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Government requests for broad civil action stays are being rejected.

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Balanced Approach for Parallel Proceedings Discovery

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RECENT DECISIONS by New York federal courts have reversed the long-standing practice of staying all discovery in civil enforcement actions during the pendency of parallel criminal proceedings. In a new trend, courts in the Eastern and Southern Districts have rejected U.S. Attorney's office requests to stay all discovery in related civil litigation brought by the Securities and Exchange Commission. These courts have balanced the many factors and equities involving discovery stays and have near-uniformly adopted a "take it as I see it" approach, rejecting blanket stays and allowing civil discovery to proceed, but giving federal prosecutors an opportunity to object to specific requests that may prejudice the integrity of the criminal case.

Parallel proceedings occur when prosecutors charge individuals or companies with federal crimes while regulators, typically the SEC, file a civil complaint against the same or related parties. Until recently, there was no "issue:" After the U.S. Attorney's office and the SEC filed contemporaneous criminal indictments and civil complaints (accompanied by press conferences and/or press releases), prosecutors would immediately seek, and be granted, the right to intervene and stay civil discovery in the SEC case pending resolution of the criminal case. Indeed, the government and white-collar defense bars in New York had become accustomed to their roles on this well-trodden stage.

The courts that have recently reversed this practice, and rejected government requests for blanket stays, have sharply questioned the historic rationales on which they were granted.

Now that the landscape has shifted, parallel proceedings present numerous issues for counsel representing individual and corporate defendants. The analyses and balancing of equities set forth in recent decisions provide defense counsel and government lawyers, in both regulatory and private civil litigation that often arises in connection with parallel criminal proceedings, with direction and opportunities to tailor their respective strategies.

The Background and the History

Prosecutors may seek to intervene in federal civil actions, governmental or private litigation, to then seek a stay of discovery under Fed. R. Civ. P. 24 when there are parallel criminal proceedings underway that involve common questions of law or fact, or implicate governmental interests.

Prosecutors have also relied on the "inherent power" of the district court to seek a stay of civil discovery in the interests of justice pending the completion of their prosecutions.

In determining whether to grant a stay, courts consider long-established factors that include the commonality of the issues, the interests and prejudices to the parties caused by delay or discovery, judicial efficiency and the public interest.[1]

Historically, courts in the Second Circuit regularly granted stays of discovery in favor of ongoing criminal cases, a pattern that continued relatively unabated until the past few years.[2] Judicial deference was given in favor of the oft-repeated and seldom questioned prejudices that would befall criminal prosecutions if civil discovery were allowed to proceed. However, this practice has recently met resistance, as district courts have begun to carefully question and reject the traditional rationales supporting the government's assertions of prejudice, particularly in their application to white-collar cases.

One of the first hard blows to the established precedent occurred in 1998, when Judge Jed Rakoff granted the SEC's motion to voluntarily dismiss an action, but described the standard operating practice of filing a civil regulatory complaint with the intent that the complaint be stayed pending the parallel criminal case, as "a misuse of the processes of these courts."[3]

In 2005, Judge Rakoff raised the issue again and noted the incongruity, evident to the defense bar, that "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."[4]

Following Judge Rakoff's lead, the tide has shifted away from the near-automatic granting of civil stays in parallel litigation. In a number of recent cases, in both the Southern and Eastern Districts, courts have rejected blanket stays sought by federal prosecutors. Indeed, it now appears that the prevailing jurisprudence is to allow discovery to proceed in SEC cases, subject to the prosecutor's right to object to narrow and particular discovery requests that directly threaten the integrity of the criminal case.[5]

Criticism of the USAO/SEC standard operating practice has also been reflected in district court opinions from other circuits ("legal legerdemain" and "gamesmanship"),[6] a number of which have adopted a balanced approach similar to that used in the recent New York cases.[7]

Recent Decisions' New Approach

In the recent decisions establishing this new approach, district courts have concluded that the prejudice to the defendant by a delayed resolution of the civil case outweighed the prejudice to the government in losing a "tactical advantage" in the criminal proceeding.

The courts also focused on the well known fact that the SEC and U.S. Attorney's offices typically work closely together in their investigations, and concluded that problems inherent to parallel proceedings are caused by charging decisions made by the "same government," not by the defendants.

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Finally, in balancing the equities, the courts have rejected broad claims of harm or prejudice, limiting relief instead to potential discovery requests creating a specific and demonstrable prejudice to the criminal case.

In three of the more recent cases denying prosecutors' requests for civil stays, decided within the past year, *SEC v. Chakrapani*, *SEC v. Cuti* and *SEC v. Cioffi*, Judges Richard Sullivan, John Koeltl and Frederic Block enumerated the traditional list of prejudices asserted by U.S. Attorney's offices.

