

BETWEEN A ROCK AND  
A HARD PLACE:  
PARALLEL PROCEEDINGS  
IN THE POST-ENRON ERA

David U. Gourevitch  
*Stueve Helder Siegel LLP*

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## TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	PARALLEL PROCEEDINGS .....	2
	A. SEC and Parallel Proceedings .....	2
	B. Self Regulatory Organizations and Parallel Proceedings .....	4
	C. The Dilemma of Parallel Proceedings .....	6
III.	INVOCATION OF THE FIFTH AMENDMENT.....	7
	A. Advantages of Invoking the Fifth Amendment.....	8
	B. Cost of Invoking the Fifth Amendment .....	9
	C. Weighing the Benefits and Costs .....	10
IV.	DEFENSE RESPONSES TO PARALLEL PROCEEDING.....	10
	A. Stay of Civil Proceedings.....	11
	1. Commonality of Issues .....	11
	2. Timing of the Motion .....	12
	3. Judicial Efficiency .....	12
	4. Public Interest.....	13
	B. Stays and Prosecutorial Abuse .....	14
	C. Partial Stays .....	14
	D. Discovery In Aid of a Motion to Quash .....	15
	E. Use of Parallel Proceeding to Obtain Discovery.....	16
V.	CONCLUSION .....	18
VI.	BIBLIOGRAPHY .....	19



## I. INTRODUCTION

In today's post-Enron world, those enmeshed in regulatory investigations face a difficult dilemma: if they testify in the regulatory investigation, they damage their position in the increasingly likely event of a criminal investigation. However, if they invoke their Fifth Amendment privilege, they undermine their position in the regulatory investigation.

Nowhere is the dilemma sharper than in broker-dealer investigations. Both the National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) bar members who invoke the Fifth Amendment when confronted with a request for an on-the-record examination. Thus, invoking the Fifth Amendment in an exchange investigation is likely to result in the loss of livelihood.

While this dilemma is not new, it has been heightened by two related trends that are changing the legal landscape:

First, the line between regulatory and criminal conduct is hazy and evolving.<sup>1</sup> Conduct that a few years ago would have resulted in a regulatory sanction, at worst, now can lead to indictment. For example, most of the accounting frauds investigated during the late 1990s ended with regulatory sanctions; similar frauds today would likely result in an indictment and possibly a multi-year prison sentence. These changing standards make it difficult to accurately assess whether a regulatory case will morph at a later stage into a criminal one.

Second, the defense bar perceives that these regulatory/criminal investigations are no longer parallel, but joint. Regulators are seen as working hand-in-glove with prosecutors, creating enormous tactical advantages for the government. These closely

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<sup>1</sup> Willful violations of the securities laws constitute both regulatory and criminal violations. 15 U.S.C. 77x, 78ff. The government has the choice of pursuing a securities law violation as a regulatory or criminal matter.

coordinated regulatory-criminal investigations effectively circumvent statutory limitations on criminal discovery; burden the invocation of the Fifth Amendment with loss of employment; and force the target to simultaneously fight on multiple fronts, taxing the resources of even affluent targets.

## II. PARALLEL PROCEEDINGS

### A. SEC and Parallel Proceedings

Parallel proceedings are simultaneous or successive criminal and regulatory proceedings. In the securities industry, they typically involve concurrent regulatory and criminal investigations. Courts have long permitted the government to conduct parallel investigations. In United States v. Kordej, 397 U.S. 1, 11 (1970), the Supreme Court explained:

It would stultify enforcement of federal law to require a government agency such as the FDA to invariably choose either to forego recommendation of a criminal prosecution once it seeks civil relief or to defer civil proceedings pending the ultimate outcome of a criminal trial."

In the seminal securities case SEC v. Dresser Indus. Inc.,<sup>2</sup> the D.C. Circuit adopted similar reasoning:

[T]he SEC must often act quickly, lest the false or incomplete statements of corporations mislead investors and infect the marketplace. Thus, the Commission must be able to investigate possible securities infractions and undertake civil enforcement actions even after Justice has begun a criminal investigation.<sup>3</sup>

<sup>2</sup> 628 F.2d 1368, 1377 (D.C.Cir. 1980) (en banc), cert. denied, 449 U.S. 993 (1980).

