

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

C. CLARK HODGSON, JR., RECEIVER	:	CIVIL ACTION
	:	
v.	:	
	:	
MAN FINANCIAL INC., et al.	:	NO. 06-1944

MEMORANDUM

Baylson, J.

December 22, 2006

The glamor of foreign shores has captured authors, composers and also investors for centuries. Offshore adventures are a standard staple of important artistic works including Homer's Odyssey, Rossini's comic opera, The Italian Girl in Algiers, and modern novels such as Hemingway's Tales of the South Pacific. Although most offshore fantasies feature romance and happy endings, in real life, an offshore business adventure designed with profit in mind can have a sad ending, and in this case it ended with investor losses of over \$200 million.

The question presented is whether the offshore directors of an offshore company, established as a purportedly legitimate part of an investment program, are required to defend themselves in United States courts, specifically this one. Presently before the Court is a Motion to Dismiss by two third party Defendants, David Lashbrook and Scott Somerville, who were residents of the Cayman Islands at all relevant times, and served as directors of the Philadelphia Alternative Asset Fund, Ltd., commonly referred to in this case as the "Offshore Fund." They will be referred to in this Memorandum as the "Directors."

A brief summary of this and related litigation is relevant. On June 24, 2005, the

Commodity Futures Trading Commission (“CFTC”) initiated a lawsuit in this district, Civil Action 05-2973, against Frank M. Eustace, and the Philadelphia Alternative Asset Management Company (“PAAMCo”), a manager of offshore funds including the Offshore Fund that is the subject of this litigation. Eustace controlled PAAMCo and directed the investments of the Offshore Fund. The CFTC immediately sought the appointment of a Receiver, and Judge Padova of this Court appointed C. Clark Hodgson, Jr., Esquire, as Receiver to investigate and seek recovery of assets belonging to investors in the Offshore Fund, and other funds, allegedly defrauded by Eustace.

Undisputed facts concerning Eustace deserve mentioning as part of the background for the resolution of the current dispute. Now living in Canada, Eustace has been deposed several times in various litigation, including this one, and has admitted to a number of fraudulent acts involving the Offshore Fund. He has consented to the entry of a consent decree filed by the CFTC, which is pending approval by this Court in Civil Action 05-2973.

On May 8, 2006, the Receiver filed the present action against Man Financial, Inc., (“Man”), which acted as a broker for the Offshore Fund’s transactions, and several individuals employed by Man. Briefly stated, the Receiver alleges under legal theories such as negligence, breach of contract, and RICO, that Man failed to exercise professional diligence in the handling of the trading accounts for which it was a broker, and is thus liable for damages to the Receiver, which, if collected, would be distributed to investors. Further details are provided in this Court’s Memorandum dated October 5, 2006, 2006 WL 2869532.

On August 4, 2006, Man filed a third-party Complaint against four individuals, including Lashbrook and Somerville, who filed the pending Motion to Dismiss, including an assertion of

lack of personal jurisdiction. This Court entered a Scheduling Order which directed the parties to pursue discovery (including depositions of the directors) limited to the question of personal jurisdiction promptly and to complete briefing on that issue, promising an expedited decision.

The Court now concludes that the Motion will be denied without prejudice.

I. Allegations of the Third Party Complaint

In its third party Complaint, Man asserts that Lashbrook and Somerville are citizens of the Cayman Islands and that both were directors of the Offshore Fund (in an affidavit, Lashbrook asserts that he is in fact a citizen and current resident of England, who lived in the Cayman Islands for a number of years). The third party Complaint asserts that Eustace caused the formation of the Offshore Fund “as a hedge fund to engage in speculative commodity futures and options trading, and its shares were offered to sophisticated qualified investors, including institutional investors.” A corporate services firm in the Cayman Islands was instructed by Eustace to act as subscriber of the Offshore Fund, which was incorporated on or about May 28, 2004 under the laws of the Cayman Islands, and the organizers appointed Somerville and Lashbrook as directors of the Offshore Fund. They served in that capacity for all of the relevant events at issue in this case, and were reappointed as directors on or about July 29, 2004. The Offshore Fund had no other officers or employees. Thus, Lashbrook and Somerville were the only individuals who had any responsibility for the Offshore Fund, and in their depositions they acknowledged that, as its directors, they had a fiduciary duty towards the Offshore Fund.

