 1966), and *United States v. Marchant*, 774 F.2d 888, 892 (8th Cir. 1985)); *United States v. Yip*, 248 F. Supp. 2d 970, 973-74 (D.Haw. 2003). In *Yip*, the court rejected the precise argument the defendants advance here: "that Congress' only intent was to prevent persons from making themselves unavailable for service of process." *Yip*, 248 F. Supp. 2d at 973. Relying on the plain language of the statute, the court found "no indication that Congress desired to put a burden on the Government with respect to determining . . . the extent to which a defendant purposefully puts himself outside the reach of the legal process." *Id*. at 974.[9]

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[7] 28 U.S.C. § 791 (1940 ed.); 28 U.S.C. § 2462 (1948 ed.). Ex. 3.

[8] Section 6531 provides: "The time during which the person committing any of the various offenses . . . is outside the United States or is a fugitive from justice . . . shall not be taken as any part of the time limited by law for the commencement of such proceedings." *Id.*

[9] As reflected in the court's reasoning in *Yip*, if the defendants' interpretation of Section 2462 were to be upheld, it would be impossible to determine whether the statute of limitations had run without a full-blown evidentiary hearing. As the defendants note, Def. Br. at 19, the SEC was able to effect service in 2012. But there is no evidence before this Court as to the defendants' whereabouts or amenability to service during the preceding six years.

Because the defendants do not contest that they were outside the United States during the relevant period, the five-year statute of limitations of 28 U.S.C. § 2462, by its express terms, does not bar the SEC's claims against them.

c. The SEC's Claims for Equitable Relief Are Not Subject to the Limitations Period of Section 2462.

By its terms, the limitations period of Section 2462 applies only to the "penalties" sought in this proceeding. The defendants contend that the SEC's claims for injunctive relief and disgorgement are punitive in nature and thus subject to Section 2462. Def. Br. at 18. The case law is to the contrary.

As noted above, statutes of limitations must be strictly construed in favor of the government. Given this principle, the "great weight of the case law in this jurisdiction supports the SEC's contention that equitable remedies are exempted from Section 2462's limitations period." *Kelly*, 663 F. Supp. 2d at 286-87 (citing cases); s*ee also SEC v. Caserta*, 75 F. Supp. 2d 79, 89 (E.D.N.Y. 1999) ("There is . . . no statute of limitations in regard to equitable relief."). Specifically, "[d]isgorgement is an equitable remedy to which Section 2642 does not apply." *SEC v. Pentagon Cap. Mgmt PLC*, 612 F. Supp. 2d 241, 267 (S.D.N.Y. 2009) (quoting *SEC v. Power*, 525 F. Supp. 2d 415, 426–27 (S.D.N.Y. 2007)); *SEC v. Lorin*, 869 F. Supp. 1117, 1120-23 (S.D.N.Y. 1994) (finding SEC enforcement action requesting permanent injunction and disgorgement "free from a limitation period"). Similarly, Section 2462's limitations period does not apply to injunctive relief. *See SEC v. McCaskey*, 56 F. Supp. 2d 323, 325-26 (S.D.N.Y. 1999) (28 U.S.C. § 2462 does not apply to equitable relief, including permanent injunctions, disgorgement of illegal profits, and bars from serving as an officer of a public company).

The defendants cite *SEC v. Jones*, 476 F. Supp. 2d 374, 380 (S.D.N.Y. 2007), for the proposition that Section 2462 applies to equitable relief. *See* Def. Br. at 18. In that case,

however, the court did not hold that all equitable remedies were subject to Section 2462. The court held that an equitable remedy would be subject to the limitations period if it were meant "to punish," but not if it were meant "to remedy a past wrong or protect the public from future harm." *Id*. at 381. In order "to make this determination" with respect to an SEC injunction, the court reviewed the evidentiary record to evaluate "the likelihood of recurrence of violations and the possible collateral consequences of issuing an injunction." *Id*. at 383. In *Jones*, unlike here, the parties had completed discovery, and the court therefore had an evidentiary basis to determine whether the particular injunction at issue would be punitive or remedial. The SEC submits that the *Jones* case, which is contrary to the weight of authority in this Circuit, was wrongly decided. But even *Jones* provides no basis for the Court to dismiss the SEC's claims for injunctive relief and disgorgement at the motion to dismiss stage.

