1998

Unjust Justice in Parallel Proceedings: Preventing Circumvention of Criminal Discovery Rules

Randy S. Eckers

Follow this and additional works at: http://scholarlycommons.law.hofstra.edu/hlr

Part of the Law Commons

Recommended Citation
Available at: http://scholarlycommons.law.hofstra.edu/hlr/vol27/iss1/6
NOTE

UNJUST JUSTICE IN PARALLEL PROCEEDINGS:
PREVENTING CIRCUMVENTION OF
CRIMINAL DISCOVERY RULES

CONTENTS

I. INTRODUCTION ........................................................................... 109

II. THE SEC INVESTIGATION ........................................................ 113
    A. Statutory Foundations and Jurisdiction ............................ 113
    B. Sources of Information ................................................... 114
    C. Informal Investigations .................................................... 115
    D. Formal Investigations ..................................................... 116
    E. Subject's Rights and Privileges ........................................ 120

III. PARALLEL PROCEEDINGS AND INTERAGENCY
    COOPERATION ......................................................................... 125
    A. Disclosure of Non-Public Information ............................ 126
    B. Motions for a Temporary Stay ......................................... 129

IV. DEPARTMENT OF JUSTICE BAD FAITH IN
    CIRCUMVENTING CRIMINAL DISCOVERY RULES .......................... 134
    A. Good Faith Standard for the Department of Justice ............ 137
    B. Statutory Amendments .................................................... 139

V. CONCLUSION ............................................................................ 141

I. INTRODUCTION

Parallel proceedings are independent, simultaneous investigations and prosecutions involving substantially the same matter and parties.¹

¹ See John H. Sturc & Alan E. Sorcher, Parallel Proceedings: The Acquisition and Use of

Published by Scholarly Commons at Hofstra Law, 1998
For example, when federal securities laws are willfully violated, enforcement authorities are free to pursue both civil and criminal penalties against the offenders. Such federal law enforcement agencies will conduct their own separate investigations and prosecutions. The Securities and Exchange Commission ("SEC" or the "Commission") conducts the administrative or injunctive proceeding, while the Department of Justice ("DOJ" or "Justice") conducts the criminal proceeding. The SEC often initiates an investigation into violations when they detect, through internal or external sources, the possible illegal activity. The Commission begins an initial "informal" investigation by soliciting information from possible witnesses or the subject of the investigation. If it becomes necessary to continue the investigation, the SEC will begin a formal investigation in which they gather documentary and testimonial evidence through subpoena and formal orders.

The witness possesses certain rights, such as the right to counsel and the right to a copy of the transcript, but many other rights are not available. Privileges that a witness may assert appear at first glance to

---

2. See id.

The possibility exists that a private litigant, or litigants, may sue the same defendant in a civil action for the same alleged securities violations. Self-regulatory agencies and the states also may investigate concurrently.
5. Once a criminal investigation is commenced the "subject" is then-technically referred to as the "target" of the investigation. See generally SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735, 741 (1984) (discussing the Securities and Exchange Commission's ("SEC") obligation to notify "targets" of non-public investigations).
6. See Hicks, supra note 4, § 2.02[3][b], at 2-13.
8. See 15 U.S.C. § 77v(b) (1994). This section states:

In case of contumacy or refusal to obey a [subpoena] issued to any person, any of the said United States courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such person an order requiring such person to appear before the Commission, or one of its examiners designated by it, there to produce documentary evidence if so ordered, or there to give evidence touching the matter in question; and any failure to obey such order of the court may be punished by said court as a contempt thereof.

Id.
9. The witness, for purposes of this Note, may be considered the subject.
10. See 17 C.F.R. § 203.7(b) (1997).
11. See id. § 203.6.
be protective but in fact might not be. Courts have upheld non-statutory privileges such as the attorney-client privilege,\footnote{See Permian Corp. v. United States, 665 F.2d 1214, 1222 (D.C. Cir. 1981) (holding that once an attorney-client privilege is waived and documents are turned over to the SEC, the defendant could not then re-assert the privilege to preclude disclosure of the same documents in another subsequent litigation).} the work-product privilege\footnote{See in re Subpoenas Duces Tecum, 738 F.2d 1367, 1370-75 (D.C. Cir. 1984).} and the Fifth Amendment privilege against self-incrimination\footnote{See U.S. CONST. amend. V; see also SEC v. Benson, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) 92,001 (S.D.N.Y. Apr. 9, 1985). In this case, Benson was charged with misappropriating $495,000 of his corporate funds. In response to SEC interrogatories, Benson asserted seven affirmative defenses including the attorney-client privilege, work-product, and the Fifth Amendment privilege against self-incrimination. The court held in reference to his Fifth Amendment assertion: While Benson has a perfect right to assert his privilege under the Fifth Amendment and to avoid furnishing evidence that might lead to a criminal conviction, his assertion of the privilege in civil litigation may have adverse consequences. For example, assertion of the Fifth Amendment in civil litigation justifies an adverse inference by the finder of fact. Id. (citations omitted); see also N. Sims Organ & Co. v. SEC, 293 F.2d 78, 80-81 (2d Cir. 1961) (holding that “failure to explain facts and circumstances warrants the inference that his testimony would have been adverse”).} so long as various factors exist. With certain exceptions,\footnote{For an in depth discussion of these factors and exceptions, see infra Part I.E.} statutory law also purportedly protects witnesses. The Right to Financial Privacy Act of 1978 ("RFPA")\footnote{12 U.S.C. §§ 3401-21 (1994).} and the Freedom of Information Act ("FOIA")\footnote{5 U.S.C. § 552 (1994).} are two statutory protections that white collar defendants seek but which rarely provide adequate protection.\footnote{See infra Part II.E.}

The SEC, while gathering evidence through subpoenas or testimony, may share that information with the DOJ.\footnote{See SEC v. Dresser Indus., Inc., 628 F.2d 1368, 1376 (D.C. Cir. 1980). In SEC v. First Financial Group, 659 F.2d 660 (5th Cir. Oct. 1981), the court held: There is no general federal constitutional, statutory, or common law rule barring the simultaneous prosecution of separate civil and criminal actions by different federal agencies against the same defendant involving the same transactions. Parallel civil and criminal proceedings instituted by different federal agencies are not uncommon occurrences because of the overlapping nature of federal civil and penal laws. The simultaneous prosecution of civil and criminal actions is generally unobjectionable because the federal government is entitled to vindicate the different interests promoted by different regulatory provisions even though it attempts to vindicate several interests simultaneously in different forums. Id. at 666-67; see also United States v. Kordel, 397 U.S. 1, 11 (1970) ("It would stultify enforce-}
tion, facing the possibility that evidence obtained in the administrative, injunctive, or civil proceeding can be used against him in a criminal action.

The latter, or parallel proceeding, may begin once the DOJ has initiated their investigation. Now the defendant must defend himself in the administrative and criminal proceedings in two different venues. The courts only block parallel proceedings in special circumstances. A defendant may move for a stay to block parallel proceedings, which will be granted only if the defendant can prove either that the government is acting in bad faith and using malicious tactics to circumvent the strict criminal discovery rules, or that there is a due process or Fifth Amendment violation. Even if a defendant meets one of these requirements, a stay is not guaranteed. The court takes many other factors into account in deciding whether a stay is appropriate in a specific situation. These factors include the commonality of the transaction or issues, the timing of the motion, judicial efficiency, the public interest, and whether or not the movant is intentionally creating an impediment. Absent special circumstances, both cases will probably proceed.

This Note focuses on the special circumstances where a stay is sought on the grounds that a parallel proceeding is brought in a bad faith attempt to circumvent the strict criminal discovery laws outlined in Federal Rule of Criminal Procedure 16(b). By acting strategically, the DOJ can successfully receive testimony that they could not ordinarily obtain through their own criminal investigation. This shared evidence can and will be used against the defendant in the latter criminal prosecution. Because the SEC and the DOJ may and likely will cooperate

---

21. See cases cited supra note 20. These special circumstances will be discussed in depth infra Part III.A.

22. See infra Part III.A.

23. See infra Part III.A.

24. This rule describes the information subject to disclosure and use by the criminal prosecutor. See Fed. R. CRIM. P. 16(b).

and share discovery, courts have been unwilling to grant a stay in the civil or administrative proceeding so long as a criminal indictment has not been brought. It is in the DOJ’s best interest to stall a criminal indictment as long as possible, limited only by the expiration of the statute of limitations. By having the SEC’s proceeding continue without a stay, the DOJ’s benefit may be so great that the DOJ may receive the defendant’s own self-incriminating testimony to use it against that defendant in a criminal action.

