

WHITE-COLLAR CRIME

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Parallel proceedings put certain rights at risk

Defendants can't always count on constitutional rights in such situations.

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THE RECENT RASH of investigations and indictments brought against corporations and their officers highlights the need for corporate officers and their general counsel to become sensitive to the inherent risks associated with the growing number of parallel proceedings. It is important to understand the steps that can be taken to achieve the fullest protection for corporate communications, privileged information and privileged communications in the face of tandem governmental initiatives.

Corporations and individual defendants faced with parallel proceedings are afforded some rights, such as the right to counsel during the course of the proceedings. However, they are not entitled to many traditional privileges, including some guaranteed by the Bill of Rights, such as the right to remain silent.

Both corporations and individual defendants faced with parallel proceedings are confronted with various grave concerns, including those related to self-incrimination, the right to effective assistance of counsel and discovery.

What are parallel proceedings and what are a corporation's rights during these proceedings? Why is it important for corporate counsel to understand the challenges associated with these proceedings? This article will address how corporations can manage today's challenging business and legal environment and how the courts are responding to governmental tactics employed in parallel proceedings.

Parallel proceedings are concurrent, adjudicative proceedings that arise out of a solitary set of transactions, and are directed against the same defendant or defendants. See 21 Marvin G. Pickholz, *Securities Crimes* § 3.01 (1998). For the purpose of this article, parallel proceedings refer to multiple contemporaneous or successive investigations, prosecutions or other actions brought against a corporation and its officers and employees by governmental agencies, such as the U.S. Securities and Exchange Commission (SEC)

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and the U.S. Department of Justice (DOJ), that arise out of a single set of transactions.

During a joint parallel proceeding involving the SEC and DOJ regarding alleged violations of the federal securities laws, a defendant possesses a number of rights and privileges. The SEC conducts investigations on a formal and informal basis. During the informal stages of the investigation, when a formal order of investigation has not yet been issued, a defendant has no duty to comply with any SEC request.

Once the SEC issues a formal order of investigation, its Rules Relating to Investigations regulate the staff's action. Those rules give a defendant the right to counsel during the course of a proceeding; the right to inspect the formal order of investigation and official transcripts of the defendant's own testimony;

Concurrent cases are typically brought by the DOJ and SEC.

and the right to request and, subject to SEC approval, receive a copy of that investigative order as well as a copy of the defendant's documentary evidence, if such evidence is nonpublic information.

Even though a defendant is entitled to the above-mentioned rights and privileges, many legal privileges, including some that are guaranteed in the Bill of Rights, are not available. This leaves a defendant with extreme concerns related to self-incrimination, right to counsel, discovery and collateral estoppel.

Self-incrimination

The Fifth Amendment to the U.S. Constitution guarantees a defendant the privilege against self-incrimination. In short, it protects a person from being forced to supply information that could provide a direct link in a chain of evidence that might lead to his or her conviction. This privilege is not limited solely to federal criminal trials and, therefore, may be invoked in any state or federal proceedings that a defendant fears may eventually lead to a criminal trial. *Kastigar v. U.S.*, 406 U.S. 441, 444-445 (1972); *Malloy v. Hogan*, 378 U.S. 1, 11 (1964).

However, a defendant's decision to invoke this privilege against self-incrimination comes with severe consequences. For example, the Fifth Amendment does not forbid the finder of facts from drawing adverse inferences against a party in a civil action when the individual decides not to testify in

response to questions posed to him or her. *Baxter v. Palmigiano*, 425 U.S. 306, 318 (1976); *SEC v. Graystone Nash Inc.*, 25 F.3d 187, 190 (3d Cir. 1994). In addition, the evidence concealed by invoking this privilege may not be used later by a defendant to sustain a claim or defense. See *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545, 549-50 (S.D.N.Y. 1985).

On the other hand, testifying during the civil proceeding carries its own risks for a defendant. Any evidence or testimony given by a defendant in a civil suit may be used against him in a subsequent proceeding, whether it is civil or criminal in nature. *U.S. v. Kordel*, 397 U.S. 1, 13 (1970). Consequently, in an SEC/DOJ parallel proceeding, a defendant faces a double-edged sword: He or she must choose between invoking the Fifth Amendment privilege against self-incrimination in the SEC's proceeding and self-incrimination in a later criminal or civil proceeding.

The Fifth Amendment also guarantees a defendant the right to effective assistance of defense counsel. See *McMann v. Richardson*, 392 U.S. 759, 771 n.14 (1970). During parallel proceedings, this right is easily undermined because the government may be able to obtain information that normally would have been protected by the attorney-client privilege or work-product privilege. For example, in an SEC/DOJ parallel proceeding, the DOJ guidelines for judging whether a corporation is cooperating with the criminal investigation allows the prosecutor to request that the corporation waive both attorney-client and work-product privileges.

A corporation's refusal to waive such privileges can lead to the loss of credit that it would have earned by cooperating as well as to its indictment.

Invoking Fifth Amendment comes with harsh results.

Furthermore, this threat could arise either during the pretrial phase, such as when the defense attorney fails to ask questions during a deposition, or as a result of the civil proceeding that may provide the prosecutor with access to the defense strategy.

Consequently, if, while defending the civil case, a defendant's attorney reveals his or her work product, including case theory, specific claims and defenses, this may weaken one's defense in the criminal case.