The SEC's claims for a civil injunction and disgorgement are therefore not precluded by the five year limitations period of Section 2462.

3. The Complaint Adequately Alleges Defendants Violated the FCPA and Aided and Abetted Magyar's Violations of the Securities Laws.

Defendants argue that the complaint fails adequately to allege certain elements of the FCPA. Specifically, Defendants argue that the complaint fails to allege: (1) that defendants made use of the United States facilities of interstate commerce; and (2) that the intended recipients of the offers to bribe and bribes in question were foreign officials under the FCPA. Both arguments lack merit.

a. The Complaint Alleges the Use of Interstate Commerce.

With regard to the interstate commerce element of the FCPA claims, the defendants argue that the complaint fails adequately to allege that the use of the facilities

of interstate commerce was made "corruptly" or that such use was "in furtherance of" the bribes. These arguments are incorrect as a matter of fact and law.

The complaint alleges that defendant Balogh used electronic mail messages to forward drafts of the Protocol of Cooperation, Letter of Intent, and copies of consulting contracts with third party intermediaries. *Id.* at ¶ 39. These email messages were transmitted by the means and instrumentalities of United States interstate commerce and were routed through and stored on network servers located within the United States. *Id.* The Protocol of Cooperation, Letter of Intent, and third party consulting agreements memorialized defendants' agreement to pay bribes to government officials in return for specific benefits for Magyar; identified the nature of what defendants were offering the government officials, *id.* at ¶¶ 21-23, 26, 29-30; and were the means by which the defendants would conceal the true nature of the payments they offered to make. *Id.* at ¶¶ 19, 31-32, 35.

It is beyond dispute that the use of the internet is an instrumentality of interstate commerce. *See United States v. MacEwan*, 445 F.3d 237, 244 (3d Cir. 2006); *United States v. Hornaday*, 392 F.3d 1306, 1311 (11th Cir. 2004); *SEC v. Solucorp Indus. Ltd.*, 274 F. Supp. 2d 379, 419 (S.D.N.Y. 2003). The complaint contains specific factual allegations that defendants communicated by electronic mail messages about their scheme to bribe government officials in Macedonia and that some of those email messages were routed via the internet through the United States. Therefore, the complaint adequately pleads that the defendants used the means or instrumentalities of interstate commerce.

i) Violation of the FCPA Does Not Require Proof That Defendants "Corruptly" Used the Means or Instrumentalities of Interstate Commerce.

The SEC need not allege that the defendants "corruptly" used the mails or any means or instrumentality of interstate commerce to adequately plead that they violated the FCPA. Defendants' attempt to engraft such a requirement onto the elements of the FCPA is inconsistent with the plain language of the statute and contrary to all relevant precedent.

As noted above, the FCPA makes it unlawful for a corporate employee to "make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of" a bribe. 15 U.S.C. § 78dd-1(a)(3). The placement of the word "corruptly" in the statutory text makes clear that it modifies only the elements that follow it: the offer, payment or promise to pay a bribe in order to induce a foreign official to commit a wrongful act. The FCPA's legislative history underscores Congress' original intent that "corruptly" modify only the payments offered, made, or promised, and not the use of interstate commerce.

> The word "corruptly" is used in order to make clear that the offer, payment promise, or gift, must be intended to induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client, or to obtain preferential legislation or a favorable regulation. The word "corruptly" connotes an evil motive or purpose, *an intent to wrongfully influence the recipient*.

S. Rep. No. 95-114, at 10 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098, 4108 (emphasis added). *Accord Stichting Ter Behartiging Van De Langen Van Oudaandeelhouders In Het Kapital Van Saybolt Int'l v. Schreiber*, 327 F.3d 173, 182 (2d Cir. 2003).

There is nothing in the plain language of the statute to suggest that the word "corruptly" is intended to add a specific intent requirement to the use of "any means or instrumentality of interstate commerce." This conclusion is consistent with the principle that the SEC need not plead or prove that defendants *knew* they were violating the FCPA -- "that is committing all the

elements of an FCPA violation." *Stichting*, 327 F.3d at 181; *see United States v. Kay*, 513 F.3d 432, 450-51 (5th Cir. 2007).

