Parallel Civil And Criminal Proceedings



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When the government seeks to coordinate its powers in parallel proceedings the emphasis is likely to be on the criminal side of the case.

THE TREND toward government coordination of civil and criminal investigations and proceedings to enhance its enforcement efforts is accelerating. Over a decade ago, in 1997, the Justice Department issued a memorandum to all federal attorneys instructing them to increase the efficiency and reach of the government's enforcement efforts by developing "greater cooperation, coordination and teamwork between the criminal and civil prosecutors who are often conducting parallel investigations of the same offenders and matters." Memorandum from the Attorney General to Federal Attorneys (July 28, 1997). Note the use of the terms "civil prosecutors," and "same offenders," reflective of a conception of civil proceedings as an adjunct to criminal prosecution. One can find similar encouragements to greater coordination of parallel civil, criminal, administrative, and regulatory proceedings with respect to the use of civil and criminal proceedings in connection with the enforcement of tax, environmental, and healthcare laws and regulations, among others. Title 6, *United States Attorney's Manual* at 22. Similar directives toward enhanced coordination can be found with respect to civil and criminal enforcement of environmental laws, *see*

USDOJ Environment and Natural Resources Division Directive 2008-02, Parallel Proceeding Policy and Title 9 USDOJ Criminal Resource Manual at 983, which sets forth guidelines for facilitating the enforcement of the civil, criminal and administrative statutes applicable to healthcare.

More recent examples of this trend are multi-jurisdictional. In May 2008, in response to the collapse of the sub-prime mortgage industry, the Mortgage Fraud Task Force was formed, involving the coordination of federal, state, and local law enforcement agencies. Amir Efrati, *Wall Street, Lenders Face Subprime Scrutiny*, Wall St. J. May 5, 2008, at A4. In November 2009, President Obama established the Interagency Financial Fraud Enforcement Task Force, which includes participants from federal agencies, regulatory authorities, and inspectors general. *See, e.g., SEC News Digest*, Issue 2009-220 (Nov. 17, 2009), available at http://www.sec.gov/news/digest/2009/dig11709.htm. On March 31, 2010, the United States Attorney's Office for the Southern District of New York announced the formation of a new unit within its Civil Division to focus on affirmative litigation in pursuit of complex frauds "as a complement to criminal prosecutions for bank, mortgage and other funds." *See* N.Y. L.J., Mar. 31, 2010 at 1. This announcement made specific reference to the lower standard of proof, availability of treble damages, and the potentially broader deterrent effect that could be obtained from aggressive use of civil litigation. *Id.* The U.S. Attorney's Office Civil Division Chief stated, if the Government is not "using [its] civil tools, you are not using every tool at your disposal." *Id.*

In view of this undeniable trend, two questions arise. First, are there any legal limitations on the Government's enhanced coordination of civil and criminal enforcement? Second, what are the principal strategic considerations for advocates representing clients who face increased risks of simultaneous or successive civil, criminal, regulatory, and administrative proceedings?

LEGAL LIMITS ON COORDINATED GOVERNMENT CIVIL AND CRIMINAL PROCEEDINGS • The appropriate starting place for an analysis of this issue is *United States v. Kordel*, 397 U.S. 1 (1970), which involved the government's use in a criminal prosecution of evidence it had obtained in answers to interrogatories in the course of a prior civil action brought by the FDA. The Supreme Court held that the use of civil discovery was permissible because the defendants had been on notice, when they answered the interrogatories, that the FDA was considering a criminal referral. Nonetheless, the Court suggested there could be circumstances of such coordination which would amount either to a due process violation or a departure "from proper standards in the administration of justice," if, inter alia, the investigation had been commenced solely to gather evidence for a criminal prosecution or if the government had failed to advise the defendants in the civil proceeding that a criminal prosecution was contemplated.

Until recently, the case perhaps most frequently relied upon by defense counsel in this context is *United States v. Parrott*, 248 F. Supp. 196 (D.D.C. 1965), where the district court held that the "government may not bring a parallel civil proceeding and avail itself of civil discovery devices to obtain evidence for subsequent criminal prosecution." *Id.* at 202. Because *Parrot* was decided before *Kordel*, and the *Parrott* indictment was dismissed on other grounds, its precedential value as a source of legal authority for limiting the use in a criminal prosecution of evidence derived from civil discovery in a prior, or parallel, Government proceeding may be limited. *Parrot* involved the an effort to use as evidence in a criminal prosecution prior testimony from SEC proceedings in which the SEC attorneys had not disclosed that a criminal referral to the Justice Department had already been made, and arguably had misled defense counsel about the possibility of a criminal prosecution.