Courts need to recognize that Justice may be acting in bad faith by waiting for the defendant to choose between asserting his Fifth Amendment right and having an adverse presumption used against him, or testifying and having that testimony used against him in the subsequent criminal action. In light of this problem, the courts should adopt new standards or, in the alternative, Congress should enact a statutory amendment in deciding when and if to grant a stay in the SEC’s proceeding when an indictment has not yet been returned.

Part II of this Note describes the basis of the SEC’s jurisdiction, their sources of information, the chronology of their investigation, and the target’s rights and privileges. Part III describes the SEC’s cooperation with the DOJ, parallel proceedings between the SEC and Justice, and motions for temporary stays in the prior proceeding. Finally, Part IV describes how the DOJ is arguably acting in bad faith by stalling the indictment and suggests a standard that the DOJ should be held to in determining when to bring an indictment. This standard, as well as a proposed statutory amendment, would ensure that the defendant in parallel proceedings receives maximum protection of his Fifth Amendment rights.

II. THE SEC INVESTIGATION

A. Statutory Foundations and Jurisdiction

Sections 19(b) and 20(a) of the Securities Act authorize the SEC to investigate and commence enforcement actions. They grant the

26. See infra Part III.
27. 15 U.S.C. § 77s(b) (1994). This section provides:
For the purpose of all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of this subchapter, any member of the Commission or any officer or officers designated by it are empowered to administer oaths and affirmations, [subpoena] witnesses, take evidence, and require the production of any books, papers, or other documents which the Commission deems relevant or material to

Published by Scholarly Commons at Hofstra Law, 1998
SEC exclusive control over investigations concerning potentially illegal securities trading or other willful violations of the securities laws.

B. Sources of Information

The SEC typically relies on two sources of information in its investigation—external and internal sources.20 The SEC obtains internal information concerning violations of law through the filing obligations of the Securities Act and the Securities Exchange Act of 1934 ("Exchange Act")21 and by monitoring market activity through special surveillance units at the national stock exchanges, as well as computer flagging systems.22 These monitoring systems help detect unusual trading patterns which could lead the SEC to possible violations of the securities regulations.23

In addition to these internal methods of detection, the SEC also receives external, or third party, information in the form of tips.24 The Commission often obtains violation referrals and other investigatory assistance from self-regulatory organizations, public complaints, informants, and state and federal agencies including state district attorneys' offices, state securities bureaus and commissions, the Internal Revenue Service, the Federal Bureau of Investigation, the office of the United States Attorney, the United States Postal Inspection Service, the DOJ, federal military authorities, and the media.25 The Commission also discovers violations by establishing investigative task forces to regulate and oversee the activities of brokerage houses, securities dealers, and the inquiry. Such attendance of witnesses and the production of such documentary evidence may be required from any place in the United States or any Territory at any designated place of hearing.

Id. 28. Id. § 77(a). This section provides:
Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

Id. 29. Id. § 77.
30. See Hicks, supra note 4, § 2.02(2), at 2-11.
33. See Hicks, supra note 4, § 2.02(2), at 2-11.
34. See id.
35. See id.
other regulated entities and individuals.\textsuperscript{36}

\textbf{C. Informal Investigations}

Once the Commission receives notification of an alleged securities violation, the staff may initiate an informal inquiry and investigation. At this early stage, formal authorization by the Commission is not required. The staff has no official power to compel production of evidence but may ask the parties for their cooperation.\textsuperscript{37} If the defendant cooperates, the production of evidence is strictly voluntary.

During this informal investigation, the staff begins to gather as many documents as they can to reconstruct the alleged illegal transaction.\textsuperscript{38} The staff can compel regulated entities (such as banks and brokerage firms), which are required to maintain certain books and records, to produce these documents. Invocation of these "exam" rights is a key element of SEC informal investigations.\textsuperscript{39} These documents become the most useful tool available to the Commission when witnesses are unavailable or unwilling to cooperate.\textsuperscript{40} Checks, financial statements, contracts, and other documents are essential to the investigation. Without these financial and legal documents, complex schemes involving dozens of transactions could not be re-created, disabling the SEC's ability to prove securities laws' violations.\textsuperscript{41}

Guidelines for staff members regarding these informal investigations first require that non-public information is only for staff use.\textsuperscript{42}

\textsuperscript{36} See id. at 2-12.

\textsuperscript{37} See id. § 2.02[3][b], at 2-13.


\textsuperscript{39} See id.

\textsuperscript{40} See id. Such documents include "[c]hecks, financial statements, contracts, and other documents." Id.

\textsuperscript{41} See id. The authors state:

This gathering of documentary evidence is a key element in discovering and prosecuting the multitude of schemes that misuse the nation's financial system. When a robbery has taken place, the only question may be who committed it. But in some types of Commission investigations, such as those concerning insider trading, whether a violation has even occurred may not be ascertainable until after the funds have been traced through numerous accounts maintained at brokerage firms and banks. As an added complication, all but the last in a series of accounts may be maintained in fictitious or nominee names. In such cases, only through obtaining and analyzing documents concerning the flow of funds can any violation be established.

\textit{Id.}

\textsuperscript{42} See 17 C.F.R. § 203.2 (1997). This rule states: "Information or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public . . . ." \textit{Id. But see} 17 C.F.R. § 146.10 (stating that certain in-
Second, subjects of an investigation may submit a written statement of their own position in regard to the subject matter of the investigation. This so-called "Wells Submission" may be quite deceiving because it may be used against a target in any subsequent proceeding. Additionally, the staff does not have to inform the target of the ongoing investigation of its activities and has a policy of not doing so. Third, if the SEC informs the subject that it will not bring an action following the investigation, the target cannot construe this as an exoneration, or that no further investigations will ensue. The SEC may settle its own case with the target, but it does not have the authority to settle any future criminal proceedings. Since documentary evidence is the most useful form of discovery for the SEC, informal investigations can be very fruitful for the DOJ in the event of a parallel proceeding.

D. Formal Investigations

If the SEC desires further testimonial evidence and it has exhausted all voluntary channels of cooperation, or if it is very suspicious of the
cooperation it has received, it may seek a Formal Order of Private Investigation ("Formal Order"). Once the staff member believes there is a "likelihood" of a violation, the Formal Order empowers the staff member to issue court enforceable subpoenas, which it could not issue through an informal investigation. The Formal Order serves three important functions. First, it defines the scope of and sets limits on the compulsory process. Second, it designates those officers who are authorized "to administer oaths and affirmations, [subpoena] witnesses, take evidence, and require the production of any books, papers, or other documents which the Commission deems relevant or material to the inquiry." These officers will then employ various subpoenas, both ad testificandum and duces tecum, to gather discovery. Third, it provides notice to witnesses that an investigation is taking place.

Upon issuance of the Formal Order, the formal investigation begins. The Rules Relating to Investigations ("Rules") regulate formal investigations, formal investigative proceedings, and the officers who are conducting the investigation. The Rules are divided into guidelines which cover the formal investigation as a whole and rules which only apply to formal proceedings. According to the rules which generally cover formal investigations, all documents and information are non-public and may only be reviewed by the SEC under Rule 2. However, Rule 2 also provides that the Commission may participate in discussions

50. See id. at 47.
51. See id.; see also SEC v. Wheeling-Pittsburgh Steel Corp., 648 F.2d 118, 130 (3d Cir. 1981) (discussing that the SEC must believe there to be a "likelihood" of a securities violation before issuing a Formal Order”).
52. See Sorkin & Jakoby, supra note 38, at 47.
54. Ad Testificandum is defined as: "To testify. Type of writ of habeas corpus used to bring prisoner to court to testify." BLACK’S LAW DICTIONARY 51 (6th ed. 1990).
55. Duces Tecum is defined as: "The name of certain species of writs, of which the subpoena duces tecum is the most usual, requiring a party who is summoned to appear in court to bring with him some document, piece of evidence, or other thing to be used or inspected by the court." Id. at 499.
56. See Sorkin & Jakoby, supra note 38, at 47.
58. See id. § 203.2. Rule 2 states:

Information or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public, but the Commission approves the practice whereby officials . . . may engage in and may authorize members of the Commission’s staff to engage in discussions with persons identified in § 240.24c-1(b) of this chapter concerning information obtained in individual investigations or examinations, including formal investigations conducted pursuant to Commission order.

Id.
concerning the investigation with other government agencies, self-regulatory organizations, receivers, special counsels, and other similar persons appointed in Commission litigation, the Securities Investor Corporation, and trustees and counsel for trustees. This Rule is imperative for the DOJ because it allows the SEC to share information with them.

Under Rule 4(b), the Commission delegates the officers assigned to the investigation the power to subpoena evidence or documents that they feel are material to the inquiry. This subpoena power is a crucial weapon in the SEC’s arsenal for four reasons: (1) the SEC gains the power to compel appearances of witnesses; (2) the subpoena recipient is financially responsible for document production; (3) the SEC does not have to establish that a securities violation is likely; (4) the SEC is not required to inform the person or persons of the reason for the subpoena.