<sup>3</sup> Id. at 1380. Similarly, in United States v. Fields, 592 F.2d 638, 646 (2d Cir. 1978), the court observed that "[t]raditionally, there had been a close working relationship between the Justice Department and the SEC" and referred to SEC-DOJ communications as a "commendable example of inter-agency cooperation".

In Dresser, the SEC and Justice Department conducted simultaneous investigations into Foreign Corrupt Practices Act violations at Dresser Industries. The SEC detailed two of its agents to Justice to work on the criminal investigation. At the same time, the SEC turned over to Justice documents and testimony that it obtained during its investigation.

Dresser moved to quash a SEC document subpoena on the grounds that the SEC was likely to turn over the documents to Justice, improperly broadening the limitations placed on criminal discovery. The en banc panel held that this practice did not circumvent the limits on criminal discovery because those rules did not apply until after indictment.<sup>4</sup> It also held that the securities laws encouraged cooperation and information sharing between regulatory and criminal investigations.

Relying on Dresser, the SEC now commonly shares documents and testimony obtained in its investigation with state and federal prosecutors. Indeed, the SEC's Form 1662, which the Enforcement Division attaches to subpoenas, warns:

The Commission often makes its files available to other governmental agencies, particularly United States Attorneys and state prosecutors. There is a likelihood that information supplied by you will be made available to such agencies where appropriate. Whether or not the Commission makes its files available to other governmental agencies is, in general, a confidential matter between the Commission and such other governmental agencies.

In recent years, the SEC has fostered a particularly close working relationship with state and federal prosecutors. In remarks last year, former Chairman Harvey Pitt touted this close relationship. He stated that the SEC assisted in "an extraordinary

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<sup>4</sup> Id. at 1381.

number of criminal prosecutions" and had brought many cases "in tandem" with criminal authorities.<sup>5</sup>

#### **B. Self Regulatory Organizations and Parallel Proceedings**

Two recent and related developments have changed the landscape for parallel proceedings in SRO investigations. First, the NASD and, to a lesser extent, the NYSE have begun working closely with the criminal authorities. Second, the NASD<sup>6</sup> and NYSE<sup>7</sup> bar individuals who invoked their Fifth Amendment privilege when confronted with a request for an on-the-record examination.<sup>8</sup>

The Second Circuit recently affirmed this practice in the important decision D.L. Cromwell Investments, Inc. v. NASD Regulation, Inc.<sup>9</sup>. The case highlights the extraordinarily close working relationship that has developed between regulators and prosecutors:

The U.S. Attorney's Office in the Eastern District of New York and the NASD opened virtually simultaneous investigations of the brokerage firm D.L. Cromwell. The Eastern District was assisted by the NASD's Criminal Assistance Prosecution Group. The Criminal Prosecution Assistance Group provided documents about D.L. Cromwell to the Eastern District.

In the course of the NASD investigation, an NASD lawyer and examiner conducted an inspection of D.L. Cromwell. Upon their return, the FBI called the NASD lawyer who passed on "general information" about what he had found.

<sup>5</sup> See Remarks by Harvey L. Pitt before the U.S. Department of Justice Corporate Fraud Conference, (September 26, 2002), available at <http://www.sec.gov/news/speech/spch585/htm>.

<sup>6</sup> NASD Rule 8210(a)(1) authorizes the NASD to require a "person subject to the Association's jurisdiction to provide information orally, in writing or electronically -- with respect to any matter involved in an investigation."

<sup>7</sup> NYSE Rule 476 authorizes the New York Stock Exchange to initiate enforcement proceedings for refusing or failing to furnish information to or to appear or testify before the Exchange in an investigation.

<sup>8</sup> The NASD Sanctions guidelines provide that "a bar should be standard" for failure to respond to a request for information. NASD Sanction Guidelines at 39 (2001).

<sup>9</sup> 279 F.3d 155 (2d Cir. 2002), cert. denied, 123 S.Ct. 580 (2003).

The Eastern District requested access to the NASD's files, and the NASD provided the FBI with documents obtained during the examination.

The NASD and the Eastern District continued to share information about their respective investigations. The Eastern provided the NASD with information from a government cooperator about D.L. Cromwell.

The NASD's Criminal Prosecution Assistance Group assisted the Eastern District in securing a search warrant of D.L. Cromwell. During the search, a D.L. Cromwell employee asked the FBI for permission to notify NASD of the search. An FBI agent reportedly responded, "We are working with the NASD—they know exactly what is going on."

