

**THE INTERNATIONALIZATION OF SECURITIES  
ENFORCEMENT: RECENT DEVELOPMENTS IN  
CROSS-BORDER INVESTIGATIONS**

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## **I. Introduction**

A decade or two ago, U.S. prosecutors and regulators shied away from collecting evidence in other countries and from bring cases where the conduct occurred overseas. The process was considered slow and burdensome and the results deemed too uncertain to justify the time and effort required. In recent years, however, they dramatically have increased their efforts not only to collect evidence beyond the borders, but also to bring cases against foreigners for conduct that either occurred in the United States or affected U.S. markets. Moreover, given the ever-increasing globalization of financial markets, the trend toward cross-border enforcement is virtually certain to continue.

The government has focused its enforcement on three areas: First, regulators and prosecutors have targeted the use of offshore shell corporations to conceal the nature and purpose of criminal activity as well as the identity of participants, to launder money and to evade taxes. Second, they have focused on frauds conducted abroad but targeted at U.S. markets. Third, the U.S. government has enlisted the financial services industry in the fight against money laundering. The Patriot Act, swiftly adopted in the wake of September 11<sup>th</sup>, imposes stringent new obligations on banks and brokerage firms to prevent and disclose money laundering.

This articles examines these three areas of enforcement activity, the application of U.S. securities law outside the United States, the techniques used for gathering evidence abroad, and the limits on Constitutional protections that may apply when the government conducts investigations overseas.

## II. Recent Developments in International Enforcement

### A. Offshore Shell Corporations

The government's initial foray into extraterritorial enforcement of the securities laws began in the mid- to late-1980s with a series of highly publicized insider trading cases. In these cases, Wall Street insiders used offshore bank and brokerage accounts in an effort to conceal their identity and the nature and purpose of their trading activity.<sup>1</sup> The SEC and federal prosecutors ultimately obtained account records and, importantly, the identity of the owner of the account from the foreign banks.

In the mid 1990s, the adoption of Regulation S as a limited exemption to the registration requirements of the federal securities laws led to a large number of offering frauds.<sup>2</sup> Regulation S provided for the sale of unregistered securities, most often at a discount to the market price, to foreigners. In Regulation S frauds, U.S. investors acquired offshore shell corporations, used them to create the false appearance that the U.S. citizens were foreign businesses and fraudulently purchased Regulation S stock through the shells at a discount to the market price.<sup>3</sup>

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<sup>1</sup> In the mid 1980s, Dennis Levine, then a managing director of Drexel Burnham Lambert, Inc., conducted an infamous insider trading scheme through an account he opened at Bank Leu International Ltd. in the Bahamas with the codename Diamond and in the names of two Panamanian corporations, IGI and DH. Levine reaped over \$12.6 million in profits. When the SEC initiated an investigation of the scheme, Levine tried to transfer \$10 million from Bank Leu to an Isle of Jersey Bank located in the Cayman Islands. See SEC v. Dennis Levine, et. al, SEC LitRel. 11095 (May 12, 1986).

<sup>2</sup> See Securities Act Release No. 6863 (April 24, 1990 (adopting Regulation S in order to clarify extraterritorial application of registration requirements).

<sup>3</sup> See, for example, In re Candies, et al, Securities Act Release No. 7263 (Feb. 21 1996); United States v. Sung and Feher, Sec. Lit. Rel. No. 14500 (May 15, 1995); SEC v. Softpoint, Inc., et. al., Sec. Lit. Rel. 14480 (April 27, 1995); E. Greene, Recent Problems Under Regulation S, Insights (August 1994); Rule Permitting Offshore Stock Sales Yields Deals that Spark SEC Concerns, Wall Street Journal at C1 (April 26, 1994). These frauds ultimately were halted by amendments to Regulation S that required foreign investors to hold the stock for at least a year. See Securities Act Release No. 33-7392 (proposing amendments to Regulation S to prevent abuses).

In the mid- to late-1990s, as microcap fraud boomed, U.S. stock promoters and market manipulators used offshore shell companies to conceal the nature and purpose of the fraudulent trading activity, as well as the identity of the participants in the schemes.<sup>4</sup> Typically they acquired shell corporations, hired nominees to act as officers and directors and opened bank and brokerage accounts offshore or in the United States in the names of the shell corporation. They then conducted the fraudulent activity through these bank and brokerage accounts, with instructions for trading and transfers of funds appearing to come from the nominees in the offshore jurisdiction.

Most recently, Enron reportedly used shell corporations in the Channel Islands for transactions designed to alleviate its liquidity problems while concealing its burgeoning debt. Enron borrowed large sums from Chase Manhattan and Merrill Lynch, among others, through complex transactions involving Channel Islands shell companies, but did not record the loans as debt on its quarterly and annual financial statements. The loans presently are the focus of investigations by the Congress, the Justice Department and the New York District Attorney's Office.

The Internal Revenue Service, meanwhile, is conducting a highly-publicized crackdown aimed at U.S. residents who use credit cards from offshore banks to evade income taxes. Last April, the IRS requested Americas Express, Mastercard and Visa to

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<sup>4</sup> See e.g. SEC v. Ballou et al., Civ. No. H-01-2579 (S.D. Texas 2001 (alleging that U.S. residents opened brokerage accounts in Canada in names of shell corporations and corporations to inflate Evans Systems stock by means of wash sales and matched orders), Sec. Lit. Rel. No. 17097 (August 9, 2001); U.S. v. McCoskey, 00 Cr. 219 (D. Ct.) (stock promoter sold millions of shares of Marcorp through Canadian brokerage accounts, Sec. Lit. Rel. 17056 (July 2, 2001); SEC v. Ogle et al., Civ. No. 99-C-609 (N.D.Ill.) (defendants used British Columbia brokerage accounts to manipulate Exsorbet stock), Sec. Lit. Rel. 16604 (June 22, 2000).