In addition, under section 19(b) of the Securities Act and its common law interpretation under SEC v. Minas DeArtemisa, S.A., the Commission or a designated officer has the power to compel the appearance of witnesses and the production of documents from anywhere inside or outside the United States. The recipient of the subpoena is financially responsible for producing the material the Commission desires. Since the SEC is not required to establish jurisdiction for the subpoena, nor must it establish that a securities violation is likely, any challenges by the recipient are unlikely to be successful. Although it is the SEC’s choice to enforce a subpoena if the recipient fails to respond fully, a court ultimately decides whether to enforce it. The court will normally defer to the SEC on the purpose of and need for an investigation. Most recipients of a subpoena do not force the issue because it

59. See id. § 240.24c-1 (including “[a] federal, state, local or foreign government or any political subdivision, authority, agency or instrumentality of such government” as authorized persons under Rule 2).

60. See id.

61. Id. § 203.4(b).

62. See Hicks, supra note 4, § 2.02[4][c][i], at 2-24.


64. 150 F.2d 215 (9th Cir. 1945).


66. See SEC v. Arthur Young & Co., 584 F.2d 1018, 1033 (D.C. Cir. 1978) (“There is a continuing general duty to respond to governmental process; in consequence, subpoenaed parties can legitimately be required to absorb reasonable expenses of compliance with administrative subpoenas.”).

67. See Hicks, supra note 4, § 2.02[4][c][ii], at 2-25.

makes the investigation public and, as a result, there is a low chance for success. 69

Furthermore, the SEC is not required to notify persons of the reasons behind the subpoena. 70 In SEC v. Brigadoon Scotch Distributing Co., 71 the court held that the SEC’s investigation should not be impeded by having to describe why each and every person is being subpoenaed. 72 The court also held that since investigations are constantly changing, this description, by nature, would be inaccurate. 73 When a person complies with an SEC subpoena, he may waive any future privilege to keep the information he has disclosed confidential. 74

Moreover, since an SEC investigation is not considered an adjudicative or adversarial proceeding, there are no parties or issues. 75 Therefore, the investigation is not governed by the judicial standards of proof. As a result, many due process protections, as well as the Federal Rules of Evidence, may not be available. 76 For example, in order to obtain information about a potential violation of the securities laws, the Commission can ask the witnesses leading questions, 77 elicit hearsay evidence, and employ unduly repetitive questioning. 78 More importantly, the right to confront and cross-examine witnesses does not apply, 79 and neither the subject nor his counsel has the right to be present at third party examinations. 80

The Commission derives a great deal of leverage against potential defendants from the laws governing the investigation process. Sections 21(h) of the Exchange Act, 81 19(b) and 20(c) of Securities Act (evidence and subpoena powers), Rule 4(b) subpoena powers, and most importantly, the authorization to share information with other agencies, empower the SEC with an arsenal of investigatory powers. 82 The breadth of

69. See id.
71. See id.
72. See id. at 1056.
73. See id. at 1056, 1057 n.10.
74. Once the SEC obtains this information, the defendant can no longer assert that the information is privileged. See infra Part II.E.
75. See In re White, Weld & Co., 1 S.E.C. 574, 575 (1936).
76. See Hicks, supra note 4, § 2.02[4][d][i], at 2-40; Sorkin and Jakoby, supra note 38, at 47.
77. See Hicks, supra note 4, § 2.02[4][d][i], at 2-40.
78. See id.
79. See id.
81. See infra Part I.E (exempting the SEC from some portions of the Right to Financial Privacy Act (“RFPA”)).
82. Rules 17a-3 and 17a-4 are equally as important. Under these rules, documents are re-
these rules foreshadows the dangers posed by permitting the fruits of their investigation to be used against a defendant in more than one proceeding.

E. Subject's Rights and Privileges

Although the SEC’s investigative authority is extraordinarily powerful and one-sided, the subject does have some defenses, rights, and privileges. The Rules provide procedural protections, in addition to various other statutory and non-statutory rights. Under the Rules, a defendant has: (1) an unqualified right to inspect the Formal Order under which the witness has been subpoenaed;83 (2) a right to a copy of the Formal Order, subject to the approval of the Commission;84 (3) an absolute right to counsel during the course of the proceeding;85 (4) an unqualified right to inspect official transcripts of the witness’s own testimony;86 and (5) a right, subject to Commission approval, to a copy of his documentary evidence if such evidence is non-public.87

The FOIA and the RFPA afford additional statutory protection to witnesses. Under the RFPA, the Commission cannot gain unfettered access to all of the documents they desire.88 The RFPA places various limitations upon governmental institutions (including the SEC) in obtaining access to financial records. Under the RFPA, any “customer”89 is entitled to notification about any governmental request for their financial records and has an opportunity to challenge that request.90 When a person is considered a customer, the RFPA denies the SEC access to the financial records unless: (1) the Commission requests information in a manner that reasonably describes the records sought, or alternatively, the SEC may access financial records without notifying the subject by issuing an administrative subpoena, a search warrant, or a judicial subpoena demonstrating that it has reason to believe that records sought are

83. See id. § 203.7(b).
84. See id. § 203.7(a).
85. See id. § 203.7(c).
86. See id. § 203.6.
87. See id.
89. The RFPA defines “customer” as “any person or an authorized representative of that person who utilized or is utilizing any service of a financial institution.” Id. § 3401(5). The term “person” includes any individual, sole proprietorship, or partnership of five or fewer individuals. See id.
90. See id. § 3402; see also Hunt v. SEC, 520 F. Supp. 580, 601 (N.D. Tex. 1981) (explaining the right to notice provision under the RFPA).
relevant to a legitimate inquiry; and (2) they fulfill specified time requirements. The SEC must issue a subpoena that complies with these requirements to gain such access. If the Commission complies, the customer's institution must then produce documents within a certain time frame, unless the customer files an objection proceeding in federal court. Consequently, the burden shifts to the customer to protect his rights under the RFPA.

Nevertheless, a customer of a financial institution may altogether lose the protections provided by the RFPA, thereby rendering statutory protection inadequate. Congress, recognizing the special needs of the SEC, added section 21(h) to the Exchange Act to override the RFPA. This provision grants to the Commission the power to subpoena financial institutions without prior notice to the customer, as long as the court grants prior ex parte approval. The customer is authorized under the RFPA to bring action in federal district court for monetary damages and injunctive relief against the government if the Commission fails to comply. However, because of the authority granted to the SEC from section 21(h) of the Exchange Act, the RFPA fails to sufficiently protect the financial records belonging to a subject of an investigation.

In addition, the FOIA is intended to allow any person providing non-public information to the SEC to prevent its public disclosure by the SEC. This protection, however, is illusory, especially with regard to the DOJ. Since Justice is one of the designated permissible recipients under Rule 2, this exception cannot protect a witness's "sensitive documents" from the DOJ in the event of a parallel proceeding.

Witnesses, however, are entitled to assert non-statutory privileges

---

91. See Hunt, 520 F. Supp. at 601-02.
92. The time frame runs concurrently with the subpoena to the institution. See 12 U.S.C. § 3407 (1994).
93. As a practical matter, such a request is rarely challenged and it is even less effective as a block.
94. See 15 U.S.C. § 78u(h) (1994). The RFPA has also been amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to permit the exchange of information, subject to the RFPA and without restriction, between the SEC and any of the following: the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Board of Governors of the Federal Reserve System; the Office of Thrift Supervision; and the National Credit Union Administration Board. See 12 U.S.C. § 3412(e) (1994).
95. See Sorkin & Jakoby, supra note 38, at 46. It is extremely rare for the SEC to use ex parte provisions. See Richard H. Rowe, How to Deal With Negative News—A Legal Analysis, in NEGATIVE NEWS 61, 202 (PLI Corp. Law & Practice Course Handbook Series No. 457, 1984).
96. See Sorkin & Jakoby, supra note 38, at 46.
such as the attorney-client privilege, the work-product privilege, the Fifth Amendment privilege against self incrimination, and other due process privileges. Nevertheless, like the statutory protections, these non-statutory protections afford inadequate protection. Despite the availability of the attorney-client privilege to any witness who testifies in a SEC proceeding, the court in In re Sealed Case found that a client waives his attorney-client privilege when the information he discloses to the SEC pertains to communications with his attorney. Once the privilege is waived, it is waived permanently. Information on the same subject matter which the witness may claim as private and confidential between the witness and counsel will no longer be protected. Significantly, once a witness has relinquished the privilege, it is not only waived in the SEC proceeding, but it is waived in all future administrative, civil, and criminal proceedings.

