

Parallel proceedings in securities enforcement actions: The growing trend against automatic grants of government requests for stays of civil cases

Stephen P. Younger* and Jenya Moshkovich

*Stephen P. Younger, Patterson Belknap Webb & Tyler, 1133 Avenue of the Americas, New York, NY 10036-6710, USA; Tel: +1 (212) 336 2685; Fax +1 (212) 336 7981; E-mail: spyounger@pbwt.com

Stephen Younger is a partner at Patterson Belknap Webb & Tyler LLP in New York City. His practice is concentrated in commercial and securities litigation and he regularly handles securities enforcement matters on the civil side particularly before State Attorney General's offices.

Jenya Moshkovich is a litigation associate at Patterson Belknap Webb & Tyler LLP in New York City.

ABSTRACT

Parallel proceedings — criminal and civil cases in progress at the same time, against the same defendant, for conduct arising out of the same facts — have become especially commonplace in securities enforcement cases. Often, when parallel proceedings are pending, the government will move to stay discovery in the civil enforcement case until the criminal case is concluded. While historically such stays have been routinely granted, more recent cases, particularly in New York, suggest that the courts will more closely scrutinise these requests. Instead of issuing a blanket stay, a court may decide to allow civil discovery to proceed, subject to the government's right to object to particular discovery requests that directly and actually threaten the integrity of the criminal case.

Keywords: *parallel proceedings, dual proceedings, discovery stays, securities enforcement, Rakoff*

INTRODUCTION

Parallel proceedings occur when both criminal and civil cases are in progress at the same time, against the same defendant, and for conduct arising out of the same facts. These cases typically involve an administrative agency (eg, the Securities and Exchange Commission (SEC) or the Internal Revenue Service (IRS)) and a criminal authority (eg, US Attorney's Office). They have become especially commonplace in securities enforcement cases because violations of the federal securities laws can carry both civil and criminal penalties. They can also involve state administrative law enforcement agencies, such as State Attorneys General's Offices or local prosecutors.

Parallel proceedings have become more prevalent as the level of collaboration between federal and state regulators and criminal authorities has increased in recent years. A review of SEC enforcement in 2009 found that the number of SEC investigations with criminal charges



increased by 43 per cent since 2008 (from 108 to 154).¹ In the midst of the financial crisis, government enforcement proceedings have also received greater public attention than in the past. (See, for example, cases against Goldman Sachs for fraud in structuring and marketing of collateralised debt obligations tied to sub-prime mortgages;² Bernard Madoff for a multi-billion dollar Ponzi scheme;^{3,4} Daniel Bonventre, Madoff's Director of Operations, for falsifying accounting records and siphoning investor funds;^{5,6} Raj Rajaratnam for insider trading.^{7,8})

As a result of these trends, one question that has become more important is whether courts should enter stays of a civil proceeding pending resolution of the parallel criminal case. While historically such stays have been routinely granted, more recent cases suggest that the courts will scrutinise such requests more closely or deny them outright.

BACKGROUND

Often, when parallel proceedings are pending, the government, the defendant, or both will move to stay the civil enforcement case until the criminal case is concluded. The government often seeks stays due to the differences in scope and timing of civil and criminal pre-trial discovery available to a defendant and to prevent its witnesses from being deposed in the civil case. In a civil case, both parties are entitled to broad discovery 'regarding any non-privileged matter that is relevant to any party's claim or defense'.⁹ In contrast, in a criminal case, a defendant is entitled to much narrower discovery of documents 'material to preparing the defense [or that] the government intends to use [] in its case-in-chief at trial'.¹⁰ To preserve this advantage, the criminal enforcement agency often intervenes in the parallel civil case to request a stay of discovery pending completion of the

criminal case.

Defendants may agree to stay the civil case. A defendant may choose to agree to a stay for a number of tactical reasons, including avoiding having to choose between waiving the Fifth Amendment privilege against self-incrimination by testifying at a deposition or asserting the privilege and refusing to testify at the cost of an adverse inference in the civil case. A defendant may also prefer to agree to stay the civil case in order to avoid the expense of defending dual proceedings. On the other hand, defendants may be opposed to stay requests when they prefer a timely resolution of both cases or wish to obtain discovery through the civil case that may prove useful in the criminal proceeding.