First, civil discovery could make information available beyond the narrower scope of criminal discovery; second, disclosure of certain testimony and witnesses could allow criminal defendants to manufacture evidence, suborn perjury, tailor testimony or intimidate witnesses; third, depositions and interrogatories could impair the usefulness of cooperating witnesses; and fourth, assertions of the Fifth Amendment right against self-incrimination could impair the discovery process by allowing defendants to use the Fifth Amendment as a shield while wielding an unlimited discovery sword.[8]

A careful review of *Chakrapani*, *Cuti* and *Cioffi* and the other recent district court decisions analyzing the arguments for and against each of the above-listed "prejudices" provides the bases for understanding the new trend. The district courts' analyses of the equities also provide insight into strategies and safe harbors for defense counsel, and government lawyers, for effective management of their parallel proceedings.

Of course, it is axiomatic to note that each case involving parallel proceedings presents different facts, circumstances and potential prejudice to the defendant or to the government. Permutations such as whether some or all civil defendants are involved (and how) in the criminal case, whether the Fifth Amendment privilege will be asserted by one or more deponents, and the timing and status of the respective civil and criminal cases, will inform the nature of any potential prejudice and affect the balancing of equities in determining whether to stay discovery.

Analyzing the 'Prejudices'

The first argument of prejudice to the government is that the broader contours of civil discovery could allow criminal defendants to gain access to evidence to which they are not otherwise entitled.[9] This argument, formerly the cornerstone of the historic rationale behind civil stays, has been recently rejected by various courts as "irrelevant" and an "insufficient basis" to grant a stay:

"[T]here is no cognizable harm to the government in providing such discovery beyond its desire to maintain a tactical advantage."[10]

Courts have also noted that the government has put the defendants in a position to circumvent the limited criminal discovery rules:

"They didn't create this civil case; they didn't ask to be sued by the SEC."[11]

Accordingly, whatever advantages that exist as a result of the differences between civil and criminal discovery are problems that the "same government" could have foreseen and avoided. In balancing the equities, a number of courts have placed significant weight on the fact that the civil defendants opposing the stay had agreed to toll the statute of limitations, which would have allowed the SEC to preserve its claims without the need to file suit.[12]

The second traditional argument of prejudice—that disclosure of testimony and witnesses could facilitate efforts to obstruct justice, suborn perjury or manufacture evidence—has been given short shrift by the recent decisions. Without any particularized showing by the government or basis to suspect misconduct, there is little traction for these arguments, particularly in white-collar cases.[13] Moreover, such broad assertions of potential wrongdoing run counter to the presumption of innocence afforded criminal defendants.

The third argument of prejudice, that discovery could impair the usefulness of cooperating witnesses, has met with differing results in recent cases, and some courts have shielded cooperators from deposition testimony.[14] The government's oft-stated contention that cooperators could become "less useful" because of civil testimony, however, does not withstand careful scrutiny.

Under the standard cooperation agreement, a cooperator's obligation is simply to testify truthfully. Cooperating witnesses are routinely called upon to testify multiple times at criminal trials of different defendants, at retrials, or at sentencing proceedings. Subjecting a cooperating witness to deposition testimony in a parallel civil action should not affect his "usefulness." Rather, civil discovery could perhaps reveal material inconsistencies or mistakes, or that the cooperator is not (or is) a credible witness. Indeed, it is hard to understand how that result can be unduly prejudicial to the government, which is duty bound to establish the truth and seek "justice."[15]

The final traditional argument of prejudice to the government involves the ability of criminal defendants to use civil discovery as a sword, but shield themselves through assertions of the Fifth Amendment. A number of courts have granted stays largely based on the argument that by allowing civil discovery to proceed under this scenario, defendants unfairly learn information valuable to their criminal defense, but use the privilege to protect against disclosing information that may be harmful to them.[16]

The concerns created by Fifth Amendment invocations, however, are ordinarily used to advocate stays sought by defendants, who confront the dilemma either of having to testify in a pretrial deposition or, by invoking the privilege against self-incrimination, subjecting themselves to an adverse inference in the civil case. As such, there is some balancing of equities, since the SEC would presumably benefit from such an inference if civil defendants continued to assert their Fifth Amendment rights through trial.