The work-product privilege has fared better in SEC proceedings. Much like the attorney-client privilege, the work-product privilege can be waived, but rarely is. The court in In re Sealed Case explained that “because [the work-product privilege] looks to the vitality of the adversary system rather than simply seeking to preserve confidentiality [as does the attorney-client privilege], the work product privilege is not automatically waived by any disclosure to a third party.” However, if a witness “discloses the privileged material to anyone without ‘common interests in developing legal theories and analyses of documents’” he will be deemed to have inconsistently maintained secrecy against his opponents and waiver of the work-product privilege will result.

The SEC may overcome the work-product privilege in three ways. The first, and most common, reason for a privilege waiver is the showing of prior production. Additionally, waiver is possible by satisfying

99. See Hicks, supra note 4, § 2.02[4][d][iii], at 2-51.
100. 676 F.2d 793 (D.C. Cir. 1982).
101. See id. at 808-09; Hicks, supra note 4, § 2.02[4][d][iii], at 2-53.
102. See Hicks, supra note 4, § 2.02[4][d][iii], at 2-53; see also Kidder, Peabody & Co. v. IAG Int'l Acceptance Group, N.V., No. 94 CIV. 4725(CSH) (SEG), 1997 WL 272405, at *3 (S.D.N.Y. May 21, 1997) (holding that once a party has waived the attorney-client privilege, they may not then re-assert it in the same proceeding). But see Byrnes v. IDS Realty Trust, 85 F.R.D. 679, 688 (S.D.N.Y. 1980) (finding that in order to encourage full cooperation, the disclosure of information to the SEC during the course of an investigation does not constitute a waiver of the attorney-client privilege in subsequent proceedings).
103. Hicks, supra note 4, § 2.02[4][d][iii], at 2-53.
105. In re Sealed Case, 676 F.2d at 809.
106. Id. at 817 (quoting United States v. AT&T Co., 642 F.2d 1285 (D.C. Cir. 1980)).
107. See In re Grand Jury Subpoena Duces Tecum Dated Oct. 29, 1992, 1 F.3d 87, 93 (2d Cir.)
either the “undue hardship” requirement of Federal Rule of Civil Procedure 26(b)(3), or by invoking the “crime-fraud exception.” Much like the attorney-client privilege, once it is waived by the witness or the court, it is waived in all future proceedings.

The Fifth Amendment provides an SEC witness with additional non-statutory protections, including the privilege against self-incrimination. When the witness believes that providing evidence to the SEC may support a conviction, he may plead this privilege. It may be asserted during any stage of a civil or criminal proceeding. Although a witness may protect himself by abstaining from providing evidence due to the possibility of future self-incrimination, the decision does not go unpunished. Unlike its assertion in a criminal proceeding, the assertion in an administrative or civil proceeding carries an adverse presumption or inference. In SEC v. Musella, the subjects of an SEC

108. See In re International Sys. & Controls Corp. Sec. Litig., 693 F.2d 1235, 1240 (5th Cir. 1982) (holding that parties may demonstrate undue hardship if the witness cannot recall the events in question or is unavailable). Rule 26(b)(3) provides that the work product privilege may be overcome by a showing that the party seeking discovery has a “substantial need” for the materials and that party is unable to obtain the substantial equivalent of the material without suffering “undue hardship.” See Fed. R. Civ. Pro. 26(b)(3).

109. See In re Sealed Case, 676 F.2d at 812 & n.74; see also Pritchard-Keang Nam Corp. v. International Sys. & Controls Corp., 751 F.2d 277, 281 (8th Cir. 1984) (explaining that in determining whether the crime-fraud exception to attorney-client privilege is applicable, timing is critical; a prima facie showing requires a showing that the client was engaged in planning a criminal or fraudulent scheme when he sought the advice of counsel to further that scheme).

For the SEC to use this exception, they must establish that there is a sufficiently serious violation to defeat the work-product privilege. This can be proven in various ways: if the client engaged in planning a criminal scheme and sought the advise of counsel, the client actually committed or attempted to commit a crime subsequent to receiving the benefit of counsel’s work, the attorney engaged in misconduct, or a fraudulent intent in the development of the work-product. See Hicks, supra note 4, ¶ 2.02[d][d][iii], at 2-57 to -58. Next, the court must find a valid relationship between the work-product and the violation. See id. at 2-58 (discussing In re Sealed Case, 676 F.2d at 813 and In re International Sys. & Controls Corp. Sec. Litig., 693 F.2d at 1243).

110. The Fifth Amendment provides, in relevant part: “No person ... shall be compelled in any criminal case to be a witness against himself.” U.S. Const. amend. V.


112. The “right to remain silent” in a criminal case includes the guarantee that the finder of fact will not be permitted to draw an adverse inference from a defendant's failure to testify. See Griffin v. California, 380 U.S. 609, 615 (1965).

113. See Baxter v. Palmigiano, 425 U.S. 308, 318 (1976) (“[T]he Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify”). The court in
proceeding asserted their Fifth Amendment privilege during their respective depositions. In addition to refusing to testify, they also refused to produce various documents because they believed they were the targets of a future criminal indictment in which the evidence would be used. The court ruled that because the assertion of the privilege may lead to a complete failure of proof for the SEC, the court should draw an adverse inference. The court further stated: "[I]t would seem proper to afford a civil litigant stymied by his adversary's silence some means of moderating the potentially overwhelming disadvantage he faces in establishing his case."

The alternative to pleading this privilege is to provide evidence and testimony that may serve to be self-incriminating in a future proceeding. The witness is therefore faced with a "double-edged sword" by having to choose between self-incrimination in the SEC proceeding and self-incrimination in a later criminal or civil proceeding. Not only does the assertion of the Fifth Amendment draw an adverse inference, but it may also preclude a defendant from presenting evidence on his own behalf. Any evidence establishing the factual basis for his denials and affirmative defenses he had asserted under his Fifth Amendment right may not be offered by the defendant. In SEC v. Benson, the defendant, claiming his Fifth Amendment right, refused to disclose evidence but sought to support the contentions in his pleadings. The court held that the defendant was precluded from offering evidence supporting propositions for which he declined to provide disclosure.

Defendant has, however, chosen the tactic of seeking to bar plaintiff's

SEC v. Musella, 578 F. Supp. 425 (S.D.N.Y. 1984), was faced with two defendants asserting their Fifth Amendment privilege against self-incrimination in an SEC administrative or injunctive proceeding. See id. at 427. The defendants argued that the court should not draw an adverse inference against them because they were the targets of a parallel criminal investigation. See id. at 429. The court recognized its sensitivity to competing policy rationales that have arisen in connection with the assertion of the Fifth Amendment; however, it decided that there should be an adverse inference from the defendant's assertion of the privilege. See id.

115. See id. at 429.
116. See id.
117. See id. The court further held that "the assertion of the privilege in a civil proceeding is materially different from its invocation in a criminal proceeding, and may be treated as such." Id. at 430.

118. Id. at 429.
120. See id. at 1129.
121. See id.
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.\textsuperscript{122}

Even if the SEC receives evidence from another source, comparable to that which the witness refused to provide, that witness will still be precluded from offering any evidence as a denial or a defense.\textsuperscript{123}

Once the staff completes the investigation, it may make its recommendation to the Commission regarding a subsequent enforcement proceeding. It can either recommend termination of the proceeding, thereby precluding the investigation from going to the Commission, or it can choose to commence an enforcement proceeding. Before making its recommendation, the staff will, at its discretion, provide prospective defendants with an opportunity to present any relevant defenses or arguments in a Wells Submission.\textsuperscript{124} The Wells Submission will then be included with the staff’s recommendation to initiate an enforcement proceeding. However, if the subject’s counsel chooses to make a Wells Submission in an attempt to persuade the SEC not to bring an enforcement proceeding, statements or arguments will be admitted into evidence and could possibly be used against the defendant in any future proceeding.\textsuperscript{125}

III. PARALLEL PROCEEDINGS AND INTERAGENCY COOPERATION

Since many administrative law violations, including those for securities regulations, carry the possibility of both civil and criminal penalties, a defendant may face two or more actions at the same time.\textsuperscript{126} Parallel proceedings initiated by another governmental agency, such as the DOJ, have been found to be both proper and constitutional.\textsuperscript{127}

