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**PROGRAM MATERIALS**

**Program #1717**

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## **Evolving Issues in Parallel SEC and DOJ Securities Investigations**

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*Navigating the Government  
Created Quagmire:  
Emerging Issues in Parallel Proceedings*



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# *Introduction*

- Government created quagmire:
  - Multiple inquiries
  - Separate proceedings
  - Coordinated with each agency
  - Significant pressure on companies
  - Can result in prejudice
- This program will examine:
  1. Background
  2. Impact
  3. Court Imposed Limitations



# *Background*

- Definition
  - Parallel proceedings are situations where both criminal and civil investigations/cases are in progress at the same time
    - not necessarily simultaneous
  - Typically an administrative agency, i.e., SEC or IRS, and a criminal authority, DOJ



# *Background*

- **Purpose**

- Standard law enforcement technique. Memorandum from the Attorney General to Federal Attorneys (July 28, 1997)
- Parallel proceedings are designed to “represent the full range of the Government’s interests” by maximizing resources by coordinating the investigation of different government agencies into the same set of circumstances. USMA Tit. 1 OFM § 27



# *Background*

- Information Sharing
  - SEC can formally refer matters to other agencies
    - Securities Act, Section 20(b); Exchange Act, Section 21(d)
    - Usually, informal referral
    - Official policy on disclosure: Standard Form 1662
      - Right to counsel, Fifth Amendment rights, and routine uses, i.e., making its files available to other government agencies
      - Does not disclose – “Assume the worst”
  - DOJ: Fed. R. Crim. P. 6(e)



# *Background*

- Increased criminalization of securities laws
  - 2002 Executive Fraud Task Force
    - Strengthen the coordination of investigations
    - Chaired by the Deputy Attorney General
    - Includes senior DOJ and SEC officials, and the heads of other federal agencies
  - “The SEC has had, and continues to have, a close relationship with its fellow law enforcement agencies. Indeed, some of the most significant SEC actions over the last several months have been brought in tandem with criminal complaints and indictments.” Former SEC Chairman Harvey Pitt Remarks at DOJ Corporate Fraud Conf. (Sept. 26, 2002).



## *Background*

- “This past year, an unprecedented high level of collaboration with our counterpart state and federal regulators and criminal authorities ensured that our mutual efforts were even more effective, and gave America’s investors even more protection for their hard earned money.”  
SEC’s FY 2006 Performance and Accountability Report,  
Message from the Chairman, pg. 2.



# *Impact: During the Investigation*

- Number of issues presented at the outset and throughout an investigation/proceeding
- Selection of Counsel
  - Civil – frequently one attorney represents multiple clients
  - Criminal – potential conflicts
  - Example: *U.S. v. Stringer*, 408 F. Supp. 2d 1083 (D. Ore. 2006), appeal docketed, No. 06-30100 (9th Cir. Feb. 27, 2006)
    - One attorney represented multiple defendants
    - Later conflicts in criminal case
    - Court: “When an apparent conflict of interest between the defendant and defense counsel comes to the attention of the government, the government is under an obligation to bring the issue to the trial court’s attention and, if necessary, move for disqualification of counsel.” *Id.* at 16.



# *Impact: During the Investigation*

- Whether to testify
  - Individuals 5th Amendment Rights
    - May decline to testify in any proceeding that may lead to criminal trial. *Kastigar v. U.S.*, 406 U.S. 441,444-45 (1972)
    - May decline to produce documents. *Fisher v. U.S.*, 425 U.S. 391 (1976)
  - Company has no 5th Amendment Rights *United States v. White*, 322 U.S. 694 (1944)



# *Impact: During the Investigation*

- Whether to testify: Potential Problems:
  - Exposure to false statements, giving away strategy, providing cross examination material, loss of cooperation credit, invite prosecution
  - Adverse Inference:
    - *Baxter v. Palmigiano*, 425 U.S. 306, 317-18 (1976) (“It is thus undisputed that [a defendant’s] silence in and of itself is insufficient to support an adverse decision...”)
    - Is it proper: adversary proceeding?
    - *SEC v. Jerry T. O'Brien, Inc.*, 467 U.S. 735 (1984)