produce records of U.S. owners of offshore credit cards.<sup>5</sup> The General Accounting Office estimates that 1-2 million U.S. residents use offshore accounts to evade \$20-30 billion a year in taxes. The IRS summons to the credit card companies sought names, addresses, social security numbers, passport numbers and telephone numbers of card holders with accounts in such tax havens as the Cayman Islands, Bermuda and Liechtenstein. In an affidavit filed with a federal court in San Francisco, the IRS asserted that by examining the records, it has identified "executives of publicly held companies, business owners, doctors, lawyers, investment professionals and promoters of tax shelter" who used the cards to pay for items ranging from groceries to country club dues.<sup>6</sup>

#### **B. Frauds Aimed At U.S. Markets**

The Securities and Exchange Commission and Department of Justice repeatedly have demonstrated a willingness to reach beyond our borders to prosecute overseas conduct that impacts U.S. markets. The cases have ranged from overseas boiler rooms, stock manipulations and Internet frauds targeting U.S. investors,<sup>7</sup> to foreign nationals

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<sup>5</sup> See IRS Looks at Offshore Mastercard Purchases in Tax Evasion Probe (Bloomberg April 11, 2002)

<sup>6</sup> See American Express to Give Offshore Information to IRS (Bloomberg March 25, 2002)

<sup>7</sup> See e.g. SEC v. Stroud, Civ. 01-999 (W.D. Ok.) (two Canadians allegedly raised \$1 million by fraudulently soliciting investments in fictitious entities over the Internet, SEC Lit. Rel. 17057 (June 29, 2001)); People v. Meyers Pollack Robbins, Morton Glickman et al., Ind. 99/000122, Supreme Court New York County (alleging Canadian manipulated stocks by bribing stock brokers). Canadian boiler rooms and phone banks account for one third of the telemarketing complaints received by Canadian and U.S. authorities. Bruce Zagaris, Canadian Telemarketing Scams into the U.S. Increase, 13 International Enforcement Reporter No. 10 (October 1997).

trading on inside information in U.S. stocks,<sup>8</sup> to foreign business executives participating in financial frauds at U.S. based companies.<sup>9</sup>

### C. Patriot Act

In the wake of September 11<sup>th</sup>, the government enlisted the financial industry in its fight against money laundering. The International Money Laundering Abatement and Anti-Terrorist Financial Act, called The Patriot Act for short, imposed sweeping obligations on banks and brokerage firms to identify and prevent money laundering. Among other things, the Patriot Act and the rules promulgated pursuant to it (a) required businesses to report cash transaction of more than \$10,000; (b) required banks and brokerage firms also to adopt comprehensive anti-money laundering compliance and education programs; and (c) required banks and brokerage firms to ascertain the true identity of any person seeking to open an account and to report suspicious activity.

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<sup>8</sup> For example, on May 10, 2001, the SEC sued and obtained an TRO against eight Mexican nationals and four offshore entities allegedly that they had engaged in insider trading in the stocks of CompUSA, Inc. and Prodigy Communications. The trading occurred shortly before the public announcement that CompUSA had agreed to be acquired by a Mexican holding company. One of the defendants was a partner in a Mexico City law firm representing the holding company in the tender offer negotiations. See SEC v. Duclaud, et al., 01 Civ. 3999 (S.D.N.Y. 2001), Sec. Lit. Rel. 16997 (May 11, 2001). On January 24, 2001, the SEC sued unknown defendants who bought and sold Ralston Purina call options through a Swiss bank in advance of Nestle' SA's announcement of plans to acquire Ralston Purina. SEC v. One or More Unknown Traders of Options on Common Stock of Ralston Purina Co., 01 Civ. 0339 (S.D.N.Y.), Sec. Lit. Rel. 16870 (January 24, 2001). In May 2000, the SEC settled insider trading charges with three Israeli citizens and residents who used inside information obtained from Chemical Securities to buy stock in five stocks: DSG International, Ltd. Truck Components, Playtex Products, Maxus Energy and Best Products Co. SEC v. Pollak, 00-Civ.3892 (S.D.N.Y. 2000), Sec. Lit. Rel. No. 16561 (May 23, 2000).

<sup>9</sup> On October 5, 2000, a federal grand jury in San Francisco indicted the former top European sales executive of Informix, for wire and securities fraud. The German sales executive allegedly participated in six sham transactions intended to inflate the Silicon Valley computer database company's so that the company would meet analysts' expectations. The defendant alleged approved secret side agreements to sales contracts in which buyer could obtain refund if unable to sell the product. Because of these secret agreements, revenue could not lawfully be recognized on the contracts. The defendant lied about the side agreements and falsely certified that there were not agreements or understandings, written or oral, that had been made which would change in any way the appropriateness, the timing of the record or the collectability of any of the transactions. See Sec. Lit. Rel. 16757.

Prosecutors wasted no time in testing the Patriot Act. In May 2002, the U.S. Attorney's Office in Massachusetts obtained the first conviction under the Patriot Act. Mohammed Hussein unsuccessfully sought a state license to receive deposits and transmit money overseas. Despite two warnings from the state that his business, Barakaat North America, Inc., could not transmit money until it received a state license, the defendant wired \$3 million to the United Arab Emirates and continued to accept deposits and transmit money overseas. Hussein was convicted under a provision of the Patriot Act prohibiting an individual from operating a foreign money transmittal business without a state license.

### **III. Extraterritorial Application of the Securities Laws**

For the lawyer whose foreign clients become enmeshed in the investigations, the first – and perhaps most important – question is whether the client is in legal jeopardy in the United States; that is, whether the client could be found to have violated U.S. securities laws. Prosecutors and regulators have enjoyed substantial, but not uniform, success in applying U.S. securities laws to prosecute foreign citizens and corporations.

Courts look to see whether they have jurisdiction over the case and jurisdiction over the person. The former is called subject matter jurisdiction; the latter is called personal jurisdiction. The court must have both subject matter and personal jurisdiction before it can apply U.S. securities law to a defendant.