The NASD demanded documents from D.L. Cromwell. D.L. Cromwell responded that the Eastern District had many of them. The Eastern District provided the NASD with an inventory of documents seized during the execution of the search warrant and some of the documents.

The NASD's Criminal Prosecution Assistance Group helped the Eastern District prepare a grand jury subpoena to a third party for D.L. Cromwell-related documents. The subpoena permitted the subpoena recipient to comply by producing the documents to the Criminal Prosecution Assistance Group's offices at the NASD.

Shortly after D.L. Cromwell's principals contested grand jury subpoenas, NASD Enforcement requested that they testify under oath with the implicit threat that the NASD would bar them from the industry if they refused. The NASD refused to postpone the testimony until the completion of the criminal investigation.<sup>10</sup>

D.L. Cromwell sought to enjoin the NASD from insisting on taking testimony. The brokerage firm argued that the NASD and Eastern District had worked so closely that the NASD had become an agent of the Eastern District. The firm also asserted that the Eastern District had used the NASD to put pressure on the firm's principals. If the D.L. Cromwell principals refused to testify in the NASD investigation, as they were certain to do because of the criminal investigation, the NASD would suspend their licenses, bar them from working in the industry and deprive them of their livelihoods.

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<sup>10</sup> 279 F.3d at 157-58.

The district court refused to enjoin the NASD absent evidence that the Eastern District had "exercised coercive power or ... provided such significant encouragement, either overt or covert, that the choice [to conduct the investigatory hearing] must in law be deemed to be that of the United States."<sup>11</sup> The district court found "no direct evidence" that the Eastern District had encouraged the NASD to seek the testimony from D.L. Cromwell's principals. Rather, the court found that NASD sought the testimony to further its own investigation and not as a government agent.

As a fallback, D.L. Cromwell argued that in conducting broker-dealer investigations, the NASD acted as a quasi-governmental agency and that, as such, it could not sanction members for invoking the Fifth Amendment. The Second Circuit held that the NASD is a private (rather than quasi-governmental) entity and that because the Fifth Amendment applies only to the government, NASD could suspend or bar members for invoking the Fifth Amendment.<sup>12</sup>

### C. The Dilemma of Parallel Proceedings

In light of the close relationship between regulators and prosecutors, witnesses must assume that testimony and documents provided to regulators are likely to be forwarded to prosecutors in the event of a criminal investigation. The decision whether

<sup>11</sup> D.L. Cromwell Investments v. NASD, 132 F. Supp.2d 248, 252 (S.D.N.Y. 2001), aff'd, 279 F.3d 155 (2d Cir. 2002), cert. denied, 123 S.Ct. 580 (2003) quoting Blum v. Yaretsky, 457 U.S. 991 (1982).

<sup>12</sup> See also In the Matter of Markowski, 51 SEC 553 at 11 (1993), aff'd, 34 F.3d 99 (2d Cir. 1994) (affirming NASD bar of registered representative for failure to cooperate with NASD investigation). In the Matter of Zubkis, SEC Exchange Act Release No. 40409 n.2 (September 8, 1998) ("It is well established - that the self incrimination privilege does not apply to questioning in proceedings by self-regulatory organizations since such entities are not a part of the government."); In the Matter of Farni, 51 SEC 1118, 1994 SEC LEXIS 1630 at \*3 (1994) ("a refusal to provide information is a violation [of Rule 8210] without regard to invocation of the right against self-incrimination."); In the Matter of Adams, 47 SEC 919, 921 (1983) (an invocation of the Fifth Amendment privilege would not affect the right of the

or not to testify requires a careful weighing of the likelihood of an indictment against the costs of invoking the Fifth Amendment in a regulatory investigation. This assessment often must be undertaken at an early stage of a regulatory investigation, prior to the initiation of a criminal investigation, with a limited understanding of the underlying facts and of the scope of the regulatory investigation. The decision is further complicated by the SEC's policy of refusing to advise witnesses whether there is, in fact, a criminal investigation.<sup>13</sup> However, unless there is no realistic prospect

of indictment, the defense of a possible criminal case, with its greater consequences, must take precedence over the civil matter.