# *Impact: During the Investigation*

- Companies:

- Cooperation standards: “culture of waiver”
- Results in less documentation of internal investigation

- Employees:

- Can limit choices
  - If do not testify or cooperate may be fired or company refusal to pay/advance attorney's fees
  - Company may waive privilege to internal investigation memoranda, expose employee criminally



# *Impact: During the Investigation*

- Example: *In Re Grand Jury Subpoena*, No. 04-4410 (4th Cir. 2006)
  - Issue: Company wanted to waive/employee did not
  - Key question: *UpJohn* warnings
    - Need to establish:
      - (1) investigating counsel represents only company, not individual employee;
      - (2) A/C privilege is held solely by company; and
      - (3) only company can waive A/C privilege



## *Impact: During the Investigation*

- Example: *In Re Grand Jury Subpoena*, No. 04-4410 (4th Cir. 2006) (cont.)
  - Adequacy of warnings during internal investigation
  - Can employees prevent company from waiving A/C privilege in response to grand jury subpoena for memos generated during internal investigation
  - Investigation attorneys gave watered down version
  - Court rejected the claim – no evidence of an A/C relationship



# *Impact: During the Investigation*

- Internal Investigations: Deputized Agent
  - Liable for false statements made to attorneys conducting internal investigations *U.S. v. Kumar and Richards*, 2004 Cr.02094 (E.D.N.Y. 2004); *U.S. v. Singleton*, Crim. 4:06CR080 (S.D.Tx Mar. 8, 2006).
  - Executives lied to outside attorneys conducting internal investigation
  - Company announced intention to cooperate with government
  - Knowledge that statement may be given to the government



# *Impact: Economies*

- Economies for All - global resolution
  - In the Matter of Prudential Equity Group, LLC, (Aug. 28, 2006); [http://www.usdoj.gov/opa/pr/2006/August/06\\_odag\\_574.html](http://www.usdoj.gov/opa/pr/2006/August/06_odag_574.html)
  - *SEC v. Federal National Mortgage Association*, (D.D.C May 23, 2006) (settlement with SEC/Office of Federal Housing Enterprise Oversight; DOJ later declined to prosecute)
- For Government - Collateral Estoppel
  - Acquittal, government gets another chance in the civil proceeding
  - Conviction, government gets the benefit of issue preclusion



# *Impact: Economies*

- For Defendant - Civil discovery permits defendants to:
  - Request documents, take depositions, and learn witness identities [Fed. R. Crim. P. 16(b)(1) v. Fed. R. Civ. P. 26(b)(1)]
- However:
  - “Thus, when the purpose of a discovery request is to gather information for use in proceedings other than the pending suit, discovery properly is denied.” *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 352 n.17 (1978)
  - But see *Dresser*, 628 F.2d at 1387, permitting prosecution to use information gained during civil discovery where SEC acted in good faith with a legitimate non-criminal purpose for its investigation



# *Impact*

## *Potential for Abuse/Prejudice*

- **Merger**

- “The Commission should work to ensure that the line between civil actions and appropriate criminal prosecutions is not blurred, and that criminal referrals for securities violations are reserved for clearly egregious cases. The Commissioners should be actively involved and have a significant role in the decision-making process before the DOJ pursues an investigation or initiates a prosecution of possible federal securities law violations, and in referrals to criminal prosecutors.” Recommendation 5., Report on the Current Enforcement Program of the Securities and Exchange Commission, U.S. Chamber of Commerce (Mar. 2006).