The Offshore Fund entered into certain agreements, including an agreement with UBS Fund Services, also in the Cayman Islands, pursuant to which UBS Cayman would serve as the service fund administrator for the Offshore Fund, and a trading advisory agreement with

PAAMCo, under which PAAMCo had broad authority to direct the Offshore Fund's trading activities "subject to the fiduciary authority of the board of directors." Man entered into a brokerage agreement with PAAMCo, acting on behalf of the Offshore Fund, and set up an account in the name of the Offshore Fund. Man sent statements to the Offshore Fund at its address in the Cayman Islands. Further details about these agreements are set forth in this Court's Memorandum dated September 18, 2006, 2006 WL 2707397.

The third party Complaint alleges that the Offshore directors committed a number of acts and omissions in derogation of their fiduciary duty. One fact frequently mentioned by Man is that the directors forwarded, unopened, the monthly account statements that the Offshore Fund had received from Man for the PAAMCo accounts to PAAMCo's office in King of Prussia, Pennsylvania. Man asserts that if Lashbrook and Somerville had opened these mailings, they would have discovered Eustace's improper activities and been able to stop them. The specific charges against Lashbrook and Somerville are for common law identification, based on theories of breach of fiduciary duty and negligence.

For purposes of ruling on the Motion to Dismiss, this Court is obliged to accept Man's allegations against the directors as true, and construe disputed facts in Man's favor. See Pinker v. Roche Holdings, Ltd., 292 F.3d 361, 368 (3d Cir. 2002).

II. Summary of Motion to Dismiss for Lack of Personal Jurisdiction

In their Motion to Dismiss under Fed. R. Civ. P. 12(b)(2), Lashbrook and Somerville assert that this Court has no personal jurisdiction over them because they have insufficient contacts with Pennsylvania and principles of due process do not allow this Court to exercise this jurisdiction.

In this case, Man asserts only the doctrine of specific jurisdiction against Lashbrook and Somerville, under which the Court must determine whether Plaintiff's claim arose from Defendants' forum-related activity and, if so, whether Man has shown sufficient minimum contacts arising from that activity in this district. Any inquiry into personal jurisdiction must also involve due process considerations. The inquiry is whether the Defendants had sufficient minimum contacts with Pennsylvania to make it reasonable and fair to require them to defend in this forum.

In this case, it is undisputed that the Offshore Fund is a Cayman Island corporation that was established to further the investment program of the Offshore Fund, as directed by PAAMCo and Eustace. It is likely that the Offshore Fund was located in the Cayman Islands for avoidance of United States taxes and/or regulatory supervision – although the record is not clear on this point.

III. Applicable Law

The applicable law in this area is well settled. One of the leading Third Circuit cases is Pennzoil Products Co. v. Colelli and Associates, 149 F.3d 197 (3d Cir. 1998). In exploring the extent of Pennsylvania's long-arm statute, 42 Pa. Cons. Stat. Ann. § 5322, which permits Pennsylvania courts, including this Court, to exercise personal jurisdiction over a non-resident defendant to the constitutional limits of the due process clause of the Fourteenth Amendment, the exercise of the long-arm statute is valid as long as it is constitutional.

In a case such as this one, where Man asserts specific, as opposed to general, jurisdiction, the Court should apply two standards – the first mandatory and the second discretionary, which serve to insure the Defendants receive due process. First, the Court must determine whether the

defendant had the minimum contacts with the forum necessary for the defendant to have reasonably anticipated being haled into court here, and second, assuming minimum contacts have been established, the Court may inquire whether the assertion of personal jurisdiction would comport with traditional notions of fair play and substantial justice.