The Court of Appeals for the District of Columbia in \textit{SEC v.}

\footnotesize
\hspace{1em}122. \textit{Id.}; see Sturc & Sorcher, \textit{supra} note 1, at 505.
\hspace{1em}123. \textit{See} Strauss, \textit{supra} note 111, at 252 (citing \textit{SEC v. Cymaticolor}, 106 F.R.D. 545, 549 (S.D.N.Y. 1985)).
\hspace{1em}124. \textit{See} Sorkin & Jakoby, \textit{supra} note 38, at 49.
\hspace{1em}125. \textit{See supra} note 44 and accompanying text.
\hspace{1em}126. The history behind having actions that give rise to both simultaneous or successive civil and criminal suits comes from the Sherman Act. The court in \textit{Standard Sanitary Manufacturing Co. v. United States}, 226 U.S. 20 (1912), first held that the government could initiate such proceedings either “simultaneous or successively,” with discretion in the courts to prevent injury in particular cases. \textit{See id.} at 52.
\hspace{1em}127. \textit{See} United States v. Kordel, 397 U.S. 1, 11-13 (1970); \textit{SEC v. Dresser Indus., Inc.}, 628 F.2d 1368, 1375-77 (D.C. Cir. 1980). There is also the possibility that the defendant may face a third proceeding—one brought by a private civil litigator.
Dresser Industries, Inc., addressed simultaneous prosecution by the SEC and Justice for securities regulation violations. The court held that effective enforcement of securities laws requires that the SEC and the DOJ be able to investigate possible violations simultaneously, unless special circumstances exist. This is true even though concrete examples of these circumstances may be few and far between. Prompt civil investigation of matters also under the scrutiny of criminal law enforcement authorities is often necessary to protect public interests, especially where the integrity of financial markets is concerned. In United States v. Kordel, a case involving a Food and Drug Administration enforcement action, the court permitted parallel proceedings and relied upon the defendant's own testimony in a prior proceeding. The court reasoned:

It would stultify enforcement of federal law to require a governmental agency . . . to choose either to forgo recommendation of a criminal prosecution once it seeks civil relief, or to defer civil proceedings pending the ultimate outcome of a criminal trial.

A. Disclosure of Non-Public Information

While information obtained by the SEC through its investigation and enforcement is non-public, the federal securities laws and the SEC's Rules of Practice provide mechanisms for the sharing of this information with other governmental authorities. Several provisions of

128. 628 F.2d 1368 (D.C. Cir. 1980).
129. See id. at 1377. For a thorough discussion about these special circumstances, see infra Part III.A.
130. See Kordel, 397 U.S. at 11.
131. See SEC v. First Fin. Group, 659 F.2d 660, 667 (5th Cir. Oct. 1981); see also In re Stillwell Coker & Co., 52 SEC Docket (CCH) 294, 295 (June 22, 1978). The court stated:

The Commission has consistently held that the Securities Acts empower it to refer evidence of violation to the Attorney General and to institute enforcement proceedings such as the instant case, that both of these powers have been vested to it by Congress to achieve the statutory aims of safeguarding investors and that the use of more than one procedure at the same time is permissible.

Id. (footnote omitted).
133. Id. at 11.
134. As to administrative proceedings or civil cases, discovery is not non-public unless there is a protective order or confidentiality agreement, similar to any other litigation. See Baxter v. A.R. Baron & Co., No. 94CIV.3913 (JGK) (THK), 1996 WL 709624, at *2 (S.D.N.Y. Dec. 10, 1996).
136. See Sturc & Leibovitz, supra note 3, at 41.
the federal securities laws provide that any information obtained by the SEC may be disclosed with the authorization of the Commission to other enforcement agencies. There are two ways to furnish such information, and in either case, the staff can render valuable assistance to the DOJ. The first and less frequent method is authorized by section 24 of the Securities Act. Through this method, there is an official communication by the Commission to Justice to inform them of possible criminal security violations. According to section 24, "[t]he Commission may transmit such evidence as may be available concerning such acts or practices [which constitute a securities violation] to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter."

The second and more frequent method of transmittal is for the staff to make the information available by "granting access." Pursuant to section 21(d) of the Exchange Act, the Commission may transmit evidence of acts or practices constituting a violation of the Exchange Act or the rules promulgated thereunder to the Attorney General. Furnishing of such assistance is sometimes required for effective presentation or prosecution of cases referred by the SEC to the DOJ as authorized.

This assistance includes such activities as explaining the structure and content of the files; indicating the violations of law discovered or under investigation; advising as to further investigative efforts or proceedings anticipated by the staff; and providing non-expert, non-opinion testimony for the purpose of document authentication or as to non-privileged, non-work-product facts.

The SEC’s Rules of Practice further provide that the Commission may refer or grant access to its investigative files, whether or not it appears that there has been a violation of federal securities laws. This includes referring the matter to the DOJ for criminal prosecution in the case of a willful violation.

---

138. Id.
141. See Sture & Leibovitz, supra note 3, at 42.
142. Id. at 42-43.
143. 17 C.F.R. § 202.5(b) (1997). This section states: "After investigation or otherwise the Commission may in its discretion take one or more of the following actions: . . . [I]n the case of a willful violation, reference of the matter to the Department of Justice for criminal prosecution." Id.
Information or documents obtained during an investigation or examination that may be deemed non-public under the RFPA may still be shared with other governmental agencies for future proceedings. The SEC published a list of certain “routine uses,” which may permit disclosure of this information with other individuals or entities in accordance with the RFPA.4

Federal prosecutors “love” the mail and wire fraud statutes because of their enormous reach and because the elements of these offenses are simple to prove. See Jennings, supra note 43, at 1504.

The elements of mail fraud are simple: (1) a “scheme to defraud,” and (2) the mailing of a letter (not necessarily by the defendant) for the purpose of executing the scheme. The mailing itself may be innocent and nondraudulent, and the defendant need not even have intended to cause others (such as the victims) to use the mails, so long as the usage of the mails was foreseeable.

Id. (footnotes omitted). No loss to the victims need be proven either; the scheme itself is in essence the crime. See id.

“To federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love. We may flirt with RICO, show off with 10b-5, and call the conspiracy law darling, but we always come home to the virtues of 18 U.S.C. § 1341, with its simplicity, adaptability and comfortable familiarity.”

Id. at 1503 (quoting Jed Rakoff, The Federal Mail Fraud Statute (Part I), 18 DUQ. L. REV. 771, 771-72 (1980)).

RICO was originally enacted in 1970 to stop the infiltration of organized crime into legitimate business, but has since been used to reach virtually all forms of fraud, particularly securities fraud. See id. at 1505.

As a criminal statute, RICO gives prosecutors enormous leverage over the defendant both because it authorizes a severe 20 year sentence plus heavy fines and because of its unique forfeiture sanction, under which the convicted defendant must surrender to the government any profits received from the activity and any interest the defendant possesses in the RICO “enterprise.”

Id. at 1505-06. “To prove a RICO violation, the prosecution must first prove that the defendants committed at least two violations of several specified federal felony statutes.” Id. at 1506. These statutes may include mail and wire fraud, as well as “fraud in the sale of securities.” Id. “Proof of such crimes does not alone establish a RICO violation.” Id. The prosecution must also prove the defendant participated in:

(1) investing income from a “pattern of racketeering activity” in an “enterprise” (§ 1962(a));
(2) acquiring or maintaining an interest in an enterprise through a “pattern of racketeering activity” (§ 1962(b));
(3) conducting or participating in the affairs of an “enterprise” through a “pattern of racketeering activity” (§ 1962(c)); or
(4) conspiring to violate (1), (2) or (3) above (§ 1962(d)).


144. See United States Securities and Exchange Comm’n, Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a
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.\(^{146}\)

The routine uses included in SEC Form 1662 consist of furnishing information to other entities for the purpose of coordinating law enforcement activities between the SEC and other federal, state, local, or foreign law enforcement agencies and securities self-regulatory organizations.\(^{147}\) Where there is evidence of an actual or potential violation of law, including criminal law, the SEC can supply relevant information to the appropriate agency charged with the responsibility of investigating or prosecuting such violations.\(^{148}\)

B. Motions for a Temporary Stay

A defendant facing a criminal proceeding, or the possibility of a criminal proceeding, may seek to temporarily stay the SEC proceeding until the conclusion of the criminal proceeding. The spirit of the stay is to protect the defendant from the DOJ’s use of information obtained during the administrative proceeding. Parallel administrative or civil proceedings can override protections afforded the accused in the criminal proceeding when Justice uses information obtained through civil discovery or testimony elicited during the investigation.\(^{149}\) This may also cause the accused to confront the prospect of divulging information which may incriminate him.\(^{150}\) There are two grounds on which the accused may base a motion for a temporary stay: (1) the defendant will suffer undue prejudice absent a stay, or (2) the government acts in bad

---

\(^{145}\) See id.
\(^{146}\) Id.
\(^{147}\) See id.
\(^{148}\) See id.; see also H.R. REP. NO. 95-640, at 10 (1977) (explaining that the Committee on Interstate and Foreign Commerce fully expected that the cooperation between the SEC and Department of Justice (“DOJ”) would continue).
\(^{149}\) See Pollack, supra note 25, at 202.
\(^{150}\) See id.
faith and uses malicious tactics to circumvent the rules of discovery.  