Moreover, the use of interstate commerce in furtherance of a violation of the securities laws is a jurisdictional element of those offenses. *See United States v. Langford*, 946 F.2d 798, 803 n.20 (11th Cir. 1991) (use of the mails is "merely a jurisdictional requirement" of Section 10(b)); *United States v. Victor Teicher & Co., L.P.*, 726 F. Supp. 1424, 1431 (S.D.N.Y. 1989) ("use of the mails, means or instrumentality of interstate commerce . . ." is a jurisdictional element of violation of Rule 10b-5); *see also SEC v. Boock*, No. 09 Civ. 8261, 2011 WL 3792819, at *17 n.20 (S.D.N.Y. Aug. 25, 2011). The "jurisdictional element of a federal offense states the basis of Congress' power to regulate the conduct at issue: its 'primary purpose is to identify the factor that makes the [conduct] an appropriate subject for federal concern.'" *United States v. Cooper*, 482 F.3d 658, 664 (4th Cir. 2007) (quoting *United States v. Yermian*, 468 U.S. 63, 68 (1984)). "[P]roof of an interstate nexus is merely a jurisdictional prerequisite, not an essential element of the crime." *United States v. Edelman*, 873 F.2d 791, 794 (5th Cir. 1989) (collecting cases). Thus, courts have consistently held there is no requirement to plead or prove that a defendant intended to or knowingly used a means or instrumentality of interstate commerce. *See United States v. Blackmon*, 839 F.2d 900, 907 (2d Cir. 1988) (no *mens rea* requirement to the purely jurisdictional element of interstate communication under the wire fraud statute). "The significance of labeling a statutory requirement as 'jurisdictional' is not that the requirement is viewed as outside the scope of the evil Congress intended to forestall, but merely that the existence of the fact that confers federal jurisdiction need not be one in the mind of the actor at the time he perpetrates the act made criminal by the federal statute." *United States v. Feola*, 420 U.S. 671, 677 n.9 (1975); *see Cooper*, 482 F.3d at 665 ("[J]urisdictional elements

generally assert jurisdiction but do not create additional statutory elements as to which defendants must have formed the appropriate *mens rea* in order to have broken the law.").[10] Therefore, the complaint need not contain factual allegations that defendants formed a *mens rea*, let alone a "corrupt" one, with respect to their use of the means or instrumentalities of interstate commerce.

ii) The Defendants' Use of Interstate Commerce was in Furtherance of their Scheme to Bribe Government Officials.

Defendants' argument that the complaint does not sufficiently allege that they used the means or instrumentalities of interstate commerce "in furtherance of" their FCPA violations misstates the requirements of the statute and disregards the express allegations in the complaint.

The electronic mail messages that defendants sent via the internet related directly to the defendants' offers to pay, promises to pay, and actual payment of bribes to government officials. Electronic mail messages were used to forward drafts of the Protocol of Cooperation, Letter of Intent, and copies of consulting contracts with third party intermediaries. *Id.* at ¶ 39. These are the documents that memorialized the defendants' agreement to pay bribes to government officials and what the defendants expected in return for those payments. *Id.* at ¶¶ 21-23, 25-26, 29-30. In other words, the Protocols of Cooperation and the Letter of Intent *were* the offers to pay or promises to pay bribes that defendants made to Macedonian government officials and

[10] Neither party has identified a reported decision addressing whether the use of interstate commerce is a jurisdictional element of an FCPA violation. However, the phrase is essentially identical to language used in both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. *Compare* 15 U.S.C. § 78dd-1(a)(3) *with* 15 U.S.C. § 78j and 15 U.S.C. § 77q(a). There is no basis for the Court to find that Congress intended to impose a *mens rea* requirement on the use of interstate commerce in the FCPA when Congress did so nowhere else in the securities laws. *See Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) ("When administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well.").

political party officials. The complaint also alleges the electronic mail messages defendants sent included copies of sham consulting agreements that were used as a vehicle for making bribe payments to foreign officials while concealing the true nature of these payments. *Id.* at ¶¶ 19, 31-32, 35. These sham consulting agreement were essential to the defendants' bribes and were therefore sent in furtherance of the payments.[11]

b. The Complaint Adequately Alleges the Involvement of Foreign Officials in the Bribe Scheme.

Defendants argue that the complaint omits to plead necessary facts to establish that the recipients of their bribes were "foreign officials." Def. Br. at 28. As required by Fed. R. Civ. P. 8(a), the complaint sets out a "short and plain statement of the claim," describing the Macedonian government and political party officials whom the defendants bribed. The complaint therefore sufficiently pleads that the bribe recipients were "foreign officials."

i) The SEC's Allegations Satisfy Federal Rule 8(a).