### III. INVOCATION OF THE FIFTH AMENDMENT

Any witness is entitled to refuse to answer questions that might tend to incriminate him.<sup>14</sup> The privilege is very broad. The witness may avail himself of the privilege even if he maintains his innocence.<sup>15</sup> The privilege may be invoked in both

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NASD to sanction the respondent for his refusal to provide information since the NASD is not a part of the government.").

<sup>13</sup> The policy arises out of United States v. Fields, 592 F.2d 638 (2d Cir. 1978) in which SEC staff, as part of a settlement of an SEC action, agreed not to make a criminal referral - a promise they broke. When the defendant was indicted and subsequently moved to dismiss the indictment, the Second Circuit found that the defendant's only remedy for the SEC's of its agreement was to re-open the SEC settlement.

<sup>14</sup> The Fifth Amendment provides, in part, "No person ... shall be compelled in any criminal case to be a witness against himself..." The privilege may be invoked whenever the testimony sought would "furnish a link in the chain of evidence needed to prosecute the witness." Hoffman v. United States, 341 U.S. 479, 486 (1951); Lefkowitz v. Turley, 414 U.S. 70, 77 (1973).

<sup>15</sup> The privilege is a "protection to the innocent though a shelter to the guilty and a safeguard against heedless, unfounded or tyrannical prosecutions." Quinn v. United States, 349 U.S. 155, 162 (1955). The question need not relate directly to criminal activity; the answer need only constitute a "stepping stone" in the government's case. Estate of Fisher v. Commissioner of the Internal Revenue Service, 905 F.2d 645, 648 (2d Cir. 1990). Although assertion of the privilege is rarely challenged, the court itself is the final arbiter of whether the invocation of the Fifth Amendment is justified and may require a showing by the claimant as to the basis of his belief that the testimony may be incriminating. E.g. Hoffman v. United States, 341 U.S. 479, 48 (1951). Such a showing may be made in an ex parte

civil and criminal proceedings, although the invocation will result in an adverse inference or worse in a regulatory investigation or civil litigation.

**A. Advantages of Invoking the Fifth Amendment**

Invoking the Fifth Amendment has multiple advantages. Most importantly, it avoids the possibility of inculpatory admissions or providing information that may prove useful to the government. However, even exculpatory testimony provides the government with the defendant's version of events, with investigative leads, with a roadmap to the defense and with fodder for cross-examination. If the witness later wants to cooperate with the government in exchange for leniency, exculpatory testimony – even if literally true – may appear to be misleading or less than fully candid, reducing the opportunities and potential benefits of cooperation.

Invoking the Fifth Amendment also eliminates the risk of perjury. Perjury during SEC or NASD testimony will increase the likelihood of a criminal referral; may lead to additional criminal charges; and result in a higher sentence. Perjury has the added detriment of assisting the government in proving the underlying offense. It often is compelling evidence of "intent" – one of the hotly contested elements in most white-collar cases. Juries that may find technical regulatory violations difficult to follow readily appreciate that only people with something to hide engage in cover-ups.

Invoking the privilege also preserves the witness's options until the focus of the investigation (and the risks and benefits of testifying) are better understood. The focus often shifts during the investigation. Testimony that may have been innocuous in light

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in camera hearing. See e.g., United States v. Duncan, 704 F.Supp. 820, 822-23 (N.D. Ill. 1989); McIntyre's Mini Computer Sales Group, Inc. v. Creative Synergy Corp., 115 F.R.D. 528, 431 (D.Mass 1987). While the danger of incrimination must be "real," a criminal investigation need not have been commenced. Hoffman, 341 U.S. at 486.

of the investigation's initial focus may prove damaging when, as often happens, the investigation takes a different turn. Postponing testimony permits counsel to learn more about the facts and the focus of the investigation, to better assess the risks and benefits of testifying, and to better prepare the witness. Many defense attorneys believe there is a presumption against testifying until the criminal charges have been resolved.

#### **B. Cost of Invoking the Fifth Amendment**

The decision to invoke the privilege requires careful consideration of the negative consequences that may result. In an NASD or NYSE investigation, invoking the privilege is likely to lead to being barred from the securities industry and loss of livelihood.<sup>16</sup> In an SEC investigation, the staff of the Enforcement Division may consider the assertion of the Fifth Amendment to be a factor in favor of recommending that civil charges be brought or a criminal referral made.