In 2005, the district court in *United States v. Scrushy*, 366 F. Supp. 2d 1134 (N.D. Ala. 2005), a criminal prosecution of the CEO of HealthSouth, applied the *Kordel* standard to suppress Scrushy's SEC testimony, causing the dismissal of perjury counts against him. Mr. Scrushy was acquitted after trial on the criminal charges which were not affected by the suppression motion. It was revealed during the course of pretrial proceedings that the United States Attorney's Office had played a significant, but covert, role with respect to Scrushy's SEC testimony. This included the SEC agreeing to a request from the prosecutors to change the city where the SEC deposition would occur, in order to provide venue for a possible perjury charge, the SEC agreeing to a request from the prosecutors that Scrushy be asked certain questions in his SEC deposition, and that they refrain from asking others, so as to better conceal from Scrushy and his counsel that he was being targeted for prosecution.

When this did come to light, and Scrushy moved to suppress his SEC testimony from use as evidence at his prosecution, the district judge acknowledged the lack of "any controlling law [for] what distinguishes a legitimate parallel investigation from an improper one." *Id.* at 1137-38. Nonetheless, citing *Kordel* and observing that parallel investigations, like parallel lines, do not intersect, the district court held that the government's failure to disclose the existence of the criminal investigation, and the prosecutor's covert involvement in the SEC investigation, constituted a "depart[ure] from the proper administration of criminal justice," requiring suppression of the SEC testimony in the criminal case. *Id.* at 1139. The district court also criticized the Government's effort to justify what occurred on the ground that "it did not outright lie to Mr. Scrushy about the existence of the criminal investigation." *Id.* at 1139-40

In 2006, a similar decision occurred in *United States v. Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006). When the United States Attorney's Office began a criminal investigation of several individuals and their company shortly after the SEC had begun an investigation of the same persons and company. The prosecutors decided they wanted to encourage the corporate officers to give evidence to the SEC, but realized that they might not do so if they knew of the existence of the criminal investigation. Consequently, the prosecutors took steps to keep their investigation secret, while prevailing upon the SEC lawyers to take testimony in such a way to facilitate a perjury prosecution, both with respect to venue and the subject matters on which the SEC sought to elicit testimony.

When Stringer's attorney directly asked the SEC attorney who was taking his client's testimony whether the SEC was working with the U.S. Attorney's Office or any other federal agency, the SEC attorney took refuge in formalistic responses aimed at evading the questions. The exchange was as follows:

Stringer's Attorney: "My first question is whether Mr. Stringer is the target of any aspect of the investigation being conducted by the SEC."

SEC Attorney: "The SEC does not have targets in this investigation."

Stringer's Attorney: "The other questions I have relate to whether or not, in connection with your investigation, the SEC is working in conjunction with any other department of the United States, such as the U.S. Attorney's Office in any jurisdiction, or the Department of Justice."

SEC Attorney: "As laid out in the 1662 form, in the "routine use of" section there are routine uses of our investigation, and it is the agency's policy not to respond to questions like that, but instead, to direct you to the other agencies you mentioned."

Stringer's Attorney: "And which U.S. Attorney's office might I inquire into?"

SEC Attorney: "That would be a matter up to your discretion."

Following an evidentiary hearing, the district court dismissed the indictment on the ground that the U.S. Attorney's Office had violated due process because it had "intentionally shielded its intentions behind the guise of a civil prosecution, resorting to subterfuge to maintain the secrecy of its involvement." The court went on to characterize as "trickery and deceit" the SEC's nonresponsive answers and reference to routine uses of SEC testimony under Form 1662 to defense counsel's direct questions about possible U.S. Attorney's Office involvement. (The district court alternatively suppressed the SEC testimony in the event the dismissal of indictment was not sustained on appeal.)

On appeal, the Ninth Circuit reinstated the indictment and reversed the suppression of the SEC testimony. *Stringer,* supra, 521 F. 3d 1189 (9th Cir. 2006). In doing so, the Court turned its back on both the district court's and Scrushy court's developing approach — that when the DOJ and SEC work so closely together that the two investigations essentially merge into a single investigation, an affirmative duty is created to inform the affected persons in the SEC investigation of the existence of the criminal investigation, and that a breach of this duty can lead to both suppression of the evidence obtained by the SEC in the criminal case as well as dismissal of the indictment.