There are various ways in which a criminal defendant, or future criminal defendant, may suffer undue prejudice by a continuation in the SEC proceedings. The defendant may be faced with a double-edged sword in having to choose between asserting his Fifth Amendment right or incriminating himself in the subsequent criminal proceeding by testifying.

Another way in which the accused may suffer undue prejudice is that the DOJ becomes privy to the basis of his defense. Where a defendant bears a "real and appreciable" risk of self-incrimination, or the risk of being forced to expose the basis of his criminal defense, the defendant may be granted a temporary stay in the administrative or civil proceeding. Courts are not constitutionally required to grant a stay in such a situation; it is at the court's discretion.

The second basis for a stay in the proceedings is when the government acts in bad faith. An example of bad faith is "where the Government has brought a civil action solely to obtain evidence for its criminal prosecution or has failed to advise the defendant in its civil proceeding that it contemplates his criminal prosecution." By attempting to circumvent the limited discovery guidelines of criminal actions, the SEC is said to have acted maliciously in attempting to violate the defendant's due process rights. The court in Dresser held that if the noncriminal proceeding is not deferred, a party might argue that going forward undermines the party's Fifth Amendment privi-

152. See discussion supra Part I.E. (describing the situation in which the defendant must choose between testifying and risk that testimony being used against him, or alternatively, assert his Fifth Amendment privilege and have an adverse presumption used against him); see also In re Miron Leshem, 63 SEC Docket (CCH) 850, 850 (Dec. 2, 1996) (denying the defendant's motion for stay where he asserted that he "wishes to avoid being forced to choose between ignoring his Fifth Amendment rights by providing testimony and information in the [Commission] proceeding that could disadvantage him in the criminal proceeding, or asserting his Fifth Amendment privilege against self-incrimination and risk a negative inference in the [Commission] proceeding"); In re Jason M. Chapnick, 55 SEC Docket (CCH) 2776, 2777 (Feb. 2, 1994) ("[I]n order to defend himself in this [SEC] proceeding, he would have to waive his Fifth Amendment privilege against self-incrimination and his attorney-client privilege, thereby undercutting his Sixth Amendment right to a fair trial.").
154. See id. at 60-61; see also Minor v. United States, 396 U.S. 87, 97-98 (1969) (holding that the defendant presented only "imaginary and insubstantial" hazards rather than the required "real and appreciable" risk needed to support a Fifth Amendment claim).
155. See Dresser, 628 F.2d at 1375.
157. See Dresser, 628 F.2d at 1376 n.21.
lege against self-incrimination; expands rights of criminal discovery beyond the limits of Federal Rule of Criminal Procedure 16(b);\(^\text{158}\) exposes the basis of the defense to the prosecution in advance of criminal trial; or otherwise prejudices the case.\(^\text{159}\) Nevertheless, the court concluded that despite these possible and valid arguments, the independent interests of the SEC and the statutory scheme at issue are of superior concern.\(^\text{160}\) The rationale is that discovery is traditionally limited in criminal cases as opposed to civil or administrative cases where the entire range of discovery, including depositions and document requests, is available.\(^\text{161}\) However, once evidence is disclosed to the SEC through a non-criminal proceeding, that evidence is freely transmittable to the DOJ or other criminal prosecutors and can be used against that defendant in the criminal suit.\(^\text{162}\) This holding creates a very high threshold, and because of the court's rigidity, the party faces a Hobbesian choice. The patent unfairness of the choice is the strongest argument for staying a civil proceeding until the completion of a criminal proceeding. The government has in essence acted in bad faith by using a malicious tactic to unconstitutionally abuse discovery.\(^\text{163}\)

Although courts have not yet found that the government has acted in bad faith by initiating a civil action solely to obtain evidence for a criminal prosecution, some courts have held that bringing an indictment to benefit a subsequent civil action using the grand jury powers was done in bad faith.\(^\text{164}\) Similarly, the Kordel court held that if the equivalent were to happen and the civil prosecutors only brought suit to obtain evidence for the criminal proceeding, it would be unconstitutional.\(^\text{165}\)

Another way the government may act in bad faith is by asking the target questions without informing him that any information he provides may be used against him in a future proceeding. In both United States v.

\(^{158}\) For an explanation of 16(b), see supra note 24 and accompanying text.

\(^{159}\) See Dresser, 628 F.2d at 1375-76.

\(^{160}\) See id. at 1376-77.

\(^{161}\) See Pollack, supra note 25, at 208; see also FED. R. CIV. P. 26(b)(1) (providing that a party may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action and the information sought during discovery in a civil case need not be admissible at trial and need only be reasonably calculated to lead to discovery of admissible evidence).

\(^{162}\) For a discussion on governmental cooperation, see supra Part III.

\(^{163}\) See Dresser, 628 F.2d at 1375-76.


\(^{165}\) See id. at 11-12.
Lipshitz and Smith v. Katzenbach, the courts found that the government acted in bad faith by illegally taking depositions from the defendants before telling them of the possible implications of their testimony.

The special circumstances that the Dresser, Kordel, and Musella courts speak of are also taken into consideration in the context of a decision to grant a stay. "In more practical terms, the courts generally treat four factors as significant, if not dispositive, weights which can tip the balance either in favor of or against a stay of the plaintiff's request for discovery." These special circumstances include: (1) the commonality of transactions or issues; (2) the timing of the motion; (3) judicial efficiency; and (4) the public interest.

First, and most importantly, for the defendant to motion successfully for a stay, there must be a great degree of overlap between the civil issues or transactions and the criminal issues. If there is no overlap, there is no danger of self-incrimination and accordingly no stay is required.

Second, the timing of the motion is very important. The strongest argument for a stay of discovery in a civil case occurs during a criminal prosecution after an indictment is returned. According to the court in Dresser, the potential for self-incrimination is greatest during this stage because the defendant confronts the immediate threat of having his Fifth Amendment rights invoked.

---

167. 351 F.2d 810 (D.C. Cir. 1965).
169. See Volmar Distrib., Inc. v. New York Post Co., 152 F.R.D. 36, 39 (S.D.N.Y. 1993) (stating that balancing these special circumstances should be done on a case by case basis with the basic goal being to avoid prejudice).
170. Pollack, supra note 25, at 203.
171. See id. Intentionally creating an impediment by the movant is another factor that courts consider in deciding a motion to stay. See id. at 205.
Amendment rights violated. The *Dresser* court, as well as other courts, have been willing to grant a stay only when an indictment was returned.

The defendant’s chances of procuring a stay are less favorable if the government is conducting an active parallel investigation in which an indictment has not been filed. A plaintiff may be adversely affected if discovery is postponed because of a stay. Evidence may be lost due to stale memories, death, incarceration, as well as several other reasons.

If no indictment is returned and no known investigation is underway, the case for a stay in discovery is far weaker. The court’s rationale for denying a stay is that a criminal action may never commence and even if it does, it may take years. Additionally, the civil plaintiffs also

---

175. See *Dresser*, 628 F.2d at 1375-76; *Pollack*, *supra* note 25, at 203. Although the court in *Dresser* insists that the potential for self-incrimination is greatest after an indictment has been returned, this cannot be the case. The harm to a defendant is no different if an indictment has not been returned and the self-incriminating evidence is later used against him. The court seems to rely inappropriately on the timing of the indictment when in fact they should be relying on whether or not an indictment will be returned.

176. The court in *Volmar* explained the reason for staying a civil proceeding after an indictment has been returned:

Defendants . . . have a real and immediate interest in staying discovery, as there is an indictment currently pending against them which arises from the same factual background alleged in the Complaint. Proceeding with discovery would force these defendants into the uncomfortable position of having to choose between waiving their Fifth Amendment privilege or effectively forfeiting the civil suit. On the one hand, if either defendant invokes his constitutional privilege during civil discovery, not only does this prevent him from adequately defending his position, but it may subject him to an adverse inference from his refusal to testify. . . . On the other hand, if either fails to invoke his Fifth Amendment privilege, he waives it, and any evidence adduced in the civil case can then be used against him in the criminal trial.

*Volmar Distrib., Inc.* v. *New York Post Co.*, 152 F.R.D. 37, 39-40 (S.D.N.Y. 1993) (citations omitted); see also infra notes 179-86 and accompanying text (discussing why courts have been unwilling to grant a stay absent an indictment).

177. See *Volmar*, 152 F.R.D. at 40.

178. See *Dresser*, 628 F.2d at 1376 (“The case at bar is a far weaker one for staying the administrative investigation. No indictment has been returned; no Fifth Amendment privilege is threatened; Rule 16(b) has not come into effect; and the SEC subpoena does not require Dresser to reveal the basis for its defense.”); see also SEC v. First Jersey Sec., Inc., [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,204, at 95,954 (S.D.N.Y. Mar. 25, 1987). In *First Jersey Securities, Inc.*, the court stated:

In the event Brennan becomes the target of the parallel grand jury investigation or is served a grand jury subpoena and is served with discovery requests in this proceeding, I will entertain a motion to stay discovery with respect to Brennan specifically. At this time, however, his Fifth Amendment claim is premature.