In Pennzoil, the court reversed the district court's dismissal of a defendant who was accused of negligent conduct occurring out of Pennsylvania, which caused harm within Pennsylvania under a provision of Pennsylvania law known as the "tort out/harm in" provision. The district court had erroneously concluded that this provision applies only to intentional tortfeasors. The circuit court disagreed and found that the Pennsylvania statute extends jurisdiction to anyone who causes harm or tortious injury, intentionally or not, in Pennsylvania through acts or omissions outside of Pennsylvania. Although Pennzoil was a products liability case, its holding would apply in this case, if only because there are numerous facts which show that Lashbrook and Somerville had frequent contacts with events in Pennsylvania.

The Supreme Court has held that jurisdiction is proper when a defendant purposely establishes "minimum contacts" in the forum state by deliberately engaging in significant activities or by creating continuing obligations such that he has availed himself of the privilege of conducting business there. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985). When determining whether personal jurisdiction exists, courts must resolve the question based on the circumstances that the particular case presents. Id. at 485.

IV. Analysis

Some of the facts on which the Court relies in finding personal jurisdiction as to Lashbrook and Somerville are as follows:

1. As general background, as noted in the prior Memoranda, the Offshore Fund entered into certain agreements in which it acknowledged that it was subject to jurisdiction in various courts in the United States. For example, the agreement between the Offshore Fund and PAAMCo contains a consent to jurisdiction in New York City, New York and any federal and state courts within New York City. The Trading Agreement between the Offshore Fund and Man contained a consent to jurisdiction in the courts of Illinois.

Thus, it cannot come as any surprise to the directors that the agreements entered into by the Offshore Fund anticipated that in the event of any litigation, the Offshore Fund itself would be subject to the jurisdiction of the United States courts, even though the Offshore Fund was governed by and headquartered in the Cayman Islands. As its sole directors, Lashbrook and Somerville cannot claim any lack of due process by being personally required to defend litigation in the United States. See Pinker, 292 F.3d at 370-71. However, this does not specifically answer the issue as to Pennsylvania.

2. Lashbrook and Somerville both acknowledge making one visit to Pennsylvania in 2005 to visit with their lawyer.¹ Although their affidavits assert that these visits were in connection with “this case,” they are, probably unintentionally, wrong because the present case was not started until sometime in 2006. Lashbrook and Somerville must have come to Pennsylvania to discuss the case started by the CFTC, which means they came to discuss the Offshore Fund, not any claim against them personally. The Court concludes that, although the discussions with their lawyer are privileged, the fact that they came to Pennsylvania to discuss the

¹ Somerville made one other visit to Pennsylvania related to a different business matter, which is relevant.

proceedings started by the CFTC is of some import, in that they could have required any United States lawyer to communicate with them in the Cayman Islands, or to visit a state other than Pennsylvania, such as one of the states where the Offshore Fund had consented to jurisdiction.

3. More significant are the large number of e-mail communications that were exchanged between Lashbrook and Somerville, in the Cayman Islands, and PAAMCo's offices in King of Prussia, Pennsylvania. Although a number of them are somewhat innocuous and insufficient to warrant personal jurisdiction, others discuss substantive matters, and when taken as a whole, they indicate a flow of communications back and forth between Pennsylvania and the Cayman Islands sufficient to carry, at this stage, Man's burden of establishing minimum contacts.