The allegations in the complaint satisfy the notice pleading standards, properly allege the elements of the violation, and give the defendants fair notice of the basis for the SEC's claim. Rule 8 does not require detailed factual allegations, although it does require more than unadorned accusations and legal conclusions. *Ashcroft v. Iqbal*,556 U.S. 662, 678 (2009), *citing Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007).

Section 30A(f)(1)(A) of the Exchange Act defines "foreign official" to mean "any officer or employee of a foreign government or any department, agency, or instrumentality thereof . . . or any person acting in an official capacity for or on behalf of such government or department,

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[11] This conclusion is entirely consistent with the holding in *Kay*, 513 F.3d at 453-54. Like the false shipping documents in *Kay*, the sham consulting agreements identified the specific amounts that would be paid as bribes, even though the payments were characterized as a "success fee" and payments for "logistics." Comp. ¶¶ 26, 31-32.

agency, or instrumentality . . . .” 15 U.S.C. § 78dd-1(f)(1)(A). The complaint satisfies the requirements of Rule 8(a) by alleging that the officials bribed by the defendants were “acting in an official capacity for or on behalf of” the government of Macedonia. *Id*.

The complaint sufficiently alleges that the officials involved in the bribery scheme were “acting in an official capacity” by virtue of the actions those officials were authorized to take on behalf of the Macedonian government. The complaint alleges that, in return for the defendants’ bribes, the governing party officials agreed to “ensure that the government delayed or precluded the issuance of the third mobile telephone license.” Comp. at ¶ 22, 25. The officials also promised, on behalf of the government, to “mitigate the other adverse effects of the new law, including exempting MakTel from the obligation to pay an increased frequency fee.” *Id*. The officials did more than just make promises on the government’s behalf. They were also empowered by their official positions to ensure that the promises were carried out. “As a result of the corrupt payments, the Macedonian government delayed the introduction of a third mobile telephone competitor until 2007. . . . The Macedonian government also, as agreed, reduced the frequency fee tariffs imposed on MakTel.” *Id*. at ¶ 38.

The complaint also sufficiently alleges that the bribed officials from the minority party were “acting in an official capacity.” The complaint alleges that the minority officials “occupied senior positions in the telecommunications regulatory agencies with jurisdiction over the tender of the third mobile license” and that they had the authority to “torpedo” the benefits sought from the ruling party. *Id*. at ¶ 27.

Because the bribed officials from both the ruling and minority parties were empowered to act on behalf of the Macedonian government, and did act on the government’s behalf, they met the FCPA’s definition of “foreign official.”

ii) The Complaint Sufficiently Alleges That Particular Government Officials Were Bribed.

In a footnote, the defendants argue that the complaint does not "even attempt to assert that any particular government official in Macedonia was offered or received a bribe." Def. Br. at 28, n.20. This contention is simply false. First, there is no requirement under the FCPA or in the case law interpreting it that the SEC's complaint identify bribed foreign officials by name.[12] Second, it is clear from the allegations in the complaint that the defendants made their bribe payments to particular officials, whose identities were known to the defendants. The officials who signed the Protocols of Cooperation, for example, identified themselves by placing their signatures on the agreements. Comp. ¶ 23. The complaint also alleges that the defendants communicated directly with the officials they bribed. Defendant Balogh volunteered to meet with the representatives of the ruling and minority parties when the sham contracts were signed in order to "inform them about the source of the money" they would receive. *Id*. at ¶ 31. Balogh also asked that he be be provided with "feedback, after the transaction, from high level representatives of both sides acknowledging that they received what we promised." *Id*. at ¶ 34.

The SEC's allegations regarding the officials involved in defendants' bribe scheme are therefore sufficiently detailed and substantive to satisfy the standards of Rule 8(a).

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[12] Any such requirement would be completely at odds with the FCPA's statutory scheme. Violations of Section 30A, for example, include inchoate actions, such as making an "offer," "promise," or "authorization" of a bribe, regardless of whether the bribe is actually paid. 15 U.S.C. § 78dd-1(a). The statute also prohibits the use of intermediaries, as were used here, as part of a bribe scheme. 15 U.S.C. § 78dd-1(a), (a)(3). By its very structure, Section 30A was drafted to prohibit corrupt transactions in which the precise identity of a government official might not be known even to the payor.