*Id.* at 95,957; see also *In re Par Pharm., Inc.* Sec. Litig., 133 F.R.D. 12, 13 (S.D.N.Y. 1990) (“The weight of authority in this Circuit indicates that courts will stay a civil proceeding when the criminal investigation has ripened into an indictment.”).

179. See *Pollack*, *supra* note 25, at 202-05.
may be adversely affected if they are forced to wait.\textsuperscript{180}

Third, judicial efficiency factors into the balancing analysis and weighs in favor of granting a stay in the civil or administrative proceeding. Resolution of a criminal case prior to a civil case will allow the possibility of a collateral estoppel or res judicata effect on some or all of the overlapping issues. It may also "moot, clarify, or otherwise affect various contentions in the civil case."\textsuperscript{181} Thus, having the criminal case prior to the civil one will avoid duplication of effort and waste of resources, and therefore supports a stay.\textsuperscript{182}

Fourth, the courts are concerned about the effect of a stay on the public. Violations of the securities regulations often alter the securities market and subsequently harm the public.\textsuperscript{183} The courts recognize and emphasize their role in protecting the integrity of the securities market. Plaintiffs also have a legitimate interest in the expeditious resolution of their case since the defendant's securities violation has likely affected the plaintiffs financially.\textsuperscript{184}

IV. DEPARTMENT OF JUSTICE BAD FAITH IN CIRCUMVENTING CRIMINAL DISCOVERY RULES

A stay represents a key protection for a defendant who faces the possibility of defending himself from the DOJ in a parallel proceeding. A court, by denying a stay in an administrative or civil proceeding, tremendously aids the DOJ's criminal prosecution since Justice stands to inherit the fruits of the SEC's discovery powers. The DOJ becomes the recipient of all SEC discovery, much of which could not be obtained through a singular, independent DOJ investigation. Any evidence the SEC obtains, Justice receives due to the statutory provisions of the Securities and Exchange Acts, as well as precedent established in \textit{Kordel} and \textit{Dresser}. If the SEC obtains information through repetitive questioning or hearsay evidence, it can share that evidence with the DOJ for later use against the defendant.\textsuperscript{185} Additionally, the SEC may subpoena financial information normally protected by the RFPA through 21(h) of

\textsuperscript{180} \textit{See Dresser}, 628 F.2d at 1380.
\textsuperscript{181} United States v. Mellon Bank, N.A., 545 F.2d 869, 873 (3rd Cir. 1976).
\textsuperscript{182} \textit{See Texaco v. Borda}, 383 F.2d 607, 608-09 (3d Cir. 1967); \textit{Pollack}, supra note 25, at 204 ("Conviction of a defendant in a parallel criminal case may effectively dispose of all common issues in a subsequent civil action, although the reverse is not true.").
\textsuperscript{183} \textit{See Pollack}, supra note 25, at 205.
\textsuperscript{185} \textit{See supra} Part II.D.
the Exchange Act, and also share that information with the DOJ.  
Finally, if the defendant inadvertently waives his attorney-client privilege or the work-product privilege, any evidence obtained as a result of the waiver will be admitted in the criminal proceeding. Although a grand jury investigation might allow discovery of some of this evidence, most of it would be disallowed.

Most importantly, if a stay is not granted and the party has testified, the DOJ will acquire something that it definitely would not have obtained without the SEC proceeding—self-incriminating testimony on the part of the defendant as well as the basis for his defense. Courts often ignore this reality when they deny a stay, and nothing could be more detrimental to a defendant in a parallel criminal proceeding.

Many courts have failed to grant a stay in a civil or administrative proceeding because a criminal indictment has not been returned. For example, the court in SEC v. Zimmerman ruled on a motion to stay an SEC proceeding. The defendant faced the possibility of having to testify against himself or accept an adverse presumption that would seriously hamper his chances for success in the SEC’s action. The defendant appropriately claimed that without a stay, his Fifth Amendment privilege against self-incrimination would not be protected. The court denied the motion because an indictment was not yet returned and held:

The Fifth Amendment is violated when a defendant, who is a defendant in both a criminal and civil case, is forced to choose between waiver of testimonial privilege and automatic entry of an adverse judgment in a civil case. This exception is not implicated in this matter, however, because Zimmerman is not a defendant in a criminal proceeding.

Similarly, the court in SEC v. First Jersey Securities, Inc. considered a motion for a protective order staying discovery where the pending criminal investigation paralleled the allegations of the civil complaint. The court denied the motion because "[t]he investigative

186. See supra Part II.E.
187. See supra Part II.E. (discussing the permanent waiver of attorney-client privilege as well as the work-product privilege).
189.  See id. at 899.
190.  See id.
191.  Id. (citations omitted).
193.  See id.
powers of the grand jury far exceed the scope of civil discovery, so that
the United States Attorney’s Office and the grand jury have no need to
‘exploit’ the SEC’s discovery.”194 The court went on to “reject the argu-
ment that access to SEC civil discovery by the criminal prosecutors
will circumvent [Federal Rule of Criminal Procedure 16(b)]. No indict-
ments have been returned against the defendants in this case . . . . Thus,
Rule 16(b) does not yet apply.”195

Again, denying a stay may prove useful to either the DOJ or, as in
First Jersey Securities, to the United States Attorney’s office. Either
way, each respective government agency has many reasons to “exploit”
the SEC’s discovery in an attempt to circumvent the Federal Rules of
Criminal Procedure. The grand jury would uncover much of what the
SEC uncovers, but the grand jury by itself will not learn the basis of the
defendant’s defense, nor will it be able to discover the defendant’s own
self-incriminating testimony.

Compared with First Jersey Securities, the court in Gala Enter-
prises, Inc. v. Hewlett Packard Co.196 went even further and denied a
motion for a stay where the defendant already was under grand jury in-
vestigation.197 Decisions such as these allow the DOJ to wait as long as
possible before bringing a criminal indictment. Since the DOJ can only
benefit from having the SEC proceeding continue, it is advantageous to
delay the return of an indictment.

The DOJ is arguably acting in bad faith by not initiating criminal
proceedings as early as possible. By choosing to stall, the DOJ compels
the SEC defendant to face the double-edged sword of having to choose
between asserting his Fifth Amendment privilege and having an adverse
presumption used against him, or testifying and risking the chance of
having that testimony used against him in a subsequent proceeding. This
type of tactic is as detrimental to the defendant as the SEC acting in bad
faith. In announcing its test, the Dresser court stated that when the SEC
brings a civil or administrative proceeding only to circumvent the strict
rules of criminal discovery, a stay must be granted so that the criminal
prosecution will be bound by their discovery rules.198 Similarly, if the
DOJ does not bring an indictment when it is able to, it is circumventing
the criminal discovery rules to benefit from a broad SEC discovery.199

194. Id. at 95,956.
195. Id. at 95,957.
197. See id. at *1.
Courts must recognize this behavior as an alternative form of bad faith and forbid it.

Granting a stay in any civil or administrative case in which it is reasonable to believe that a criminal action will follow, will prevent the DOJ from circumventing the strict rules of discovery. The defendant will no longer face a dilemma in asserting his Fifth Amendment privilege because the case will be stayed automatically if the court believes that a criminal proceeding will follow, even if no indictment has been brought. Additionally, with respect to the DOJ, a good faith standard is crucial. Requiring the DOJ to return an indictment as quickly as possible, will preserve the defendant’s constitutional rights and will result in a quicker and more efficient administration of justice.

A. Good Faith Standard for the Department of Justice

A good faith standard for deciding when to bring an indictment provides better protection for the Fifth Amendment rights of a white collar defendant involved in parallel proceedings between the SEC and the DOJ. It would charge Justice with the burden of bringing an indictment as soon as reasonably possible instead of stalling to exploit the SEC evidence, such as self-incriminating testimony. Such a standard is necessary even though Courts would face an additional burden in deciding whether or not the DOJ actually acted in good faith in bringing, or failing to bring, an indictment. Several basic considerations could adequately guide the court’s decision.

These guiding factors for determining if the DOJ has acted in good faith should include: (1) the overlapping of issues between the SEC and the criminal proceedings; (2) how long the DOJ knew about, or should have known about, the SEC’s investigation, and how long afterward it took to bring an indictment, if one was brought at all; (3) the reasons why the DOJ failed to bring an indictment before the defendant is asked to, or was asked to testify before the SEC; and (4) if it is reasonable to believe that the DOJ would benefit from a stay being denied and having the defendant testify before the SEC.