Instead, the Ninth Circuit affirmed the propriety of the SEC's close coordination of its investigation with prosecutors and the sharing of evidence and testimony obtained during its civil investigation, even though the SEC had refused to disclose to the defendants that there was an ongoing criminal investigation at the time they were required by subpoena to testify. *Id.* at 1191-93. The grounds on which the Ninth Circuit based its decision were:

- The SEC's civil investigation was not conducted in bad faith solely to collect evidence for the criminal investigation, but had commenced about two weeks before the initiation of the criminal investigation and eventually led to consent degrees;
- The SEC did not affirmatively mislead or deceive the subject of a parallel civil and criminal investigation into believing that the investigation was exclusively civil in nature and would not lead to criminal charges; and
- The SEC provided the defendants with its standard Form 1662, which advised them of their Fifth Amendment rights and disclosed that the SEC often made its files available to United States Attorneys' Offices and prosecutors.

Id. at 1198-99. (The SEC also tends to rely on statutory authority, namely, provisions in the '33 and '34 Acts which authorize the sharing of investigative information and civil discovery with the Justice Department. *See* 15 U.S.C. §77t(b); 15 U.S.C. §780u(d).)

PRACTICAL AND STRATEGIC CONSIDERATIONS • Counsel are accustomed to weighing the risks and potential benefits from cooperating and providing evidence in a proceeding. These risks are magnified in the parallel proceeding context. They include the risk of self-incrimination; the cost of an adverse inference in civil proceedings from the invocation of the privilege; the adverse effects on a highly regulated entity, or public company, from non-cooperation in an investigation, and collateral consequences in other forums or proceedings.

In addition to these well-known challenges, the existence of parallel proceedings can also give rise to opportunities. A parallel civil and criminal case can be an avenue for civil discovery that is not available in the criminal case, a fact which often prompts

a prosecution application for a stay of the civil case so as to protect its witnesses from exposure to civil discovery. While it has been commonplace to regard such stay applications to be granted on a nearly automatic basis, there is some recent evidence of less predictable outcomes in this context. For instance, in *SEC v. Saad,* 229 F.R.D. 90, 92 (S.D.N.Y. 2005), Judge Jed S. Rakoff denied a government application for a stay of discovery in an SEC enforcement action which had been filed in tandem with a parallel criminal case. In *Saad,* the Government supported the stay application by making the traditional argument that the civil process would permit the defendants to gain a "special advantage" because of the broader discovery of the Government's case than it would be entitled to under Rule 26 of the Federal Rules of Civil Procedure. However, Judge Rakoff held that the Government's position was difficult to credit where "the U.S. Attorney's Office, having closely coordinated with the SEC in bringing simultaneous civil and criminal actions against some hapless defendant, should then wish to be relieved of the consequences that will flow if the two actions proceed simultaneously." For other examples of greater judicial scrutiny of Government applications for stay of civil proceedings, *see SEC v. Oakford Corp.,* 181 F.R.D. 269, 271-72 (S.D.N.Y. 1998); *SEC v. Kornman,* 2006 WL 1506954, at *4 (N.D. Tex. May 31, 2006); *SEC v. Sandifur,* 2006 WL 3692611, at *2-3 (W.D. Wash. Dec. 11, 2006); SEC v. Yuen, CV03-4376, slip op. at 13 (C.D. Cal. Oct. 4, 2006).

Moreover, the existence of a parallel civil and criminal case can sometimes lead to unexpected results. In the *Galleon* insider trading matter which has been widely described as the largest inside trading case ever brought, the defendants in the criminal case, *United States v. Rajaratnam,* overlap substantially with the defendants in the parallel SEC case, *SEC v. Galleon Management LP.* The prosecution case is based on an enormous number of wiretapped conversations of the defendants and others. Although the prosecutors did not share the tape recordings with the SEC, they were given by the prosecutors to the criminal defendants in *United States. v. Rajaratnam,* pursuant to Title III of the Omnibus Crime Control and Safe Streets Act of 1968, 18 U.S.C. section 2510 et seq.