Many of these e-mails are attached to Man's brief in opposition to the Motion to Dismiss. See, for example, an e-mail "chain," Documents MF 01223-01224, MF 1155-1159, containing an exchange between Eustace and Lashbrook concerning a "rep" [representation] letter for the Offshore Fund, although on PAAMCo's stationery, which Eustace forwarded to Lashbrook, requesting Lashbrook and Somerville to sign it and forward it to the auditors, as they required. Lashbrook advised Eustace that he was not a signatory for PAAMCo and could not sign that letter but, as he added, it was not clear whether the auditors wanted a representation letter from the investment manager or directors. He noted "normally it is from the directors of the fund." See Document MF 01226. See also, the exchange of e-mails and attachments at MF 1160-1165, which imply that Lashbrook, in the Cayman Islands, was advising Eustace, in Philadelphia, what representation letters to sign. The Court finds this of particular significance because the representation letters to Deloitte & Touche, as auditors, made a number of representations, including "we have no knowledge of any fraud or suspected fraud affecting the fund. . . ." As

events turned out, these representations were false. There is nothing in the present record to suggest that Lashbrook or Somerville had any knowledge of a falsity at that time, but their communications with Eustace, in Philadelphia, about signing the representation letters is important in a due process analysis of the fairness of requiring Lashbrook and Somerville to defend themselves in this litigation in this Court. The present record does not show that Lashbrook or Somerville themselves signed any of the representation letters, but it appears that they may have, and certainly were willing to. The attachments in the record do not make precisely clear which documents were referenced in the e-mails.

4. From the evidence on file, Somerville and Lashbrook, although taking on the title of directors, did very little.² Indeed, under the allegations by Man, Lashbrook and Somerville basically ignored their fiduciary obligations to the Offshore Fund and allowed it to be run by Eustace. Under Pennzoil, Somerville and Lashbrook's actions and inactions in the Cayman Islands caused harm in Pennsylvania, and this is sufficient to establish the "minimum contacts."

5. Lashbrook also wrote an e-mail on July 23, 2004, document MF 00770, noting that Eustace had executed a certain agreement, but "it should have been executed by us [Lashbrook and Somerville]. . . ." This indicates Lashbrook and Somerville's willingness to fully participate in the signing of documents that were essential to the legal status of the funds and their mutual interrelationships.

² Eustace listed, as a second mailing address for the Offshore Fund, his own office at 2701 Renaissance Blvd., 4th Floor, King of Prussia, PA. See Attac. A to Doherty Declaration, Doc. No. 17, Document Man/Rec 001752. As this Court's prior Memoranda have noted, the directors of the Offshore Fund, although not specifically signing the trading agreement with Man, thereafter ratified it by knowing that the Offshore Fund used Man for many large transactions, but failed to repudiate it. However, there is no evidence the directors knew this fact.

6. Although the above points of evidence are important, they do not convey the overarching concept, the knowledge of which must be charged to Lashbrook and Somerville on this record, that the investment program was based in Pennsylvania but required an offshore entity, and Cayman Islands law required this entity to have Cayman Islands directors, i.e., Lashbrook and Somerville. The directors well knew that the operations were headquartered in and carried out in Pennsylvania, principally by Eustace, and thus there was a direct connection between their fiduciary status as directors with the operations of the fund in Pennsylvania. One could not operate without the other; both were needed to have the effective offshore advantages, and those advantages were an integral part of the strategy based in Pennsylvania.

Both parties rely on the comprehensive and oft-cited opinion of former District, now Chief Circuit, Judge Anthony J. Scirica, in Rittenhouse & Lee v. Dollars & Sense, Inc., 1987 WL 9665 (E.D. Pa. 1987) as setting forth some of the guiding principles. Judge Scirica's opinion deals mostly with an analysis of a motion to dismiss by a non-Pennsylvania resident named Woodington, who was the general manager of the corporate defendants in the case. After reviewing a number of other decisions, Judge Scirica concluded that, although the corporate shield doctrine generally protects corporate officers from personal jurisdiction merely because of corporate activities in a forum, under a flexible due process analysis, a court could establish personal jurisdiction over the individual director, based on the individual's corporate activities, such as when the individual is personally engaged in egregious activity, even if he is acting on behalf of the corporation. Id. At *4. The factors in the test are (1) the officer's role in the corporate structure; (2) the nature and quality of the officer's forum contacts; and (3) the officer's personal participation in the tortious conduct. Id. At *4 n.6.