#### **A. Subject Matter Jurisdiction**

Courts apply two tests to determine if they have subject matter jurisdiction over a case. The first test is the "effects test", *i.e.*, did the conduct, even if it occurred outside

the United States, have an effect in the United States. This test is used most often when the perpetrators are outside the United States. The second test is known as the "conduct test", *i.e.*, did conduct that furthered the fraud occur in the United States? This test is most often used when the victims of the fraud are located outside the United States.

### 1. Effects Test

Under the effect test, courts examine whether the fraud had an effect in the United States, *e.g.*, whether the fraud affected the price of a security trading on a U.S. stock exchange. The seminal case is Schoenbaum v. Firstbrook.<sup>10</sup> There, the Second Circuit affirmed the extraterritorial application of U.S. securities laws even though the issuer, Banff Oil, was a Canadian company that did no business in the United States and even though the fraudulent conduct largely occurred in Canada. The Second Circuit held that Banff Oil's listing on the American Stock Exchange sufficed to create subject matter jurisdiction in the United States. Thus, under Schoenbaum, U.S. courts have jurisdiction over a securities fraud case where the security trades on a U.S. exchange.

### 2. Conduct Test

Rather than focusing on whether U.S. markets or investors were affected, the conduct test examines whether the fraudulent conduct occurred in the United States. Inherent in the test is the principle that the United States should not be used as "a base for manufacturing fraudulent security devices for export, even when peddled only to foreigners." Psimenos v. E.F. Hutton, 722 F.2d 1041, 1045 (2d Cir. 1983), quoting, IIT

<sup>10</sup> 405 F.2d 200 (2d Cir. 1968), aff'd in part, rev'd in part on other grounds, 405 F.2d 215 (2d Cir. 1968)(en banc), cert. denied, 395 U.S. 906 (1969).

v. Vencap, Ltd., 519 F.2d 1001, 1017 (2<sup>nd</sup> Cir. 1975).<sup>11</sup> Under this test, a federal court has subject matter jurisdiction if (1) the defendant's activities in the United States were "more than merely preparatory" to a fraud conducted elsewhere and (2) the activities in the United States "directly caused" the victim's losses. E.g. Itoba, Ltd. v. Lep Group PLC, 54 F.3d 118, 122 (2d Cir. 1995), citing Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972).

In Leasco Data Processing Equipment, a U.S. company acting through a Netherlands Antilles subsidiary, bought shares in a U.K. firm. The stock of the U.K. firm was not listed on a U.S. exchange, and the U.K. firm did not do business in the United States. However, the plaintiff alleged that the defendants made misrepresentations during negotiations held in the United States. The Second Circuit drew a distinction between conduct material to the fraud, which would give rise to subject matter jurisdiction, and conduct "merely preparatory" to the fraud, which would not. The Second Circuit held that the misrepresentations in this case were more than "merely preparatory" to the fraud and that U.S. courts, therefore, had subject matter jurisdiction.

Similarly, in Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975), a U.S. citizen sued on behalf of U.S. and foreign plaintiffs residing in the U.S. and abroad. The defendant was a Canadian company. The transaction at the heart of the suit occurred mostly abroad. It involved the sale of securities outside the U.S. The securities were not traded on a U.S. exchange.

<sup>11</sup> See also SEC v. Kasser, 548 F.2d 109 (3d Cir.) (finding subject matter jurisdiction over Ponzi scheme perpetrated in the U.S. against Canadian investors), cert. denied sub nom. Churchill Forest Industries (Manitoba) Ltd. v. SEC, 431 U.S. 933 (1977).

However, the U.S. plaintiff obtained a prospectus in New York. In addition, meetings between the issuer, underwriter, accountants and the SEC occurred in the United States -- acts the Second Circuit deemed "preparatory" to the fraud. The court concluded that the antifraud provisions of the securities laws:

1. apply to losses from sales of securities to U.S. residents in the U.S. regardless of whether acts material to the fraud occurred in this country;
2. apply to losses from sales of securities to U.S. citizens resident abroad, if acts of material importance to the fraud occurred in the U.S. and "contributed significantly" to the sales of the securities.
3. do not apply to foreigners living outside the United States unless acts of material importance to the fraud (or a culpable failure to act) occurred within the United States and "contributed directly" to the losses.

The court, therefore retained jurisdiction over the U.S. plaintiffs, but dismissed the claims of the foreign plaintiffs. Similarly, in IIT v. Vencap, 519 F.2d 100 (2d Cir. 1975), decided the same day as Bersch, the Second Circuit held that foreign plaintiffs' suits under the securities laws would be heard only when "substantial acts in furtherance of the fraud" occurred in the U.S.

Applying Leasco Data Processing and Bersch, courts have found subject matter jurisdiction under the conduct test where a foreign issuer made a single filing with the SEC,<sup>12</sup> a contract was signed in the U.S. by a foreign buyer and seller of non-U.S.-listed stock,<sup>13</sup>; and commodities futures trades were executed in the United States.<sup>14</sup>

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<sup>12</sup> Itoha v. Lep Group, 54 F.3d at 122.

<sup>13</sup> Grumenthal GmbH v. Holtz, 712 F.2d 421, 425 (9<sup>th</sup> Cir. 1983).

Along similar lines, a New York State court upheld jurisdiction in a criminal case against two Venezuelan businessmen who defrauded Puerto Rican bank by wiring money through Federal Reserve Bank of New York. People v. Castro Llanes, 1996 N.Y. Misc. LEXIS 281 (N.Y.Co. S.Ct. 1996)

### **B. Personal Jurisdiction**

Courts look not only to whether they have jurisdiction over the "subject matter," but also whether they have so-called "personal jurisdiction," that is jurisdiction over the defendant. Personal jurisdiction requires "minimum contacts" with the United States in order to satisfy the requirements of due process. See World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980). In order to comply with due process, the defendant must have purposefully established minimum contacts with the United States, and the exercise of jurisdiction must not violate traditional notions of fair play and substantial justice. SEC v. Carrillo, 115 F.3d 1540, 1542 (11<sup>th</sup> Cir. 1997)

The defendant's contacts must satisfy three criteria: First, the contacts must be related to the plaintiff's cause of action or have given rise to it. Second, the contacts must involve some acts by which the defendant purposefully availed himself of the privilege of conducting activities within its forum. Third, the defendant's contacts must be such that the defendant should reasonably anticipate being hauled into court. Id., quoting Vermeulen v. Renault, U.S.A., 985 F.2d 1534, 1535 (11<sup>th</sup> Cir. 1993).