4. The Complaint Adequately Alleges Defendants Violated Exchange Act Rule 13b2-2.

The complaint satisfies all the requirements of Federal Rule 9(b) with respect to the SEC's claim that defendants violated Rule 13b2-2, which prohibits the making of "a materially false or misleading statement" or an omission of "any material fact necessary in order to make the statements made . . . not misleading," to an accountant in connection with an audit, review, or examination of an issuer's financial statements. 17 C.F.R. §240.13b2-2(a).

a. The Standard of Pleading Required under Rule 9(b)

"In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b). "The primary purpose of Rule 9(b) is to afford defendant fair notice of the plaintiff's claim and the factual ground upon which it is based." *Ross v. Bolton*, 904 F.2d 819, 832 (2d Cir. 1990). Rule 9(b) also acts "to safeguard a defendant's reputation from improvident charges of wrongdoing, and to protect a defendant against the institution of a strike suit." *O'Brien v. Nat'l Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991). However, Rule 9(b) "must be read together with Rule 8(a) which requires only a 'short and plain statement' of the claims for relief." *Ouaknine v. MacFarland*, 897 F.2d 75, 79 (2d Cir. 1990). Rule 9(b) "does not require nor make legitimate the pleading of detailed evidentiary matter." *Ross v. A.H. Robins Co.*, 607 F.2d 545, 557 (2d Cir. 1979); *Accord Arista Records, LLC v. Doe 3*, 604 F.3d 110, 120 (2d Cir. 2010).

The Second Circuit has held the heightened pleading standards of Rule 9(b) apply to securities cases when "the claims are premised on allegations of fraud." *Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004). If Rule 9(b) applies, the complaint must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where

and when the statements were made, and (4) explain why the statements were fraudulent." *Mills v. Polar Molecular Corp*., 12 F.3d 1170, 1175 (2d Cir. 1993). The complaint satisfies all these requirements.[13]

b. The Commission's Rule 13b2-2 Claim is Pled with Adequate Particularity.

The complaint does not rely on "impermissible group pleading," nor does it "merely lump the defendants together." The complaint identifies the specific statements each individual defendant made to auditors that the SEC charges were misleading, the nature of those statements, when and where they made, and why they were false or misleading.

With respect to defendant Straub, the complaint alleges he made the following misleading statements to Magyar's auditors: "we have made available to you all financial records and related data"; "we are not aware of any accounts, transactions or material agreement not fairly described and properly recorded in the financial and accounting records underlying the financial statements"; and "we are not aware of any violations or possible violations of laws or regulations . . . ." Comp. ¶ 63. Straub made these statements in management representation letters he signed between July 2005 and January 2006. *Id.* The complaint further alleges Straub signed these letters even though he knew that Magyar Telecom had entered into at least seven bogus contracts in 2005 and 2006, *Id.* at ¶ 65; that payments made under these contracts would be used to bribe government and political party officials in Macedonia and Montenegro, *Id.* at ¶ 66; that

[13] If the Court determines the SEC's Rule 13b2-2 claim is not pled with adequate particularity, the SEC should be afforded an opportunity to file an amended complaint to cure any deficiency. *See Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986) ("Complaints dismissed under Rule 9(b) are 'almost always' dismissed with leave to amend.").

the seven contracts did not accurately reflect the true purpose of the payments; and, that as a result, Magyar's books and records were false. *Id*. at ¶ 67. The complaint also alleges Straub failed to disclose the nature of the agreements Magyar had signed with Macedonian and Montenegrin government officials that amounted to a scheme to bribe them. *Id.* at ¶¶ 68-69.

The complaint identifies the following statements that defendants Balogh and Morvai made to Magyar's auditors: "[A]ll material information related to my area was disclosed accurately and in full (actuals and accruals) and in agreement with the subject matter of the management representation letter." *Id.* at ¶ 64. Balogh and Morvai made these statements when they each signed sub-representation letters for quarterly and annual reporting periods in 2005. *Id*. The complaint alleges that when Balogh and Morvai signed these letters, they possessed the same knowledge that Straub had about the seven bogus contracts; that the seven contracts did not accurately reflect the true purpose of the payments; and that, as a result, Magyar's books and records were false. *Id.* at ¶¶ 65-69.