Judge Scirica's discussion holds that a corporate officer or director may be responsible to respond to litigation in the forum not only when the conduct was performed within the forum, but also if the officer's egregious acts were performed outside the forum. However, normal corporate activity should not be part of a jurisdictional inquiry. Judge Scirica concluded that consideration of all of Woodington's acts was appropriate under the circumstances. Woodington was more than an ordinary corporate official; he was the key player in the corporate structure and the driving force behind a joint venture which was the focal point of the litigation.

Judge Scirica concluded that Woodington should not be permitted to use the corporate shield to protect himself from liability for actions he undertook, noting that Woodington had "purposely availed himself of the privilege of doing business [in Pennsylvania] and should have reasonably anticipated being haled into this court to defendant plaintiff's allegations." *Id.* at *5.

In the present case, Lashbrook and Somerville are the only two individuals involved in the Offshore Fund. They served as its sole directors, but their activity was minor compared to Woodington. Their depositions acknowledge that they had a fiduciary duty to the corporation. Man's allegations made in the Complaint and in the briefing on this Motion establish, with reference to forwarding mail unopened, e.g., that if Lashbrook and Somerville been more attentive to the discharge of their fiduciary duty to the Offshore Fund, the alleged wrongdoing would have been discovered before the full extent of harm was suffered by the investors in the Offshore Fund.

This Court has previously found as a fact that all of the assets of the Offshore Fund are located in the United States. See Memorandum dated October 31, 2005 in the CFTC case. Thus, the allegations of Man, that the Offshore Fund was adversely impacted by the acts and omissions of Lashbrook and Somerville in the Cayman Islands, supplemented by their visit to and

communications into Pennsylvania, are sufficient to establish personal jurisdiction.³ The corporate shield doctrine does not apply on these facts.

However, because Lashbrook and Somerville have the right to final determination of this issue based on a full record, and not just the unproven allegations in Man's Complaint, and because it appears that the documentary record presented as of this date (because of the expedited discovery and briefing schedule) may not be as full or complete as it will be after the completion of merits discovery, the totality of facts to be presented at the close of merits discovery may establish that their actual contacts with this forum are insufficient to satisfy either the minimum contacts requirement or the due process requirement. Thus, the Court's ruling will be without prejudice.

An appropriate Order follows.

³ Judge Scirica also noted that courts have crafted a narrow exception to these jurisdictional rules for cases in which the corporation is a sham to shield individual officers, directors, or shareholders from liability, or where the officers are corporate alter egos. Man does not specifically allege that the Offshore Fund was a sham, (perhaps because it was Man's customer).

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MAN FINANCIAL INC., et al.	:	NO. 06-1944

ORDER

AND NOW, this 22nd day of December, 2006, for the reasons stated in the foregoing Memorandum, it is hereby ORDERED as follows:

1. The Motion to Dismiss filed by third party Defendants Lashbrook and Somerville as to personal jurisdiction only, is DENIED, without prejudice.

2. Counsel for Lashbrook and Somerville shall communicate with counsel for Man and other counsel in the case, with the objective of reaching agreement on completion of merits discovery on an expedited basis. Although the present pretrial schedule is under discussion with all counsel, the Court will expect most dispositive motions to be filed no later than the beginning of March 2007, but will allow Lashbrook and Somerville, in order to have some additional time for merits discovery, to file their anticipated dispositive motion slightly later, with a shortened response time.

3. The trial of this case will start in early May 2007. Although there may be a motion for bifurcation of the claims in this case, that decision will not be made until after all dispositive motions have been filed.

4. If necessary to resolve any disputes on scheduling, counsel shall schedule a conference call with the Court during the week of January 8, 2007. In that event, the parties shall

submit proposed scheduling orders to chambers in advance of the conference call.

BY THE COURT:

s/Michael M. Baylson

Michael M. Baylson, U.S.D.J.