# *Impact*

## *Potential for Abuse/Prejudice*

- Over-criminalization
- Criminal investigation concealed behind civil investigation
- Use of evidence gathered by one agency to benefit another without same use for defendant
- Use of civil discovery to benefit defendant in criminal trial



# *The Courts*

## *Parallel Proceedings Approved*

- *U.S. v. Kordel*, 397 U.S. 1 (1970)
  - Leading case
  - Corporation/officers under investigation for violations of Food, Drug, and Cosmetic Act. Informed possible criminal proceedings
  - Sought to stay the civil action/extend time to answer interrogatories until after criminal proceedings to prevent government to use civil discovery to assist criminal prosecution
  - Motion was denied



# *The Courts*

## *Parallel Proceedings Approved*

- *U.S. v. Kordel*, 397 U.S. 1 (1970)
  - Vice President answered interrogatories without asserting 5th Amendment
  - In criminal prosecution, District court denied defendants' motion to suppress
    - Defendants claimed use of the interrogatories equaled bad faith
  - USSC reversed Ct. of Appeals: government's use did not violate the officers' 5th Amendment because officers knew about possible criminal proceedings
  - Knowledge is the key



## *The Courts*

### *Parallel Proceedings Approved*

- *Standard Sanitary v. U.S.*, 226 U.S. 220 (1912)
  - USSC held parallel proceedings in a Sherman Anti-trust Act permitted
  - There is no rule that civil suits brought under the Sherman Act to dissolve an illegal combination must first await criminal trial against the same defendants



# *The Courts*

## *Parallel Proceedings Approved*

- *Standard Sanitary v. U.S.*, 226 U.S. 20 (1912)
  - “The Sherman Act provides for a criminal proceeding to punish violations and suits in equity to restrain such violations, and the suits may be brought simultaneously or successively. The order of their bringing must depend upon the Government; the dependence of their trials cannot be fixed by a hard-and-fast rule or made imperatively to turn upon the character of the suit. Circumstances may determine and are for the consideration of the court. An imperative rule that the civil suit must await the trial of the criminal action might result in injustice or take from the statute a great deal of its power.” *Id.* at 52.



# *The Courts*

## *Parallel Proceedings Approved*

- *SEC v. Dresser Indus., Inc.*, 628 F. 2d 1368 (D.C. Cir. 1980) (*en banc*)
  - Challenged SEC execution of a subpoena *duces tecum*
    - “Dresser argues principally that the SEC subpoena abuses the civil discovery process of the SEC for the purpose of criminal discovery and infringes the role of the grand jury in independently investigating allegations of criminal wrongdoing.” *Id.* at 1371.



# *The Courts*

## *Parallel Proceedings Approved*

- *SEC v. Dresser Indus., Inc.*, 628 F. 2d 1368 (D.C. Cir. 1980) (*en banc*)
  - Court of Appeals disagreed:
    - Statutes explicitly empower SEC to “investigate possible infractions of the securities laws with a view to both civil and criminal enforcement, and to transmit the fruits of its investigations to Justice in the event of potential criminal proceedings.” *Id.* at 1376.
    - Effective enforcement requires SEC/DOJ investigate simultaneously
    - Absent substantial prejudice, parallel proceedings are unobjectionable
    - May be problematic where there is “specific evidence of agency bad faith or malicious governmental tactics” *Id.* at 1376.



# *The Courts*

## *Parallel Proceedings Approved*

- In *Kordel* the Court cautioned against abuse. Can bring when:
  - (1) the government had not brought the civil actions solely to obtain evidence for the criminal prosecution;
  - (2) the corporation and its officers had been notified that the Food and Drug Administration contemplated criminal proceedings against them before the interrogatories were answered by one of the officers;
  - (3) the case did not involve a defendant without counsel or a defendant who reasonably feared prejudice from adverse pretrial publicity or other unfair injury; and
  - (4) there were no special circumstances that might suggest the unconstitutionality or even the impropriety of the criminal prosecution.