Taken together, these allegations put the defendants on notice of what statements the SEC claims each defendant made that were fraudulent, when and where the statements were made, and why the SEC alleges they were misleading. That all defendants were aware of the same set of underlying facts, and that it was this common set of facts that made their statements to Magyar's auditors misleading, does not equate to the impermissible use of "group pleading."[14] The complaint specifically alleges that

[14] It is not entirely clear why defendants claim that reliance upon "group pleading" would be "impermissible," Def. Br. at 30, in light of the fact that the "group pleading doctrine is recognized as an exception to the requirement that the fraudulent acts of each defendant be

"Straub, Balogh, *and* Morvai" were aware of the facts that made their statements misleading; not that one *or* the other of them were aware of those facts.

c. The Complaint Adequately Pleads the Materiality of Defendants' Misstatements to Auditors.

Defendants' perfunctory argument that the SEC's Rule 13b2-2 claim should be dismissed because it does not properly allege a factual basis to establish the materiality of defendant's misstatements and omissions to Magyar's auditors is without merit for three reasons: Materiality for purposes of Rule 13b2-2 is *not* based on the understanding of a reasonable investor; there is no requirement the complaint allege reliance by the auditors; and materiality is an issue of fact for the jury.

Defendants' argument that for purposes of Rule 13b2-2 materiality depends on whether a "reasonable investor" would believe the misstatements to be significant, Def. Br. at 30, makes little sense where the misstatements at issue are those made to "an accountant." 17 C.F.R. § 240.13b2-2(a). There is no indication in Rule 13b2-2 that the misstatement must be communicated to an investor in order to establish a violation of the rule. That is why courts that have considered the issue have held, based on *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976), that for purposes of Rule 13b2-2, a statement is material if "'a reasonable auditor would conclude that it would significantly alter the total mix of information available to him.'" *SEC v. Patel*, No. 07 Civ. 39, 2009 WL 3151143, at *30 (D.N.H. Sept. 30, 2009) (*quoting United States v. Goyal*, No. CR 04-00201, 2008 WL 755010, at *5 (C.D. Cal. Mar. 21, 2008), *rev. on other grounds* 629

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identified separately in the complaint." *Camofi Master LDC v. Riptide Worldwide, Inc.*, No. 10 Civ. 4020, 2011 WL 1197659, at *6 (S.D.N.Y. Mar. 25, 2011).

F.3d 912 (9th Cir. 2010)).[15] This interpretation is consistent with the stated purpose of Rule 13b2-2 to "encourage careful and accurate communications *between auditor and issuers* from whom they request information during the audit process, deter the making of false, misleading or incomplete statements to accountants, and thereby enhance the integrity of financial disclosure system." *Promotion of the Reliability of Financial Information*, Exchange Act Release No. 34-15570, 1979 WL 173674, at *12 (Feb. 15, 1979) (emphasis added) (Ex. 4).

Defendants' argument that the SEC's Rule 13b2-2 claim is legally insufficient because there is no allegation that anyone "relied to their detriment on" the defendants' misstatements fails because the Rule does not require proof of reliance. As a general principle, the SEC "is not required to prove reliance when it brings enforcement actions under the securities laws." *KPMG*, 412 F. Supp. 2d at 375.

Finally, defendants' motion to dismiss the Rule 13b2-2 claim should be denied because the materiality of the misstatements they made to auditors is "a mixed question of law and fact that generally should be presented to a jury." *Press v. Chemical Inv. Serv. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999). The complaint alleges that if Magyar's auditors had known the facts not disclosed by defendants concerning the seven sham contracts, the auditors would not have accepted defendants' representation letters and would not have issued an unqualified audit opinion for Magyar's annual report. Comp. ¶ 70. This

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[15] Defendants' reliance upon *SEC v. Nacchio*, 438 F. Supp. 2d 1266 (D. Col. 2006), is misplaced because that court *did not* deny the motion to dismiss the Rule 13b2-2 claim on the ground that the false statements to auditors would have been material to investors. The court expressly held that the misrepresentations were considered necessary by the auditors. *Id.* at 1285.

factual allegation sufficiently alleges the materiality of defendants' misstatements to Magyar's auditors. The issue therefore should be presented to the jury.

CONCLUSION

For the foregoing reasons, the Court should deny the defendants' motion to dismiss the complaint.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on December 5, 2012, a copy of the foregoing document was served upon all counsel of record via the Court's electronic filing system, which sends notification to the following parties:

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