Based on these criteria, courts generally, but not consistently, have held that the government has personal jurisdiction over foreign nationals living outside of the United

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<sup>14</sup> Psimenos v. E.F.Hutton & Co., 722 F.2d 1041, 1047 (2d Cir. 1983); Tamari v. Bache & Co. (Lebanon), S.A.L., 547 F. Supp. 309, 313-15 (N.D.Ill. 1982), aff'd, 730 F.2d 1103 (7<sup>th</sup> Cir.), cert. denied, 469 U.S. 871 (1984).

States who have done business in the United States directly or through a subsidiary. See SEC v. Carrillo, 115 F.3d at 1548 (personal jurisdiction over Costa Rican corporation and its officers who placed misleading articles in in-flight airline magazines, mailed applications to buy stock and offering materials to U.S. and maintained bank accounts in United States); SEC v. Wang, 944 F.2d 80 (2d Cir. 1991) (assuming personal jurisdiction over defendant who placed single trade in United States in insider trading case); In re Marc Rich & Co. A.G., 707 F.2d 663 (2d Cir.) cert. denied, 463 U.S. 1215 (1983) (personal jurisdiction over the foreign corporation for purposes of service of grand jury subpoena through a wholly owned foreign-based subsidiary that conducted business in New York).

#### **IV. Evidence Gathering**

In the past, regulators and prosecutors were reluctant to pursue extraterritorial investigations because of the difficulty of gathering evidence. The process was slow, and the results uncertain. Obtaining evidence sometimes required years. Today, however, thanks in large part to mutual assistance treaties, the results are quicker and more likely to yield success. Foreign governments sometimes respond within months or even weeks. Consequently, government lawyers are more aggressive in developing offshore cases.

Prosecutors and regulators gather evidence located in other countries by means of (1) grand jury and administrative subpoenas, (2) requests for assistance to other nation's governments under Mutual Legal Assistance Treaties (MLATs) and Memorandums of Understanding (MOUs), and (3) letters rogatory.

### **A. Administrative and Grand Jury Subpoenas**

Subpoenas are the quickest, easiest and one of the most common methods used by U.S. prosecutors and regulators to obtain testimony and evidence. The SEC has the power to issue administrative subpoenas to compel production of documents and testimony that are relevant to an SEC investigation. The federal laws empower the SEC to subpoena witnesses "from any place in the United States." Federal prosecutors have similar authority to issue subpoenas in the name of the grand jury.

These provisions have been broadly construed to require production of evidence located outside the United States so long as the subpoenas have been validly served in the United States. In SEC v. Minas de Artemisa, S.A., 150 F.2d 215 (9<sup>th</sup> Cir. 1945), for example, the SEC served a subpoena to a Mexican company on the Arizona home of a U.S. citizen who managed the company. The Ninth Circuit permitted the SEC to compel production of documents located in Mexico. The court held that "the obligation to respond applies even though the person served may find it necessary to go to some other place within or without the United States in order to obtain the documents required to be produced." 150 F.2d at 218.

#### **1. U.S. Subsidiary or Parent**

One common tactic is to serve a subpoena on the U.S.-based affiliate of foreign corporation requesting that the foreign corporation produce documents in its possession. Since jurisdiction is readily established over the U.S. entity, the issue becomes whether the U.S. corporation has "control" of the documents located in the overseas offices of foreign corporation.<sup>15</sup> Control includes not only actual possession, but also the legal

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<sup>15</sup> Generally, the recipient of a subpoena is required to produce documents in its "custody, possession or control." See e.g. Fed.R.Civ.P. 34(a).

right to obtain documents requested upon demand. In the case of a U.S. parent corporation and a foreign subsidiary, the U.S. parent usually will be deemed to have control over the documents in hands of a foreign subsidiary. Compare In re Uranium Antitrust Litigation, 480 F. Supp. 1138, 1151-52 (N.D. Ill. 1979)(parent deemed to have control for document production purposes of wholly owned subsidiary, but not of 43.8 percent owned subsidiary that conducted its corporate affairs separately from parent) with In re Arawak Trust Co. (Cayman) Ltd., 489 F. Supp. 162 (E.D.N.Y. 1980) (parent that owned 28 percent of Cayman Island trust company not deemed to have control of company).

However, where a subpoena is served upon a U.S. subsidiary of a foreign parent, the issue of control is more a question of fact than of law. The result rests on a determination of whether the subsidiary has practical managerial control over, or shares control with, its parent, regardless of the formalities of corporate organization. In re Uranium Antitrust Litigation, 480 F. Supp. at 1145. Courts have found that subsidiaries "control" documents in the possession of their parent corporations under a variety of theories:

- The alter ego doctrine, that is, the subsidiary and parent are so closely connected that the parent is the subsidiary's alter ego.
- The subsidiary acted as an agent of the parent in the transaction that is the focus of the litigation.
- The subsidiary can obtain documents from the parent in the ordinary course of the subsidiary's business, to meet its own needs or when helpful for use in litigation.
- The subsidiary marketed and serviced the parent's products.

Gerling International Insurance Co. v. Commissioners of Internal Revenue Service, 839 F.2d 131, 140 (3d Cir. 1988).<sup>16</sup>

## 2. Blocking Statutes

Banks, brokerage firms and other frequent recipients of subpoenas often seek to avoid compliance by asserting that foreign law prohibits compliance. However, the existence of a foreign blocking statute, by itself, will not prevent U.S. courts from enforcing a subpoena.

In Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Court, 482 U.S. 522 (1987), the Supreme Court developed a balancing test weighing the need for international comity against legitimate discovery requests. In determining whether a French company could be compelled to comply with a U.S. discovery order in light of French blocking laws, the Court identified five factors:

- the importance of the documents to the litigation as a whole
- the degree of specificity of the request

<sup>16</sup> See also First National City Bank of New York v. Internal Revenue Service, 271 F.2d 616, 618 (2d Cir. 1959) (control found where subsidiary and parent exchanged documents in the ordinary course of business), cert. denied, 361 U.S. 948 (1960); Uniden America Corp. v. Ericsson, Inc., 181 F.R.D. 302, 305 (M.D.N.D. 1998) (control found because U.S. firm and foreign affiliate coordinated sales efforts and shared documents, and because foreign affiliate provided U.S. firm with documents to assist in litigation); Japan Halon Co. v. Great Lakes Chemical Corp., 155 F.R.D. 626 (N.D. Ind. 1993) (control found because of subsidiary's extreme closeness to parent; parent would benefit from lawsuit; subsidiary and parent had engaged in "international hide and seek"); Addamax Corp. v. Open Software Foundation, 148 F.R.D. 462, 465, 468 (D. Mass. 1993) (control found because subsidiary acted as agent for parent); Camden Iron and Metal, Inc. v. Marubeni American Corp., 138 F.R.D. 438, 433 (D.N.J. 1991) (control found when subsidiary had "easy and customary" access to documents in parent's possession and parent played role in and benefited from transaction that was at heart of litigation) M.I.C., Inc. v. North American Philips Corp., 109 F.R.D. 134, 138 (S.D.N.Y. 1986), ( control found where common legal counsel had access to documents of parent in prior litigation and parent had supplied them to oppose summary judgment and "when it was in its interest"); Cooper Industries, Inc. v. British Aerospace, Inc., 102 F.R.D. 918 (S.D.N.Y. 1984) (control found because subsidiary distributed and serviced the parent's airplanes and was presumed to have access to blueprints and, manuals of the planes it serviced); Compare Wasden v. Yamaha Motor Co., 131 F.R.D. 206, 209 (M.D. Fla. 1990) (control not found where plaintiffs alleged no facts showing that subsidiary was controlled by parent; mere assertion of parent-subsidiary relationship insufficient to establish control).

- whether the information originated in the U.S.
- the availability of alternative means for securities the information, and the extent to which noncompliance would undermine important interests of the U.S. or the state where the evidence is located.

Id. at 544 n. 28, citing, Restatement of the Foreign Relations Law of the United States at 427(1)(c) (Tent. Draft No. 7. 1986, approved May 14, 1987).

In addition, in deciding whether to impose sanctions on a foreign corporation for failing to comply with a subpoena due to a blocking statute, courts consider whether the corporation has sought to obtain a waiver from the account holder whose records were subpoenaed. Compare United States v. Vetco, Inc., 691 F.2d 1281, 1287 (9<sup>th</sup> Cir.) (affirming contempt order to accountants for failure to produce documents in response to IRS subpoena over accountant's claim that compliance would violate Swiss secrecy laws because accountants, inter alia, had not attempted to produce documents), cert. denied, 454 U.S. 1098 (1981); Compagnie Francaise Assurance v. Phillips Petroleum, 105 F.R.D. 16 (S.D.N.Y. 1984) (requiring subpoena recipient to make good faith efforts to obtain document from French government) with In re Sealed Case, 825 F.2d 494 (D.Cir.) (per curiam) (refusing to affirm contempt sanction because, inter alia, bank had acted in good faith), cert. denied, 484 U.S. 963 (1987)

Most but not all courts have rejected the argument that ordering a foreign entity to produce the documents would violate the laws of the country in which the documents are located. Courts have held that by conducting business in several countries,

companies have accepted the risk of incurring inconsistent obligations in different jurisdictions.

In SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981), the SEC sought to compel a Swiss bank to disclose the identity of customers involved in an insider trading scheme. The bank argued that disclosure would violate Swiss secrecy laws and subject it to civil and criminal liability. The court held that the bank had acted in bad faith. The bad faith consisted of the bank's efforts to invoke Swiss bank secrecy laws in a commercial transaction to which it had been a party. Foreign corporations, the court ruled, should not be permitted to "invade American markets, violate American laws if they were indeed violated, and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law. "

In United States v. Bank of Nova Scotia, 740 F.2d 817 (11<sup>th</sup> Cir. 1984), cert. denied, 469 U.S. 1106 (1985), the court affirmed a \$1.5 million civil contempt order against the Bank of Nova Scotia for refusal to produce documents from its Cayman Islands subsidiary. The bank argued that production of the documents would violate Cayman bank secrecy laws. The court compelled the bank to turn over the documents reasoning that since it chose to do business in both jurisdictions it must pay the price associated with conflicting demands. 740 F.2d at 828. See also In re Grand Jury Proceeding, 532 F.2d 404 (5<sup>th</sup> Cir. 1976) (Canadian managing director of Cayman Island required to testify before grand jury, even through testimony might violate Cayman bank secrecy laws); United States v. Chase Manhattan Bank, 584 F. Supp. 1078 (S.D.N.Y. 1984) (Hong Kong bank secrecy laws do not shield U.S. bank from having to comply with IRS tax summons).

However, efforts to obtain documents in the face of bank secrecy laws have not always been successful. In In re Sealed Case, 825 F.2d 494 (D.C. Cir.) (per curiam), cert. denied, 484 U.S. 963 (1987), the court declined to compel a bank to comply with a grand jury subpoena because the bank itself was not the subject of the investigation and the request would violate bank secrecy laws. See also United States v. First National Bank of Chicago, 699 F.2d 341 (7<sup>th</sup> Cir. 1983) (refusing to enforce subpoena against non-target U.S. bank to produce customer records from office in Greece where compliance would have exposed bank to criminal liability under Greek bank secrecy laws).