# *The Courts: Stays*

- Generally, courts have discretion
- Standards:
  - 1) the extent to which the issues in the criminal case overlap with those presented in the civil case; 2) the status of the case, including whether the defendants have been indicted; 3) the private interests of the plaintiffs in proceeding expeditiously weighed against the prejudice to plaintiffs caused by the delay; 4) the private interests of and burden on the defendants; 5) the interests of the courts; and 6) the public interest. *In re Worldcom*, 2002 WL 31729501 \*4 (S.D.N.Y. 2002).

# *The Courts: Stays*

- Absent showing substantial prejudice, parallel proceedings not objectionable. *Kordel*, 397 U.S. at 11-12.
- Will generally deny stay requests
  - *Standard Sanitary v. U.S.*, 226 U.S. 220 (1912); *SEC v. Dresser Indus., Inc.*, 628 F. 2d 1368 (D.C. Cir. 1980)
  - *SEC v. Reyes, et. al.*, No. C 06-04435 CRB (N.D. Cal.) (USAO motion to stay SEC case denied as “unfair”)
- But *SEC v. HealthSouth Corp.*, 261 F. Supp. 2d 1298, 1316 (N.D. Ala. 2003) (granting stay because defendant should not be “placed in the precarious position of either waiving his Fifth Amendment rights” or asserting the privilege and losing the civil proceeding)



## *The Courts: Stays*

- Alternatives
  - Delay discovery
  - Limit the scope of discovery
  - Grant protective orders
  - Limit stay to certain subjects
  - Limit disclosure to only counsel



# *The Courts*

## *Abuse: Key is Knowledge*

- Basic test for abuse:
  - Constitutional violation
  - Adverse to tenets of jurisprudence
  - Two categories of cases:
    - Fundamental unfairness
    - Concealment/deception
- If abuse, courts may:
  - Dismiss the case/indictment
  - Suppress testimony/evidence
  - Other orders leveling the playing field



# *The Courts*

## *Abuse: Fundamental Unfairness*

- Abuse: where government takes unfair advantage of parallel investigations
  - *SEC v. HealthSouth*, 261 F. Supp. 2d 1298 (D. Ala. 2003)
    - Motion to freeze all of the CEO's assets
    - Court stayed civil case, pending resolution of a criminal investigation
    - SEC evidence offered at hearing was from parallel criminal investigation



# *The Courts*

## *Abuse: Fundamental Unfairness*

- *SEC v. HealthSouth*, 261 F. Supp. 2d 1298 (D. Ala. 2003)
  - Defendant denied access to evidence from criminal case
  - SEC claimed the U.S. attorney or FBI had the material
  - Denied SEC motion finding “the government has undoubtedly manipulated simultaneous criminal and civil proceedings”



# *The Courts*

## *Abuse: Fundamental Unfairness*

- *SEC v. Reyes, et. al.*, No. C 06-04435 CRB (N.D. Cal.)
  - Much fanfare, USAO/SEC announced parallel proceedings re: option backdating at Brocade
  - Witnesses interviewed by USAO/SEC in proffer sessions take 5th Amendment in civil depositions
  - Defense motion to compel testimony
  - SEC argued:
    - No authority to grant immunity
    - Parallel proceedings appropriate
    - If criminal trial proceeds, witnesses may be available



# *The Courts*

## *Abuse: Fundamental Unfairness*

- *SEC v. Reyes, et. al.*, No. C 06-04435 CRB (N.D. Cal.)
  - Court denied motion as premature
  - Judge noted he was “sympathetic to Defendants’ argument that SEC and DOJ attorneys have selectively used their power to grant use immunity[,]” but at this point the factual record was inadequate to support the requested remedies



# *The Courts*

## *Abuse: Concealment/Deception*

- Standard - Can use, unless violation of constitutional rights or departs from proper administration of criminal justice
- Merger - To “be parallel, by definition, separate civil and criminal investigations should be like the side-by-side train tracks that never intersect.” *Scrushy*, 366 F. Supp. 2d at 1139.
- Prejudice - When “a defendant knows that he has been charged with a crime, or that a criminal investigation has targeted him, he can take actions to prevent the providing of information in an administrative or civil proceeding that could later be used against him in the criminal case.” *Id.*