In the event of a civil action, the assertion of the Fifth Amendment also may preclude the defendant from later "offering into evidence any matter relating to the factual bases for his denials and defenses" as to which he asserted the privilege.<sup>17</sup> In addition, the trier of fact may draw an adverse inference against the witness, although

<sup>16</sup> See D.L. Cromwell, *supra*, 279 F.3d 155.

<sup>17</sup> SEC v. Cymaticolor, 106 F.R.D. 545, 549 (S.D.N.Y. 1985); SEC v. Benson, 657 F. Supp. 1122 (S.D.N.Y. 1987). In Cymaticolor, the defendant was precluded from offering evidence establishing the factual bases for his denials and affirmative defenses, as to which he had asserted the Fifth Amendment. 106 F.R.D. at 549. The Court rejected the defendant's request to limit preclusion as to information that the SEC could not obtain from other sources. 106 F.R.D. 545. In Benson, the defendants refused to disclose the basis of his pleadings based on the Fifth Amendment. The court precluded him from offering evidence in support of those position, explaining:

Defendant has, however, chosen the tactic of seeking to bar plaintiff's access to the evidence. At least to the extent of pleading the Fifth Amendment, that is his right. But in a civil case, he cannot have it both ways. By hiding behind the protection of the Fifth Amendment as to his contentions, he gives up the right to prove them.

657 F. Supp. at 1129.

the Supreme Court has held that silence alone would be insufficient to support an adverse decision against one who refused to testify.<sup>18</sup>

In today's environment, invoking the Fifth Amendment also may result in loss of a job, public position or status. The SEC and Justice Department have placed enormous pressure on businesses to terminate employees and officers who invoke the Fifth Amendment in response to questions about the job. Some corporate compliance policies require officers and employees to cooperate with both internal and government investigations. The board of directors may well suspend or terminate an employee who remains silent. In addition, an employer may be unwilling to advance legal fees for an employee who relies on the privilege.

#### **C. Weighing the Benefits and Costs**

Weighing the benefits against the costs of invoking the Fifth Amendment is more art than science. There is no "one-size-fits-all" answer. If the defendant has been indicted or the risk of an indictment is high, the decision is easy. If an indictment is highly unlikely, it may be worth the risk to testify. However, most cases fall in between such as where no criminal investigation has been started but the facts suggest one might be. The answer in these cases turns on a calculus of whether the testimony is likely to increase the risk, the likely fallout from an invocation of the Fifth Amendment and other factors.

#### **IV. DEFENSE RESPONSES TO PARALLEL PROCEEDING**

Defense counsel must consider strategies to blunt the enormous tactical advantage that the government gains from parallel proceedings. These strategies may include a quick settlement of the civil case, a stay of the civil case (or at least of

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<sup>18</sup> See e.g., *Baxter v. Palmigiano*, 425 U.S. at 317; *Lefkowitz v. Cunningham*,

discovery in the civil case) pending the outcome of the criminal case, and the use of offensive discovery in the civil case to build a defense in the criminal case.

#### A. Stay of Civil Proceedings

Although courts have discretion to stay discovery for good cause, they have been reluctant to issue a stay at the request of the defendant except in "special circumstances" where the parallel investigation "demonstrably prejudices substantial right of the investigated parties."<sup>19</sup> The likely harm resulting from invoking the Fifth Amendment in a civil case to protect one's position in the criminal case does not, generally, suffice to obtain a stay.<sup>20</sup>

In determining whether to issue a stay, courts have considered the following factors:

1. commonality of issues;
2. the timing of the motion;
3. judicial efficiency; and
4. the public interest.<sup>21</sup>

##### 1. Commonality of Issues

The commonality of issues between the civil and criminal cases is "the most important factor."<sup>22</sup> A stay may be "appropriate where both the civil and criminal

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431 U.S. 810, 808 (1977).

<sup>19</sup> Dresser, 628 F.2d. at 1377.

<sup>20</sup> SEC v. First Financial Group of Texas, Inc., 659 F.2d 660, 667 (5<sup>th</sup> Cir. 1981); SEC v. Grossman, 121 F.R.D. 207, 210 (S.D.N.Y. 1987) ("the discomfort of defendant's position does not rise to the level of a deprivation of due process. Others have faced comparable circumstances; the choice may be unpleasant, but it is not illegal and must be faced."); FTC v. J.K. Publications, Inc., 99 F.Supp.2d 1176 (C.D. Cal. 2000) ("while the choice between testifying or invoking the Fifth Amendment may be difficult ... it does not create the basis for a stay.")