To circumvent bank secrecy laws, prosecutors can request a court to order the account holder, if its identity is known, to direct the bank to turn over the account records to the government. See Doe v. United States, 487 U.S. 201, 219 (1988) (court may require defendant to instruct to turn over his account records; such instructions are not testimonial and therefore do not violate Fifth Amendment). Along similar lines, the government may obtain a court order directing the owner of the bank account not to take legal action abroad, i.e., to drop a lawsuit against the bank in its home country seeking to block prosecutors' efforts to obtain evidence. United States v. Davis, 767 F.2d 1025, 1036-39 (2d Cir. 1985). In Davis, the Second Circuit affirmed a trial court's order requiring Davis to produce records from his Cayman Islands bank account and to halt his legal efforts in the Caymans to prevent the Cayman bank from releasing his bank records.<sup>17</sup> See also United States v. Ghidoni, 732 F.2d 814 (11<sup>th</sup> Cir), cert. denied, 496 U.S. 932 (1984) (court order requiring defendant to sign directive to

Cayman Island bank consenting to disclosure of bank did not violate Fifth Amendment). But see *In re Grand Jury Investigation*, 599 F. Supp. 746 (S.D. Texas 1984) (signing consent form required the admission that the foreign accounts existed and were subject to target's control and that the target had authority over them).

### 3. Foreigners Visiting the U.S.

U.S. prosecutors and regulators can subpoena foreign nationals while they are in the United States and compel them to testify. *United States v. Field*, 532 F.2d 404 (5<sup>th</sup> Cir.), cert. denied, 429 U.S. 940 (1976); *In re Grand Jury Proceedings (Bowe)*, 694 F.2d 1256 (11<sup>th</sup> Cir. 1982) (compelling Bahamian lawyer subpoenaed while in U.S. to testify about clients and client records); *In Re Sealed Case*, 825 F.2d 494 (D.C. Cir. 1987) (per curiam) (compelling bank manager, citizen of a foreign country but working in the United States, to testify concerning bank transactions in a third country).

### 4. U.S. Citizens and Foreigners Living Abroad

The United States can subpoena a U.S. citizen or resident living abroad to return to the United States to testify, assuming that the government can achieve service of the subpoena. 28 U.S.C. §§ 1783, 1884. Foreigners outside the United States and with no contacts with the United States cannot successfully be subpoenaed here. *CFTC v. Nahas*, 738 F.2d 487, 495 (D.C. Cir. 1984); *FTC v. Compagnie de Sant Gobain-Pont a Mousson*, 636 F.2d 1300, 1323-26 (D.C. Cir. 1980).

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<sup>17</sup> See also *In re Grand jury Proceedings (Marsoner)*, 40 F.3d 959 (9<sup>th</sup> Cir. 1994) (defendant held in contempt for refusing to sign instructions to bank to turn over his account records); *United States v. Ghidoni*, 732 F.2d 814 (11<sup>th</sup> Cir.) (same), cert. denied, 469 U.S. 932 (1984)

## **B. MLATs & MOUs**

### **1. MLATs**

Mutual Legal Assistance Treaty (MLAT) requests are another common means by which prosecutors and regulators seek to obtain both documents and testimony abroad. The United States has 41 such treaties with other countries, including Canada.<sup>18</sup> Thirteen others have been signed but are not yet in force.<sup>19</sup> MLATs are treaties that establish procedures by which a signatory can obtain evidence held inside the other signatory's territory. An MLAT typically allows prosecutors and regulators to request that law enforcement officials of a foreign jurisdiction gather evidence for use in U.S. proceedings. While the terms of the MLATs vary from country to country, they generally provide for:

- taking testimony or statements,
- executing search and seizure warrants,
- arranging for third party production of documents, and
- confiscate, freeze or return of property and providing other assistance in the forfeiture of instrumentalities or proceeds of crime.<sup>20</sup>

An MLAT request typically includes a request for judicial assistance, a brief description of the facts of the case, the laws that were allegedly violated, the nature of

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<sup>18</sup> The agreements are with Antigua-Barbuda, Argentina, Australia, the Bahamas, Barbados, Belgium, Brazil, Canada, China, the Czech Republic, Dominica, Estonia, Grenada, Hong Kong, Hungary, Israel, Italy, Jamaica, Latvia, Lithuania, Luxembourg, Mexico, Morocco, the Netherlands, Panama, the Philippines, Poland, South Korea, Spain, Thailand, Trinidad-Tobago, Turkey, Ukraine, Cayman Islands, United Kingdom and Uruguay.

<sup>19</sup> These countries are Belize, Colombia, Cyprus, Egypt, France, Greece, Ireland, Nigeria, Organization of American States, Romania, Russia, South Africa and Venezuela.

the assistance sought and the name and address of the person or entity abroad from whom evidence is sought, as well as the names of persons involved in the investigation. If a request for testimony and document production is granted, foreign law enforcement will gather the documents and schedule the testimony. Although foreign law enforcement nominally conducts the testimony, the common practice is for U.S. government lawyers to draft the questions, attend the testimony and play an active role in the interrogation.

MLATs offer advantages over letters rogatory, the alternative method for obtaining evidence abroad. While foreign enforcement of letters rogatory is discretionary, compliance with requests for assistance under MLATs is mandatory in most situations. In addition, MLATs, because they are treaties, supercede bank secrecy laws, while letters rogatory sometimes do not.

MLATs, however, were intended for governments to obtain evidence in criminal investigations. They do not provide rights for private parties, although a private party may try to persuade the Justice Department or court to submit an MLAT request on the private party's behalf. *Cf. United Kingdom v. United States*, 238 F.3d 1312, 1316 (11<sup>th</sup> Cir. 2001)(U.K.-U.S. MLAT does not provide for private parties to request production of information); *United States v. \$734,578.82*, 286 F.3d 641, 658 (3d Cir. 2002) (U.S.-U.K. MLAT intended solely for mutual legal assistance between parties; it does not give any private person right to obtain, suppress or exclude evidence or impede execution of a request). Ordinarily, however, private parties' principal discovery opportunities are through letters rogatory or subpoenas.