This led the SEC, in the civil case, to serve on the civil defendants (who are also the defendants in the criminal case) discovery demands, pursuant to Fed. R. Civ. P. 26 and 34, for the production of copies of the tape recordings. After briefing and argument, the district court ordered the production to the SEC all of the tape recordings the defendants had received from the prosecutors, pursuant to a protective order that they not be disclosed to any person not a part to the case. Memorandum Order Feb. 9, 2010, *SEC v. Galleon Management LP,* 683 F. Supp. 316 (S.D.N.Y. 2010). This may be a unique instance of the SEC and the Justice Department not sharing their evidence in parallel proceedings, thus setting the stage for the SEC seeking to obtain prosecution evidence through civil discovery of the defendants it has sued.

The principal defendants in both the SEC enforcement proceeding and the criminal prosecution, Raj Rajarantnam and Danielle Chiesi, appealed the discovery order primarily on the ground that it was wrong to require them to provide the wiretaps to the SEC as a matter of civil discovery in the SEC enforcement case prior to any determination of their legal validity in motion practice in the criminal case. On September 29, 2010, the Second Circuit reversed Judge Rakoff's discovery order, holding that the wiretaps should not be subject to disclosure in the SEC case prior to a ruling on their legality in the criminal case. *SEC v. Rajaratnam,* 622 F.3d 159 (2d Cir. 2010).

The strategic considerations in representing a client in parallel proceedings can only be touched upon here rather than fully discussed or analyzed. Two of the key practice points are as follows. First, be alert to the existence of a parallel proceeding.

In *Scrushy,* the discovery of the prosecutor's involvement in the SEC investigation appeared to be serendipitous. Counsel in Stringer asked the direct question at a deposition and made a record. Second, seize opportunities for discovery. Seeking to depose in a civil case the prosecution witnesses in a parallel criminal case — whether or not it leads to a stay of the civil case — carries with it tactical benefits, either in the form of the revelation of evidence or, if a stay is entered, the cessation of hostilities on one front.

CONCLUSION • Like so many subject matters of complexity, there are no neat and tidy solutions to the issue of whether advocates can formulate arguments that will lead courts to limit some of the perceived adversarial advantages to the government from its expanded use of parallel proceedings. Based on the foregoing, perhaps the most that can be said with confidence is that district court decisions in the *Scrushy* and *Stringer* cases represent the current high-water marks of judicial limits on the government's coordinated use the weapons in both its civil and criminal arsenal — and the Ninth Circuit's decision in Stringer removed at least one of those high-water marks. From the perspective of charting the interplay of civil and criminal parallel proceedings, the Second Circuit's reversal of the discovery order in the Galleon civil case shows once again the primacy of the criminal prosecution over a parallel civil case, including a parallel SEC enforcement proceeding.

PRACTICE CHECKLIST FOR
Parallel Civil And Criminal Proceedings

- There are two important questions to keep in mind with respect to parallel proceedings: First, are there any legal limitations on the Government's enhanced coordination of civil and criminal enforcement? Second, what are the principal strategic considerations for advocates representing clients who face increased risks of simultaneous or successive civil, criminal, regulatory, and administrative proceedings?

- The appropriate starting place for an analysis of limitations on the enhanced coordination issue is *United States v. Kordel,* 397 U.S. 1 (1970). Historically, the case most frequently relied upon by defense counsel in this context is *United States v. Parrot,* 248 F. Supp. 196 (D.D.C. 1965). More recent cases include *United States v. Scrushy,* 366 F. Supp. 2d 1134 (N.D. Ala. 2005) and *United States v. Stringer,* 408 F. Supp. 2d 1083 (D. Or. 2006).

- Parallel proceedings can also give rise to opportunities. A parallel civil and criminal case can be an avenue for civil discovery that is not available in the criminal case, a fact which often prompts a prosecution application for a stay of the civil case so as to protect its witnesses from exposure to civil discovery. There is some recent evidence of less predictable outcomes in this context. For instance, in *SEC v. Saad,* 229 F.R.D. 269, 273 (S.D.N.Y. 1998), Judge Jed S. Rakoff denied a government application for a stay of discovery in an SEC enforcement action which had been filed in tandem with a parallel criminal case. For other examples of greater judicial scrutiny of Government applications for stay of civil proceedings, *see SEC v. Oakford Corp.,* 181 F.R.D. 269, 27 (S.D.N.Y. 1998); *SEC v. Kornman,* 2006 WL 150694, at *4 (N.D. Tex. May 31, 2006); *SEC v. Sandifur,* 2006 WL 3692611, at *2-3 (W.D. Wash. Dec. 11, 2006); *SEC v. Yuen,* CV03-4376, slip op. at 13 (C.D. Cal. Oct. 4, 2006).