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Tweel*, 550 F. 2d 297 (5th Cir. 1977)
  - IRS violated Tweel's 4th Amendment rights
  - IRS deceived defendant's accountant into believing no criminal authority involvement in investigative audit
  - Based on the representation, defendant disclosed documents used by the criminal authorities to prosecute Tweel for tax evasion
- *U.S. v. Rand*, 308 F. Supp. 1231 (N.D. Ohio 1970)
  - Violation of defendant's Fifth Amendment rights
  - Failed to warn about the immanent criminal action
  - Actual assurance of no criminal proceeding
  - Induced defendant to give self-incriminating evidence



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Parrott*, 248 F. Supp. 196 (D.D.C. 1965)
  - Dismissed indictment
  - SEC told defendants they were not criminal targets
  - Government delayed bringing a criminal proceeding for over two years, while the prosecutor attended civil proceeding and used defendants' civil testimony against them in criminal proceeding



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Lipshitz*, 132 F. Supp. 519 (E.D.N.Y 1955)
  - Granted motion to suppress
  - Violation of defendant's 4th and 5th Amendment rights
  - Criminal federal agent directed civil federal agent to obtain documents outside the scope of a routine audit
  - Disguised criminal investigation and did not disclose to defendant



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Scrushy*, 366 F. Supp. 2d 1134 (D. Ala. 2005)
  - Motion to suppress SEC testimony
  - USAO contacted SEC attorney and suggested:
    - Questions relevant in a criminal case;
    - Areas to avoid to conceal criminal investigation; and
    - SEC move the deposition to a location to obtain criminal jurisdiction.
  - Court granted motion finding the DOJ and SEC investigations merged



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Stringer*, 408 F. Supp. 2d 1083 (D. Ore. 2006), appeal docketed, No. 06-30100 (9th Cir. Feb. 27, 2006)
  - Dismissed indictment because criminal prosecutors hid behind a civil SEC investigation
  - SEC deliberately concealed parallel criminal investigation
  - Asked directly if parallel criminal proceeding, SEC gave misleading response



# *The Courts*

## *Abuse: Concealment/Deception*

- *U.S. v. Stringer*, 408 F. Supp. 2d 1083 (D. Ore. 2006), appeal docketed, No. 06-30100 (9th Cir. Feb. 27, 2006)
  - SEC relied on Form 1662 standard warnings:
    - Right to counsel, Fifth Amendment rights, and routine uses, i.e., making its files available to other government agencies
    - Don't tell – “Assume the worst”



# *The Courts: Post Stringer*

- Courts tend to distinguish *Stringer*
  - Stay denied and *Stringer* distinguished because the SEC became “a tool of the respective criminal investigations” *SEC v. Sandifur*, 2006 WL 40716 at \*2 (W.D. Wash. June 19, 2006)
  - Form 1662: *Stringer* incorrectly trivialized the Form *U.S. v. Luce*, 20006 WL 2850478 (N.D. Ill. Sept. 29, 2006)



## *The Courts: Future Issues*

- *U.S. v. Stringer* on appeal: SEC brief
  - Relies on Form 1662
  - No duty to disclose parallel investigation
  - Standard operating procedure for SEC
  - Decision later this year



# *The Courts: Future Issues*

- *SEC v. Reyes*:
  - Court promised to level the playing field, if necessary
  - Criminal case going to trial June 2007



# *Lessons and Conclusions*

- Continue to increase
- Potential benefits for government/defendants if aware of a parallel proceeding
- Potential for abuse if not aware of parallel proceeding
  - Government cannot take unfair advantage or be deceptive
  - Level playing field
  - Evidence should be available to all
- Future dispositions
  - *Stringer & Reyes*

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