In recent decisions denying stays, some courts placed an emphasis on defense counsel representations that their clients would not pursue active discovery while simultaneously invoking their Fifth Amendment rights.[17]

Finally, judicial determinations identifying civil discovery requests that unduly prejudice the integrity of the criminal case have been limited. Concerns have been raised about cooperator depositions and certain investigative reports.[18] Beyond that, prosecutors will undoubtedly seek to develop a more robust list of objectionable discovery and defense counsel will undoubtedly argue against such limitations. The "take it as I see it approach" will require careful judicial oversight and creative solutions to discovery issues.

Conclusion

As the government continues to bring parallel proceedings, courts will need to balance the competing interests of the government, defendants, the public and judicial efficiency. The new approach allowing for simultaneous civil and criminal discovery creates additional issues and burdens for all parties.

In creating their strategies, counsel should take into account that recent court decisions have placed significant weight on whether civil defendants were offered (and agreed to accept) tolling agreements, whether key cooperating witnesses were being subjected to broad discovery requests, and whether criminal defendants are likely to assert their Fifth Amendment rights in civil discovery. Ultimately, while the courts will balance the equities to decide whether a stay of civil proceedings is warranted under the facts of a particular case, counsel may have the ability to shape the factual landscape in which the balancing occurs.

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1. These factors apply equally to USAO requests for stays in parallel civil enforcement proceedings brought by the SEC or other governmental agencies, see *SEC v. Jones*, 2005 WL 2837462, at *1 (S.D.N.Y. Oct. 28, 2005), as well as to USAO requests to stay private civil litigation, see *In re WorldCom Inc. Sec. Litig.*, 2002 WL 31729501, at *3-4 (S.D.N.Y. Dec. 5, 2002) (collecting cases).

2. See *SEC v. Treadway*, 2005 WL 713826, at *3-4 (S.D.N.Y. March 30, 2005); *In re WorldCom Inc. Sec. Litig.*, 2004 WL 802414, at *5-6 (S.D.N.Y. April 15, 2004); *SEC v. Kozlowski*, 2003 WL 1888729, at *1-2 (S.D.N.Y. April 15, 2003); *SEC v. Beacon Hill Asset Mgmt. LLC*, 2003 WL 554618, at *1-2 (S.D.N.Y. Feb. 27, 2003); *Morris v. AFSCME*, 2001 WL 123886, at *2 (S.D.N.Y. Feb. 6, 2001); *SEC v. Google*, 1997 U.S. Dist. LEXIS 20878, at *8-9 (D. Conn. April 30, 1997); *Volmar Distrib. Inc. v. New York Post Co.*, 152 F.R.D. 36, 40-41 (S.D.N.Y. Dec. 14, 1993); *SEC v. Downe*, 1993 WL 22126, at *13-14 (S.D.N.Y. Jan. 26, 1993); *Twenty First Century Corp. v. LaBianca*, 801 F. Supp. 1007, 1010-11 (E.D.N.Y. 1992); see also *Parallel Civil and Criminal Proceedings*, 129 F.R.D. 201 (1990)(Judge Pollack)(collecting pre-1990 cases, and noting almost uniform judicial support to stay all discovery in civil actions until disposition of the criminal matter).

3. *SEC v. Oakford Corp.*, 181 F.R.D. 269, 273 (S.D.N.Y. 1998).

4. *SEC v. Saad*, 229 F.R.D. 90, 91 (S.D.N.Y. 2005).

5. See *SEC v. Chakrapani*, 09 Civ. 325, Hearing Tr. at 14, 28 (S.D.N.Y. July 29, 2009); *SEC v. Cuti*, 08 CV 8648, Hearing Tr. at 58 (S.D.N.Y. Jan. 20, 2009); *SEC v. Cioffi*, 2008 WL 4693320, at *2 (E.D.N.Y. Oct. 23, 2008); *SEC v. Collins & Aikman Corp.*, 07 CV 2419, Hearing Tr. at 24 (S.D.N.Y. Sep. 6, 2007); *SEC v. Jones*, 2005 WL 2837462, at *2; *SEC v. Saad*, 229 F.R.D. at 92. Unpublished decisions and transcripts cited in this article are available from the authors.

6. *SEC v. Kornman*, 2006 WL 1506954, at *4 (N.D. Tex. May 31, 2006).

7. See, e.g., *SEC v. Sandifur*, 2006 WL 3692611, at *2-3 (W.D. Wash. Dec. 11, 2006); *SEC v. Reyes*, CV 06-4435, Hearing Tr. at 5 (N.D. Cal. Oct. 4, 2006); *SEC v. Yuen*, CV 03-4376, slip op. at 13 (C.D. Cal. Oct. 27, 2003); but see *SEC v. Nicholas*, 569 F. Supp. 2d 1065, 1072-73 (C.D. Cal. 2008) (granting stay); *SEC v. Offill*, 2008 WL 958072, at *5 (N.D. Tex. April 9, 2008)(same).