Rule 16 of the Federal Rules of Criminal Procedure governs discovery in criminal cases. Generally, a defendant is not entitled to the

statements of government witnesses, the case agent's memorandum of witness interviews or his or her rough notes of such interviews.

During discovery in a federal criminal case, the defendant is only entitled to receive four basic pieces of information: his written or recorded statement; a copy of his prior criminal record; the results and reports of any physical and mental evaluation or scientific experiments that are either material to the preparation of the defense or are intended for use at trial by the prosecutor; and a written summary of any expert testimony the prosecutor intends to use, including the expert's qualifications, opinion and the basis for such opinion.

Furthermore, discovery of witness statements that are within the possession of the prosecutor are not discoverable under Rule 16 until the conclusion of the testimony from the witnesses during direct examination at the criminal trial.

Conversely, Rule 26(b)(1) of the Federal Rules of Civil Procedure provides for discovery of any matter, not privileged, that is relevant to the subject matter involved in the pending action. The rules also permit a party to depose the other party and his or her witnesses, to serve interrogatories on the parties and to examine the other parties' documents and tangible items.

Collateral estoppel

The collateral estoppel doctrine, which states that issues litigated and determined in a proceeding are binding for the parties involved should those issues arise in a subsequent proceeding, may affect the outcome of parallel proceedings, depending on the order in which the actions are resolved. Typically, a guilty plea or conviction in a criminal proceeding triggers the application of collateral estoppel in subsequent civil litigation. See *SEC v. Gruenberg*, 989 F.2d 977 (8th Cir. 1993).

Recent judicial action

In a recent federal court decision, *U.S. v. Stringer*, 408 F. Supp. 2d 1083 (D. Ore. 2006), a federal court found that the assistant U.S. attorneys had used an SEC civil investigation to hide an ongoing parallel criminal investigation. The court determined that this misconduct warranted the dismissal of the

indictment and the suppression of all evidence gathered by the SEC.

The court held that the investigative process used during the parallel proceeding violated the defendants' due process rights on several grounds. First, the prosecutors had effectively used the SEC's civil proceeding to gather information in order to hide the criminal investigation. Second, the court ruled that the SEC's deliberate and persistent efforts to conceal the criminal investigation amounted to "deceit, trickery or intentional misrepresentation." Finally, it determined that the government interfered with an individual defendant's right to due process by failing to disqualify the company's counsel, who jointly represented an individual who was a serious target of the criminal investigation.

In an earlier case, *U.S. v. Scrushy*, No. CR-03-BE-0530-S (N.D. Ala. 2005), a federal court found that the government's actions departed from the proper administration of criminal justice by commingling the SEC's civil investigation with the DOJ's ongoing criminal investigation. Accordingly, this warranted the suppression of Richard Scrushy's SEC deposition, which led to the dismissal of three perjury counts during the trial.

The court concluded that the government had manipulated the simultaneous investigation for its own purpose, including the transfer of Scrushy's deposition from the Northern District of Georgia to the Northern District of Alabama for venue purposes.

Corporations are not always granted stay of the civil action.

While these two cases do not change the government's ability to conduct parallel civil and criminal proceedings, they may suggest an era of heightened scrutiny of governmental conduct during parallel proceedings.

To avoid providing evidence in a civil case, administrative proceeding or successive actions that might be harmful to the corporation in a criminal proceeding, a corporation may request a stay of such

proceedings pending the completion of the criminal case. Courts have weighed a number of factors in deciding this issue: the interest of the plaintiff in the proceeding and the potential prejudice the plaintiff will suffer; the burden that will be placed on the defendant(s); the burden faced by the court in managing its cases and efficiently using judicial resources; the interest of individuals not party to the civil litigation; and the interests of the public in the pending civil and criminal litigation.

When no indictment has been returned, the case for stay of a civil action is much weaker. *Federal Sav. and Loan Ins. Corp. v. Molinaro*, 889 F.2d 899, 902 (9th Cir. 1989). While courts have the power to issue a stay when the interest of justice requires it, the Constitution does not require a stay of a civil action in a parallel proceeding. *Kashi v. Gratsos*, 790 F.2d 1050, 1057 (2d Cir. 1986).

A corporation also may request protective orders to deny criminal investigators, including grand juries, access to evidence developed in the civil case. Courts are split on whether protective orders are appropriate in any case. The 2d U.S. Circuit Court of Appeals has approved protective orders in a situation where the government failed to establish a strong showing of need. See *Minpeco S.A. v. Conticommodity Services Inc.*, 832 F.2d 739, 742 (2d Cir. 1987). The 4th, 9th and 11th circuits have refused requests for protective orders to deny grand juries access to evidence developed in the civil case. See *In re Grand Jury Subpoena*, 836 F.2d 1468 (4th Cir.), cert. denied, 487 U.S. 1240 (1988); *In re Grand Jury Proceedings*, 995 F.2d 1013 (11th Cir. 1993); *In re Grand Jury Subpoena*, 62 F.3d 1222 (9th Cir. 1995).

In light of recent trends in corporate fraud enforcement, parallel proceedings most likely will continue to occur with even greater frequency, and courts will be called upon to balance competing interests to ensure the most equitable outcome. **NLJ**

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