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<sup>20</sup> See R.L. Pisani & R. Fogelnest, *The United States Treaties on Mutual Assistance in Criminal Matters*, in *International Criminal Law: A Guide to U.S. Practice and Procedure* (1987) at 236.

## 2. Memorandums of Understanding

Memorandums of Understanding (MOUs) are agreements between regulatory agencies in the United States and their foreign counterparts. Thus, the SEC has entered MOUs with securities regulators in various countries. These agreements, unlike some MLATs, cover regulatory investigations, as well as criminal ones. Under the agreements, each party promises to assist the other in obtaining evidence in investigations. MOU requests generally can be fulfilled quicker than MLAT requests, and their coverage is sometimes broader.

### C. Letters Rogatory

A letter rogatory is a letter of request from a court in the United States to a court in a foreign country requesting foreign judicial assistance in obtaining evidence. Letters rogatory typically include (1) background (who is investigating whom of what charge), (2) enough information about the case for a foreign judge to conclude that a crime has been committed and to see the relevance of the evidence sought, (3) assistance requested, (4) the text of the statutes violated, and (5) a promise of reciprocity. U.S. Attorney's Criminal Resource Manual §9-275. The power of a federal court to issue letters rogatory derives from 28 U.S.C. § 1781. Federal courts also possess the authority to execute letters rogatory at the request of foreign tribunals.

Because cooperation is voluntary, letters rogatory have met with mixed success, and, consequently, have generally been replaced by MLAT requests as a means of gathering evidence. See United States v. Zabady, 546 F.Supp. 35 (M.D.Pa. 1982) (dismissing indictment because of delays in obtaining evidence by means of letters

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rogatory; only three of eight letters rogatory granted); 6 Moore's Federal Practice § 28.12[1] ("discovery through [letters rogatory] can be a very lengthy process.)

## V. Constitutional Protections

The U.S. Supreme Court generally has limited the scope of the Constitutional protections to searches conducted by the government in domestic matters. See U.S. v. Verdugo-Urquidez, 494 U.S. 259, 266 (1990). The Court refused to endorse the view that every constitutional provision applies wherever the United States Government exercises its power. Id. at 268.

### A. Fourth Amendment

Although the Fourth Amendment's exclusionary rule generally does not apply to searches conducted by foreign law enforcement, United States v. Verdugo-Urquidez, 494 U.S. 259 (1990), two noteworthy exceptions exist. First, if the foreign search is so extreme as to "shock the conscience," a court may use its supervisory powers to exclude the evidence. Second, if U.S. law enforcement officials conducted a "joint" operation with foreign law enforcement authorities, or if the foreign authorities acted as agents of U.S. law enforcement in conducting the search, the exclusionary rule may apply. See e.g. United States v. Barona, 56 F.3d 1087, 1091-92 (9<sup>th</sup> Cir. 1985); Birdsell v. United States, 346 F.2d 775, 782 n.10 (5<sup>th</sup> Cir.), cert. denied, 382 U.S. 963 (1995); Stonehill v. United States, 405 F.2d 738, 743 (9<sup>th</sup> Cir. 1968), cert. denied, 395 U.S. 960 (1969).

Most courts have rejected claims of "joint ventures" where U.S. agents provided information to their foreign counterparts and were present at the search. See Barona, 56 F.3d at 1096 (provision of information by U.S. agents to foreign law enforcement

that led to search does not render search joint); United States v. Behety, 32 F.3d 503, 510-511 (11<sup>th</sup> Cir. 1994)(U.S. agent's presence at, and videotaping of, search and provision of information that led to search does not render search joint); United States v. Rosenthal, 793 F.2d 1214, 1231 (11<sup>th</sup> Cir. 1986)(U.S. agent's presence at search does not render search joint), cert. denied, 480 U.S. 9191 (1987); United States v. Maher, 645 F.2d 780 (9<sup>th</sup> Cir. 1981)("limited support and assistance" by U.S. agents to Canadian authorities did not render search joint where Canadians had initiated investigation); United States v. Morrow, 537 F.2d 120, 140 (5<sup>th</sup> Cir. 1976 (communication between United States and Canadian agents about name and number of informant did not render search joint), cert. denied, 430 U.S. 956 (1977).

However, a few courts have excluded evidence under the joint venture exception. In United States v. Verdugo-Urquidez, 856 F.2d 1214 (9<sup>th</sup> Cir. 1988), rev'd on other grounds, 494 U.S. 259 (1990), the Ninth Circuit held that the search of the defendant's Mexican residence was a joint venture. The court found that the search of the residence, although nominally executed by Mexican law enforcement, had been conducted at the behest of, and for the benefit of, U.S. agents seeking to obtain evidence for defendant's trial in the United States. The U.S. agents had instigated, planned and participated in the search, and the Mexican authorities had promised them all of the evidence seized in the search. Id. at 1228. See also United States v. Emery, 591 F.2d 1266, 1268 (9<sup>th</sup> Cir. 1978) (joint venture found where DEA tipped Mexican authorities to smuggling; planted undercover with trafficker; conducted surveillance of site and signaled Mexican law enforcement to move in and made the arrest); United States v. Peterson, 812 F.2d 486 (9<sup>th</sup> Cir. 1987) (joint venture found between DEA agents

testified that the investigation was a "joint venture and where they assumed substantial role in the case).

## **B. Fifth Amendment**

### **1. The Supreme Court**

Two Supreme Court cases seem to hold that the Fifth Amendment does not apply outside the United States. In Johnson v. Eisentrager, 339 U.S. 763 (1950), the Supreme Court refused to extend the right of habeas corpus to aliens convicted of war crimes by military tribunals sitting overseas. While the aliens claimed their convictions violated due process, the Court rejected the extraterritorial application of the Fifth Amendment in this setting. The Court reiterated its conclusion in United States v. Verdugo-Urquidez, 494 U.S. 259 (1990):

Indeed, we have rejected the claim that aliens are entitled to the Fifth Amendment outside the sovereign territory of the United States . . . . [O]ur rejection of the extraterritorial application of the Fifth Amendment was emphatic.