8. In addition to the traditional prejudices asserted by the government, the courts in *Chakrapani*, *Cuti* and *Cioffi* also noted the two primary prejudices to defendants occasioned by civil stays: the inability to clear one's name in a timely manner and the inability to collect and preserve evidence necessary to defend a civil proceeding. See *SEC v. Chakrapani*, Hearing Tr. at 11-12, 28; *SEC v. Cuti*, Hearing Tr. at 36, 39, 55-58; *SEC v. Cioffi*, 2008 WL 4693320, at *2; see also *SEC v. Yuen*, slip op. at 5 (prejudice from civil freeze of defendants' assets).

9. Compare Federal Rule of Civil Procedure 26(b) (discovery "regarding any nonprivileged matter that is relevant to any party's claim or defense") with Federal Rule of Criminal Procedure 16(a)(1)(E)(discovery of documents "material to preparing the defense [or that] the government intends to use the item in its case-in-chief at trial.")

10. *SEC v. Cuti*, Hearing Tr. at 54 (quoting *SEC v. Oakford Corp.*, 181 F.R.D. at 272-73)); *SEC v. Cioffi*, 2008 WL 4693320, at *2 (same).

11. *SEC v. Collins & Aikman Corp.*, Hearing Tr. at 18.

12. See, e.g., *SEC v. Cuti*, Hearing Tr. at 12, 27, 55; *SEC v. Collins & Aikman Corp.*, Hearing Tr. at 17-18.

13. In a well-publicized decision denying the government's application for a discovery stay in private civil litigation arising from the Martha Stewart criminal case, Judge John Sprizzo rejected the government's assertions of obstruction and intimidation, noting: "This is not John Gotti." *Semon v. Stewart*, 02 Civ. 6273, Hearing Tr. at 26 (S.D.N.Y. Sept. 30, 2003).

14. Compare *SEC v. Saad*, 229 F.R.D. at 91 (staying depositions of cooperators and criminal defendants); *SEC v. Treadway*, 2005 WL 713826, at *4 (staying certain depositions); *SEC v. Collins & Aikman Corp.*, Hearing Tr. at 24 (staying certain depositions); and *In re WorldCom Inc. Sec. Litig.*, 2004 WL 802414, at *5 (staying cooperator and certain other depositions; "Counsel invariably mine each iteration to point out real and imagined inconsistencies. Therefore, civil depositions of critical witnesses in a criminal trial place a significant burden on the prosecution, and may at the extreme, undermine its ability to obtain a just verdict.") with *SEC v. Chakrapani*, Hearing Tr. at 27 (denying stay and allowing cooperator testimony); *United States v. FINRA*, 09 MC 188, slip op. at 4 (E.D.N.Y. April 9, 2009)(same); and *Semon v. Stewart*, Hearing Tr. at 19-20 (same; "What interest does the government have to protect its witnesses from being deposed? What are you worried about, that they will give an inconsistent statement, other than what they have given to the grand jury?").

15. *Berger v. United States*, 295 U.S. 78, 88 (1935)(United States Attorney's Office represents the sovereign, whose interest "in a criminal prosecution is not that it shall win a case, but that justice shall be done.").

16. See *SEC v. Nicholas*, 569 F. Supp. 2d at 1070 ("The specter of parties and witnesses invoking their Fifth Amendment rights would render civil discovery largely one-sided."); *SEC v. Saad*, 229 F.R.D. at 91 ("Fifth Amendment privilege will play havoc with the orderly conduct of [discovery]."); see also *United States v. Cioffi*, 08 CR 415, Hearing Tr. at 11-12 (E.D.N.Y. July 14, 2009)(affirming stay by Magistrate Judge as not "clearly erroneous" as criminal trial was about to proceed and because criminal defendants were asserting their Fifth Amendment rights at deposition: "[W]hat's sauce for the goose is sauce for the gander.").

17. See, e.g., *SEC v. Cuti*, Hearing Tr. at 38, 57; *SEC v. Yuen*, slip op. at 8; see also *SEC v. Chakrapani*, Hearing Tr. at 4-5, 21 (noting potential for Fed. R. Civ. P. 21 severance to address prejudice to civil defendant not asserting Fifth Amendment rights).

18. Some courts have carved out cooperator depositions from civil discovery, see supra note 14, but there is an understandable paucity of other potential examples, see, e.g., *SEC v. Collins & Aikman Corp.*, Hearing Tr. at 4, 21 (internal investigation report); *SEC v. Offill*, 2008 WL 958072, at *4 (SEC investigative reports).