The first factor, whether or not the civil issues overlap with the criminal issues, is identical to the first factor used by courts in determining whether a stay should be granted.\textsuperscript{200} Although courts may be hesitant

\textsuperscript{1} (Conn. Super. Ct. Jan. 11, 1994) (holding that where a party is a defendant in a state proceeding and is facing a pending parallel proceeding in federal court, a stay of the federal proceeding may be granted).

\textsuperscript{200} See supra notes 171-73 and accompanying text.
to impose a standard beyond the respective statute of limitations, this factor allows a court to gain some insight into the intentions behind the DOJ's delay in bringing the indictment. If there is little or no overlap, it is unlikely that the DOJ will gain any leverage against the defendant in the criminal proceeding. Therefore, it can be presumed that the reason for its delay is something other than bad faith. However, if the matters, issues, and factual backgrounds do overlap, it is more likely that Justice is acting in bad faith.

The next factor courts should use in determining if the DOJ acted in good faith is how long Justice knew, or reasonably should have known, about the SEC's investigation or proceeding and how long it actually took to bring an indictment. This factor may require the courts to determine when the SEC first shared its inquiry and investigation with the DOJ.201 If the SEC informed Justice at a very early stage and the DOJ failed to act by not bringing an indictment for a significant time, then it will point more in the direction of a bad faith motive. Alternatively, if the SEC did not cooperate with the DOJ until a later period and the DOJ did not bring an indictment immediately thereafter because of legitimate reasons,202 it is less likely to have been motivated by bad faith. This factor is dependent upon the first factor because, without overlapping issues, the timing of the indictment is of no consequence. This second factor might raise the question of a slippery slope in deciding how long is too long between being informed of an investigation and bringing the indictment. However, this question can reasonably be considered on a case by case basis when in conjunction with the next factor—the purported reasons why the DOJ did not bring the indictment sooner.

Examining these purported reasons why the DOJ failed to bring an indictment at an earlier time requires the court to inquire into the subjective intent of the DOJ. Because subjective intent is always difficult to determine, the court must also consider objective evidence in order to discern the subjective intent. If, after analyzing the objective evidence, the court determines that the underlying reason behind failing to bring the indictment in a timely manner is to exploit the possibility of the defendant having to testify against himself, then the DOJ clearly acted in bad faith.

201. This may leave room for SEC bad faith in not sharing its evidence with the DOJ in order to force the DOJ to stall in bringing an indictment, thereby increasing the possibility of having self-incriminating testimony used by the DOJ against the defendant.

202. One possible legitimate reason is to not conduct the investigation at too fast a pace so as to be unable to adequately prepare.
The DOJ’s likely explanation for the delay will be that it was preparing for its action against the defendant. It will claim that it did not want to bring the indictment prematurely before exercising due diligence. Although this may be a legitimate reason, it only becomes legitimate within the totality of the circumstances. Courts must view this need for preparation in the context of the overall picture. Because the real intent is difficult to ascertain, the court should balance the adequacy of the preparation time with the detriment to the defendant in facing the double-edged sword if a stay were not granted. The court, based on its findings, should then decide if Justice’s reasons for the delay outweigh the defendant’s assertion of his Fifth Amendment right.

The last factor a court should consider in determining if the DOJ acted in good faith is whether it is reasonable to believe that Justice would benefit from the denial of a stay. If a stay would not be beneficial, it can be concluded that the DOJ did not act in bad faith. However, if the DOJ would likely benefit from the defendant’s self-incriminating testimony, it can be reasonably presumed that the DOJ failed to bring a timely indictment because of this benefit.

Deciding whether or not the DOJ is attempting to circumvent Federal Rule of Criminal Procedure 16(b)\(^{203}\) (thereby violating the defendant’s Fifth Amendment privileges) is a question of dire consequences for the defendant that courts need to consider fully before denying a stay in the SEC proceeding.\(^{204}\) Consequently, courts must employ all of the above factors in determining the DOJ’s subjective intent in failing to bring an expedient indictment.

**B. Statutory Amendments**

An alternative to imposing a good faith standard\(^{205}\) is the adoption by Congress of a statutory amendment creating an exception to the various laws permitting cooperation between the SEC and other governmental agencies. Once it is reasonable to believe that a criminal indictment will be brought, this amendment would stay the cooperation and sharing of evidence between the SEC and Justice until the defendant decides

---

203. For an explanation of the requirements of 16(b), see *supra* note 24 and accompanying text.

204. The court should also consider the factors where the party is a defendant in a civil proceeding and the DOJ is obtaining evidence which can be held against the defendant in a subsequent criminal proceeding.

205. An alternative to the good faith standard is necessary because courts may be unwilling to implement such a standard. A statutory amendment would have virtually the same effect as the good faith standard but, as statutory law, would involve a less subjective inquiry by courts.
whether to testify against himself in the SEC proceeding. This would serve the same purpose as staying the SEC proceedings but without the delay. To wit, it would protect a defendant from choosing between testifying or having an adverse presumption used against him in the prior SEC proceeding.

A statutory exception is preferable not only because it would avoid any delay in either the initiation of a criminal proceeding (due to DOJ stalling) or in the SEC or civil proceeding (due to the granting of a stay), but also because the courts would no longer be forced to consider the effect a stay would have on the public.206 The statutory exception would also promote judicial efficiency by eliminating the need for stays. Most importantly, it would fully protect the defendant's Fifth Amendment rights. A defendant would no longer have to fear the Hobbesian choice, and would be able to base his decision to testify solely on the consequences in the SEC proceeding. The language for a statutory exception should read:

In a case where it is reasonable to believe that a criminal indictment will be brought against a defendant on the same grounds as the SEC proceeding, and such indictment has not been brought yet, then cooperation between the SEC and the DOJ will be stayed with regard to any possible self-incriminating testimony, if: (1) the same issues are encompassed in both proceedings; and (2) the defendant faces the reasonable possibility of self-incrimination through testifying in the prior proceeding.

Requiring "a reasonable belief that a criminal indictment will be brought" along with the overlap of issues and the reasonable possibility of self-incrimination through testifying in a prior proceeding, would mirror the proposed DOJ good faith standard.207 Nevertheless, unlike the good faith standard, a statutory exception would not require a subjective inquiry into Justice's motives. Rather than focusing on whether the DOJ was attempting to circumvent Federal Rule of Criminal Procedure 16(b), the inquiry would only question whether allowing the DOJ to share the SEC's evidence is in fact likely to circumvent 16(b) regardless of any bad faith motive. A reasonable belief that an indictment will be brought compels the court to look past how long the DOJ knew, or should have known, about the SEC's investigation, and the reasons why

206. For a discussion on the special circumstance of public interest in deciding a stay, see supra notes 185-86 and accompanying text.
207. See supra Part IV.A.
it did not yet bring the indictment. It would therefore focus on the real issue, whether or not 16(b) is being circumvented.

Moreover, a statutory amendment would have the same effect as imposing a good faith standard. The first statutory factor, "if the same issues are encompassed in both proceedings," is identical to the first good faith factor. This factor, again, is central to determining if the defendant is truly in danger of self-incrimination. If the issues are not overlapping, there is no danger to the defendant. In addition, the second statutory factor, the reasonable possibility of the defendant's self-incrimination in the prior proceeding, is analogous to the fourth good faith factor, "if it is reasonable to believe that the DOJ would benefit from a stay being denied." If the DOJ would be harmed from a stay in the SEC proceeding because it would lose the opportunity to have the defendant testify against himself, the defendant is undoubtedly faced with the reasonable possibility of self-incrimination.

V. CONCLUSION

Adoption of either the good faith standard for the DOJ, or in the alternative, a statutory amendment, would better protect a defendant facing parallel proceedings against the undue prejudice of sacrificing his Fifth Amendment privilege against self-incrimination. This result, along with the fact that the DOJ is likely acting in bad faith by delaying an indictment to maximize the evidence against the defendant, fulfills both prongs of the Dresser standard for granting a stay: undue prejudice to the defendant, and, governmental bad faith in using malicious tactics to circumvent the rules of discovery.

Randy S. Eckers*

---

208. See supra Part IV.A. This is the second factor in determining whether or not the DOJ has acted in good faith.

209. See supra Part IV.A.

210. See supra Part IV.A.

* I wish to thank Professor Robert D. Ellis for his expertise, time, and guidance; Anne C. Flannery of Morgan, Lewis & Bockius LLP for her insight into the securities enforcement process; the Hofstra Law Review, especially Lori Diakel and the Managing Office, for their hard work and dedication; and Andrew W. Reiss for bringing parallel proceedings to my attention. I also wish to thank my family and my fiancee, Melissa Greenberg, for their support and encouragement throughout law school and life. I dedicate this Note to my father, Jerry Eckers, and my grandmother, Celia Markowitz, whose lives have always provided me with a model of strength, courage, and determination.