<sup>21</sup> Pollack, Parallel Civil and Criminal Proceedings, 129 F.R.D. 201 (1990).

charges arise from the same remedial statute such that the criminal investigation is likely to vindicate the same public interest as would the civil suit.<sup>23</sup>

## 2. Timing of the Motion

"The strong case for granting a stay is where a party under indictment is required to defend a civil proceeding involving the same matter."<sup>24</sup> The civil proceeding, if not stayed, "might undermine the party's Fifth Amendment privilege against self incrimination, expand the rights of criminal discovery beyond the limits of Federal Rule of Criminal Procedure 16(b), expose the basis of the defense to the prosecution in advance of the criminal trial or otherwise prejudice the case."<sup>25</sup> Conversely, when a grand jury investigation is ongoing but no indictment has been filed, courts are reluctant to grant stays.<sup>26</sup>

## 3. Judicial Efficiency

Defendants seeking a stay should stress that a stay would promote judicial efficiency. The outcome of the criminal case may well be dispositive of the civil case or

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<sup>23</sup> Pollack, *supra*, 129 F.R.D. at 201; see also Dresser, 628 F.2d at 1375-76 ("A stay of civil proceedings is most likely to be granted where the civil and criminal actions involve the same matter.")

<sup>24</sup> *In re Par Pharmaceuticals*, 133 F.R.D. 12 13-14 (S.D.N.Y. 1990); Pollack, *supra*, at 204.

<sup>25</sup> *Volmar Distributors, Inc. v. The New York Post Co., Inc.*, 152 F.R.D. 36, 39 (S.D.N.Y. 1993); see also Dresser, 628 F.2d at 1375-76; *Par Pharmaceutical, Inc. Securities Litigation*, 133 F.R.D. at 13.

<sup>26</sup> *Volmar*, 152 F.R.D. at 39; but see *DeVita v. Sills*, 422 F.2d 1172 (3d Cir. 1970) (declining to enjoin disciplinary proceeding against attorney who had been indicted); *United States v. Simon*, 373 F.2d 649 (2d Cir. 1967) (order staying defendant's deposition reversed in absence of showing that deposition would interfere with defendant's trial or preparation of his defense in criminal case).

<sup>27</sup> See e.g. *Sterling National Bank v. A-1 Hotels Int'l, Inc.*, 175 F. Supp. 573 (S.D.N.Y. 2001). See also *SEC v. Dresser*, 628 F.2d at 1371-74; but see e.g. *Brock v. Tolkow*, 109 F.R.D. 116 120 (E.D.N.Y.) (staying civil case prior to indictment).

at least streamline discovery and trial.<sup>27</sup> Transcripts from the criminal case will become available and reduce the need for civil discovery.

#### 4. Public Interest

Courts are most likely to deny a stay when faced with a continuing risk of public harm. In Kordel, for example, the Supreme Court cited the need for prompt action to protect the public in denying a stay involving the distribution of misbranded drugs.<sup>28</sup> Similarly, in Dresser, the court invoked the continued dissemination of false or misleading information by companies to the investing public as a basis to deny a stay.<sup>29</sup>

Conversely, courts are most likely to stay a civil case where the misconduct occurred in the past and does not pose a continuing threat to the public.<sup>30</sup> In these cases, it can be argued that a prosecution will suffice to "advance the public interests at stake."<sup>31</sup> Thus, in Brock v. Tolkow,<sup>32</sup> the court granted a partial stay because "mismanagement of a pension fund simply does not present the same danger to the public interest as violations that other courts have found to warrant denial of a motion for a stay."<sup>33</sup> The court distinguished Dresser and Kordel as matters involving "a tangible threat of immediate and serious harm to the public at large. While the

<sup>27</sup> See e.g. SEC v. Mersky, 1994 U.S. Dist. LEXIS 519 at \*9 (E.D.Pa. January 25, 1994); Brock v. Tolkow, 109 F.R.D. 116, 120 (E.D.N.Y. 1985).

<sup>28</sup> 397 U.S. at 11.

<sup>29</sup> 628 F.2d at 1377.

<sup>30</sup> Dresser, 628 F.2d at 1376 ("If delay of the noncriminal proceeding would not seriously injure the public interest, a court may be justified in deferring it.")

