

# Tenth Circuit Affirms SEC's Extraterritorial Reach

January 29, 2019

Last week, in a much-anticipated decision, the U.S. Court of Appeals for the Tenth Circuit held in *SEC v. Scoville et al.* that Congress “clearly intended” Section 929P(b) of the Dodd-Frank Act to grant the U.S. Securities and Exchange Commission (“SEC”) authority to enforce the anti-fraud provisions of the federal securities laws abroad where there is sufficient conduct or effect in the United States.<sup>1</sup> In affirming the lower court’s decision, the Tenth Circuit undertook a thorough analysis of the legislative history of Section 929P(b) and concluded that Congress “affirmatively and unmistakably” intended to grant extraterritorial authority to the SEC where either “significant steps” are taken in the U.S. to further a violation of the anti-fraud provisions, or conduct outside the U.S. has a “foreseeable substantial effect” within the U.S.

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The *Scoville* decision thus provides judicial affirmation of the SEC’s ability to bring enforcement actions under what is essentially the same “conduct-and-effects” test that the Supreme Court rejected for private securities litigation in *Morrison v. Nat’l Australia Bank Ltd.*, 561 U.S. 247 (2010). The Tenth Circuit’s decision, though not entirely unexpected, is significant in that it represents the first Circuit Court decision to directly address the SEC’s authority to enforce the federal securities laws extraterritorially after the Supreme Court’s rejection of the “conduct-and-effects” test in *Morrison*.

**Background.** The SEC brought an enforcement action in federal district court against Charles Scoville alleging that he operated an unlawful Ponzi scheme through his internet traffic exchange business, defendant Traffic Monsoon, LLC. The company purportedly sold bundles of internet ads (“AdPacks”) to customers who became members with a promise to direct internet traffic to members’ websites and internet ads. Further, if members clicked on a certain number of ads for other members’ websites when they logged onto their Traffic Monsoon account, they qualified to share in Traffic Monsoon’s revenue, although Traffic Monsoon did not disclose how revenue was to be split between members and the company. Members living outside the U.S. accounted for 90 percent of the company’s Adpack sales.

<sup>1</sup> *SEC v. Scoville, et al.*, No. 17-4059, 2019 WL 302867, \*1 (10th Cir., Jan. 24, 2019).

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The U.S. District Court for the District of Utah granted the SEC's request for preliminary orders enjoining Scoville and Traffic Monsoon from continuing to operate and freezing defendants' assets.<sup>2</sup> In granting the request, the District Court held that the legislative history and plain language of Section 929P(b) of Dodd-Frank reflected the intention of Congress to allow the federal securities laws to be applied extraterritorially in SEC enforcement actions. Importantly, the District Court held that *Morrison* still applied to restrict the extraterritorial application of the federal securities laws in private causes of action.

**The Tenth Circuit's opinion.** Citing *Morrison*, the Tenth Circuit began its analysis by noting that whether a federal statute applies to conduct outside the U.S. is first a question of Congressional intent. The Court then looked to the language in Section 929P(b) of the Dodd-Frank Act and concluded that it was clear that Congress "affirmatively and unmistakably" directed that the federal securities laws apply extraterritorially. The Dodd-Frank Act amended both the Securities Act of 1933 and the Securities and Exchange Act of 1934 acts to reach:

- "(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; and
- (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

While the Tenth Circuit acknowledged that Section 929P(b) amended only the jurisdictional sections of the federal securities laws and not the substantive provisions themselves, the Court reasoned that "context and historical background" surrounding the enactment of the amendment made it clear that Congress "undoubtedly intended" that the anti-fraud provisions apply extraterritorially when the statutory conduct-and-effects test is satisfied. The Tenth Circuit pointed to the title Congress gave the section ("Strengthening Enforcement by the Commission"), the fact that Congress commissioned the SEC to conduct a study on whether private rights of action should also extend extraterritorially and statements by members of Congress, including Section 929P's drafter, confirming that the purpose of the provision was to make clear that the anti-fraud provisions apply extraterritorially to enforcement actions.

Applying the "conduct-and-effects" test in considering Traffic Monsoon's sales of Adpacks, the Tenth Circuit affirmed the District Court's conclusion that the company's conduct constituted "significant steps" to further the violation of the anti-fraud provisions of the federal securities laws. The Tenth Circuit noted that Scoville conceived

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<sup>2</sup> *SEC v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275 (D. Utah 2017).

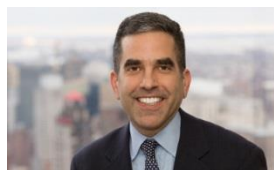
and created Traffic Monsoon in the U.S., created and promoted the Adpack investments over the internet while residing in Utah, and the servers housing the Traffic Monsoon website were physically located in the U.S.

**Final thoughts.** While the outcome of the *Scoville* decision is perhaps not surprising, it represents the first decision by a Circuit Court interpreting Section 929P(b) of the Dodd-Frank Act. The decision makes clear that U.S. regulatory authorities, unlike civil litigants, may enforce the anti-fraud provisions of the U.S. securities laws abroad and pursue actions against those outside the U.S. where the “conduct-and-effects” test can be satisfied. Foreign transactions in which there is significant conduct in the U.S. or a foreseeable substantial effect within the U.S. thus may be subject to civil and criminal securities enforcement proceedings by U.S. authorities.

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Please do not hesitate to contact us with any questions.

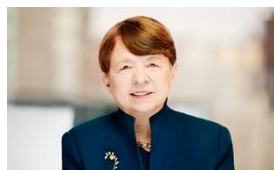
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