Such extraterritorial application of organic law would have been so significant an innovation in the practice of governments that, if intended or apprehended, it could scarcely have failed to excite contemporary comment. Not one word was cited. No decision of this Court supports such a view. None of the learned commentators on our Constitution has even hinted at it. The practice of every modern government is opposed to it.

Id. a 269 (citations omitted); see also Harbury v. Deutch, 233 F.3d 596 (D.C. Cir. 2000) (wife asserted husband's due process rights were violated because U.S. government concealed her husband's captivity and torture by Guatemalan military; however, the due process did not apply to Guatemalan citizen residing in Guatemala.), rev'd and remanded on other grounds, 122 S.Ct. 2179 (2002).

## 2. bin Laden

However, a different conclusion was reached in a highly publicized case in which the defendants were interrogated overseas, but tried in the United States. In United States v. bin Laden, 132 F. Supp.2d 168 (S.D.N.Y. 2001), two defendants had been interrogated by FBI agents after being arrested in Kenya and South Africa. The FBI agents read the defendants a modified advice of rights form, in which they were advised they had the right not to answer questions. In addition, they were informed that if they had been questioned in the United States, they would have had the right to have an attorney present during questions, but that because they were not in the United States, the authorities could not ensure that a lawyer would be appointed prior to questioning.

The bin Laden court ruled that these warnings were insufficient because they created the impression that the defendants' right to counsel depended on the country in which the questioning occurred. However, the court found that the violations were cured by later correct readings of the defendants' Miranda rights. Both defendants' statements, therefore, were held to be voluntary and admissible. The bin Laden decision is important because the court held that Miranda warnings must be given in the context to extraterritorial interrogations on nonresident aliens.

## 3. Joint Venture Exception

The bin Laden decision receives some support from pre-Verdugo-Urquidez cases holding that the Fifth Amendment applied to interrogations conducted outside the United States by foreign law enforcement, where the interrogations were conducted jointly with U.S. agents or where U.S. agents actively participated in the questioning.

See Pfeifer v. Bureau of Prisons, 615 F.2d 873, 877 (9<sup>th</sup> Cir. 1980); United States v. Emery, 591 F.2d 1266, 1268 (9<sup>th</sup> Cir. 1978)(fifth amendment applies to joint interrogations); United States v. Hensel, 509 F. Supp. 1364, 1375 (D. Me. 1981)(same).

#### 4. Fear of Foreign Prosecution

In United States v. Balsys, 524 U.S. 666 (1998), the Supreme Court held that a person generally cannot invoke the Fifth Amendment based on a fear of foreign prosecution, however, real and legitimate. However, the Court left open the possibility that a person might be able to invoke a privilege where (1) the U.S. and the other country had similar criminal codes and (2) the United States granted a person immunity from domestic prosecution for the purpose of obtaining evidence to be delivered to the other nation for use in a prosecution there. 524 U.S. at 698-99. Cf. In re Impounded, 178 F.3d 150 (3d Cir. 1999) (holding that witnesses had not made out facts sufficient to apply possible Balsys exception).

#### C. Sixth Amendment

In contrast to bin Laden, one recent decision held that the Sixth Amendment does not apply to interrogations by U.S. law enforcement conducted overseas. In United States v. Raven, 103 F. Supp.2d 38 (D. Mass. 2000), the defendant, a Netherlands citizen, was incarcerated in a Belgian jail. U.S. prosecutors requested assistance from Belgian authorities through a letter rogatory, and a Belgian magistrate approved such assistance. The interrogation complied with Belgian law, which does not permit defense counsel to be present. U.S. prosecutors took part in the interrogation.

The defendant later moved to suppress his statements arguing that the questioning in Belgium violated his Sixth Amendment right to counsel. In denying the

motion, the district court held that foreign nationals do not benefit from the U.S. constitution when custodial interrogation takes place overseas. 103 F. Supp.2d at 40.

## **VI. Asset Freezes**

The SEC has had some success in freezing and seizing assets in other countries. In these cases, the Commission obtains a freeze or seizure order from a U.S. court that it then seeks to enforce abroad or through a U.S. affiliate of a foreign institution. In SEC v. Wang, 88 Civ. 4461 (S.D.N.Y. 1989), for example, a Taiwanese businessman made \$25 million trading on inside information obtained from a Morgan Stanley employee. Before the Taiwanese businessmen settled the case, the SEC obtained a temporary restraining order freezing his assets in Hong Kong bank accounts. The Hong Kong bank conducted business in New York, and the SEC proceeded to enforce the freeze order through the bank's New York branch. The court rejected the bank's claim that it could be subject to double liability if Hong Kong courts ordered the bank to pay the customer.

More recently, the SEC persuaded the Supreme Court of British Columbia to enforce a disgorgement order issued by the U.S. court against the former president of Softpoint, Inc., Robert Crosby. The U.S. court had frozen Crosby's assets and ordered him to disgorge almost \$780,000 for his role in a financial fraud. Instead of honoring the order, Crosby fled to Hong Kong. In January 1999, Canadian authorities stopped him as he tried to enter Canada from Hong Kong with \$100,000 in currency. They seized the cash and denied Crosby entrance to Canada. The SEC sought the seized

funds, and in March, 2000, the Supreme Court of British Columbia agreed to enforce the New York court's disgorgement order.

## **VII. Conclusion**

In light of the globalization of markets, it is not surprising that the regulatory and criminal focus has broadened to include the international aspects of securities frauds. These include (a) frauds perpetrated abroad, but aimed at the United States and (b) use of foreign brokerage and bank accounts for money laundering and conceal the identities of the participants in U.S. frauds. Indeed, the increasingly aggressive efforts to pursue investigations beyond the nation's borders is almost certain to not only continue, but to accelerate, as we move toward a global marketplace.