<sup>31</sup> Plumbers and Pipefitters National Pension Fund v. Transworld Mechanical, Inc., 886 F. Supp. 1134, 1140 (S.D.N.Y. 1995).

<sup>32</sup> 109 F.R.D. 116 (E.D.N.Y. 1985).

<sup>33</sup> Id. at 120.

allegations in this case are indeed serious, there is no indication that plan beneficiaries are suffering or will suffer any irreparable injury if civil discovery is stayed.<sup>34</sup>

#### B. Stays and Prosecutorial Abuse

Courts have exhibited a willingness to impose a stay where the defendant can demonstrate that the government has used parallel proceedings to gain a tactical advantage. In Kordel, for example, the Supreme Court suggested that the defendant may obtain a stay where the government had brought the parallel civil proceeding for the purpose of obtaining evidence for the criminal action. Similarly, in SEC v. Musella,<sup>35</sup> the court noted in dicta that it would be reluctant to penalize an indicted defendant for invoking the privilege, "given the invitation to prosecutorial abuse this might entail."<sup>36</sup>

In Afro-Lecon, Inc. v. United States, 820 F.2d 1198 (Fed. Cir. 1987), the court of appeals stayed a civil proceeding after the government arranged for a criminal investigator to "sit in" on and participated in a non-criminal conference without advising the target of the investigator's role or purpose. Similarly, in United States v. Rand, 308 F. Supp. 1231 (N.D. Ohio 1970), the court dismissed the indictment where the government had failed to give the defendant notice of a pending grand jury investigation and evidence elicited in the civil proceeding was irrelevant to the case but relevant to the criminal action.

#### C. Partial Stays

One alternative to a stay of the entire parallel proceeding is a stay of discovery until the completion of the criminal proceeding, but such stays are not routinely granted.

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<sup>34</sup> Id., citing Gordon v. Federal Deposit Insurance Corp., 427 F.2d 578, 580 (D.C. Cir. 1970) ("Here, the government's need for civil relief, which involves merely the collection of money is not as strong as that in Kordel.")

<sup>35</sup> 578 F. Supp. 425 (S.D.N.Y. 1984).

<sup>36</sup> 578 F.Supp. at 430.

Compare Dresser, 628 F.2d at 1375; Brock v. Tolkow, 109 F.R.D. 116, 120 (E.D.N.Y. 1985) (staying civil discovery until after criminal proceedings where threat to public interest was slight)<sup>37</sup> with SEC v. United Brands, Co., E.B.D. No. 75-192, 1975 WL 432 (D. Mass. Nov. 10, 1975) (refusing to quash SEC subpoenas in parallel proceeding in absence of evidence of collusion between SEC and prosecutor). Another alternative is to seek a protective order preventing the SEC from sharing information with the Justice Department,<sup>38</sup> but some courts refuse to impose such limits, citing the statutory authorization and judicial interpretations in favor of the SEC's ability to make information available to other agencies.<sup>39</sup>

#### D. Discovery In Aid of a Motion to Quash

Courts have authority to permit the subpoena recipient to conduct discovery of the government in aid of a motion to quash a subpoena.<sup>40</sup> In Dresser, the D.C. Circuit cautioned that district courts should be cautious in granting discovery. The court explained that discovery should be permitted where "the respondent is able to

<sup>37</sup> In Gordon, *supra*, 427 F.2d at 580, the court declined to stay discovery, but agreed to limit it:

The fact that the civil case is not stayed does not mean that discovery must proceed in the same way as in ordinary litigation. The court must not only be concerned with the general consideration of whether the real purpose of the civil discovery is to obtain information that is unavailable directly in a criminal proceeding, but with the further question whether to permit any discovery of the type that requires the defendant to testify, for this obviously involves aspects of the privilege against self-incrimination. And so a court properly provides a protective order to prevent discovery, such as interrogatories which may well provide proof to the Government from which it may establish the criminal charges against the indicted defendants.

<sup>38</sup> SEC v. Gilbert, 79 F.R.D. 683 (S.D.N.Y. 1978); SEC v. Grossman, 121 F.R.D. 207, 210 (S.D.N.Y. 1987) (denying defendant's motion for a stay but entering a protective order prohibiting SEC from disclosing documents or interrogatories to DOJ); SEC v. First Financial Group Inc., 659 F.2d 660, 667 (5<sup>th</sup> Cir. 1981); SEC v. Grossman, 121 F.R.D. 207, 210 (S.D.N.Y. 1987); Martindell v. ITT, 594 F.2d 291 (2d Cir. 1979) (denying government's application for access to sealed depositions).

<sup>39</sup> SEC v. Rubinstein, 95 F.R.D. 529 (S.D.N.Y. 1982)

distinguish himself from the class of the ordinary respondent by citing special circumstances that raise doubts about the agency's good faith.\* Even then, the court held, discovery should be limited to the minimum necessary by requiring specific interrogatories or affidavits rather than full discovery. *Id.*

#### E. Use of Parallel Proceeding to Obtain Discovery

In some cases, the benefits of going forward with civil discovery may outweigh the disadvantages. An example of such a circumstance is where the defendant testified during the investigative phase or where his positions on the facts are well established and well known. Once the SEC has brought its case, the defendant has an opportunity to take civil discovery from the government, obtaining discovery from the SEC that he would not be entitled to in the criminal case. In these cases, the government often seeks to stay the civil case in circumstances.

A majority of courts have granted the SEC's requests for stays, holding that the government's needs in the criminal case outweighed the defendants' right to discovery in the civil case.<sup>41</sup> However, in United States v. Percuoco, 109 F.R.D. 565 (D. Mass. 1986), the court allowed the defendants

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<sup>40</sup> Dresser at 1387 n. 18.

<sup>41</sup> In SEC v. Downe, *supra*, the U.S. Attorney successfully intervened in an insider trading case and sought to stay discovery concerning a co-defendant, Downe, who was cooperating in an on-going grand jury investigation. The court held that the defendants in the civil case should not be able to obtain discovery that would be unavailable to them in a criminal proceeding, thus harming the grand jury investigation. In SEC v. Chestman, 861 F.2d 49 (2d Cir. 1988), the U.S. Attorney intervened in an SEC case to stay discovery requests by the defendant who was under indictment. The district court granted the request, and the Second Circuit denied a petition for mandamus because the defendant did not have a right to the discovery in the criminal case and would not be prejudiced in the criminal case because discovery would proceed after the stay was lifted. Similarly, in SEC v. Drexel Burnham Lambert Inc., 128 F.R.D. 47 (S.D.N.Y. 1989), *aff'd*, 948 F.2d 1358 (2d Cir. 1991), Michael Milken and his brother Lowell sought documents under the Federal Rules of Civil Discovery. The court denied the request on the ground that the Milkens who had been indicted would not be entitled to them in the criminal case.

in a criminal case to conduct discovery in a parallel civil action filed by private citizens claiming to have been injured by the same misconduct alleged in the criminal case. Although the court noted the "strong federal policy of not permitting litigants in civil case to circumvent the rules governing criminal discovery," the court held that "[a] sharp distinction must be drawn, however, between cases in which a criminal defendant institutes a civil case in order to initiate discovery and those in which a criminal defendant seeks civil discovery to defend himself or herself in a civil action initiated by another. *Id.* at 567.

Similarly, in *SEC v. Oakford*, 181 F.R.D. 269 (S.D.N.Y. 1998), the court reprimanded the SEC for failing to provide discovery. In *Oakford*, the SEC filed a civil case against the defendants shortly after the Justice Department returned a parallel indictment. The SEC moved to stay discovery when faced with the prospect of having to provide discovery in the form of answers to interrogatories. The defendants filed an answer and prepared their responses to the SEC's discovery. Faced with the prospect of having to provide discovery to the defendants, the SEC moved to dismiss the case without prejudice. Although the court granted the request, it noted that "the SEC never had any intention of providing discovery but nonetheless permitted the case to proceed, thereby seeking advantage of filing its charges without having to support them."<sup>42</sup> The court continued that to "use the federal courts as a forum for filing serious civil accusations that one has no intention of pursuing until a parallel criminal case is completed is a misuse of the processes of these courts."<sup>43</sup>

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<sup>42</sup> *Id.* at 273.

<sup>43</sup> *Id.*

v. **CONCLUSION**

The past few years have witnessed increased cooperation between regulatory and criminal authorities. The cooperation yields huge tactical benefits to the government. For defense counsel, decision-making is difficult. The consequences of an error in judgment are grave, and the decisions frequently must be made without full knowledge of the facts.

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