REQUESTING A STAY

Although courts are not constitutionally required to grant stays of civil proceedings pending the outcome of criminal proceedings,¹¹ courts have the discretion to stay civil proceedings, postpone civil discovery, or impose protective orders and conditions 'when the interests of justice seem[] to require such action, sometimes at the request of the prosecution, ... sometimes at the request of the defense'.¹²

In making the decision whether to grant such a stay, courts balance the parties' interests in staying the proceedings against allowing them to continue. The inquiry focuses on some variation of the following factors:

1. the extent of overlap between the criminal and civil proceedings;
2. the status of the criminal case;
3. the private interests of the civil plaintiff;
4. the burden on the defendant from proceeding with or delaying the civil litigation;
5. the interests of the courts; and
6. the public interest.¹³

Typically, the question of whether to grant a stay comes before a court by way of a prosecutor's motion to intervene in the civil case, together with a motion to stay some or all civil discovery (or the civil proceeding as a whole), which the SEC usually does not oppose. The Federal Rules of Civil Procedure allow for permissive intervention 'when an applicant's claim or defense and the main action have a question of law or fact in common'.¹⁴ Because parallel proceedings arise from the same facts by definition, this standard is generally met and the court typically permits the prosecutor to intervene, and then turns to considering whether to grant the stay requested.

In support of a stay, prosecutors have traditionally argued that a stay is necessary to avoid prejudicing criminal prosecutions by allowing broader civil discovery to proceed. Until recently, courts have routinely granted the government's requests to stay civil proceedings pending the completion of criminal cases.¹⁵ In recent years, however, instead of automatically granting such stays, some courts have begun to question and even reject the traditional arguments supporting the government's assertions of prejudice justifying a stay. The underlying question has remained the same: 'Whether it is more unfair for a criminal defendant to get discovery to which he would not otherwise be entitled or for a civil defendant to be subject to a set of serious civil charges to which he cannot immediately respond.'¹⁶ The answer, in some cases, has been to reject the government's generalised request for a discovery stay and allow the defendant to conduct broader civil discovery.

RECENT TRENDS

In 1998, in *SEC v. Oakford Corp.*, Judge Jed S. Rakoff of the Southern District of New York described the impact of parallel

proceedings as placing a defendant 'in the jaws of a pincers' and questioned the government's standard practice of filing concurrent civil and criminal cases with the intention to stay the former.¹⁷ Judge Rakoff reasoned that 'To use the federal courts as a forum for filing serious civil accusations that one has no intention of pursuing until a parallel criminal case is completed is a misuse of the processes of these courts.'¹⁸ Judge Rakoff also noted that providing discovery to those defending themselves against serious civil charges, which may also be helpful in defending their criminal case, is not a cognisable harm to the government.¹⁹ Rather, it only implicates the government's desire to maintain a tactical advantage, which is not by itself a proper basis for granting a stay.²⁰ Judge Rakoff concluded by explicitly putting the SEC and the US Attorney's Office on notice that 'such doubtful practices will receive strict scrutiny in the future'.²¹

In 2005, Judge Rakoff applied the same analysis to deny a request by the US Attorney's Office for a general stay of discovery in *SEC v. Saad*, a civil enforcement action.²² In *Saad*, the SEC and US Attorney's Office filed civil and criminal charges, respectively, against the defendants for alleged fraud in reporting financial results of a public company. The US Attorney then intervened in the civil suit to seek a stay of certain discovery pending the resolution of the criminal case.²³ In support of the requested stay, the US Attorney argued that the civil process would allow the defendants to obtain a "special advantage" because, if they were only facing a criminal indictment, they would not be entitled to [the requested discovery] at this time'.²⁴ Judge Rakoff noted that although such requests are not uncommon in parallel proceedings, they are not without what he termed 'bizarre aspects'.²⁵ Specifically, he described it as

strange that ‘the US 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’.²⁶ The court then denied the US Attorney’s request, emphasising that ‘[t]he defendants [were] not just facing a criminal indictment; they [were] also facing a very serious SEC civil action, and they [were] thus fully entitled to the timely discovery that federal law grants them in defending such an action’.²⁷

In the last few years, several federal courts, particularly in the Southern and Eastern Districts of New York, have followed Judge Rakoff’s approach to government requests for staying discovery in civil cases brought by the SEC.²⁸ For example, in *SEC v. Cioffi*, the Eastern District of New York denied the US Attorney’s motion to stay all discovery proceedings in a civil enforcement case.²⁹ Citing *Oakford*, the court explained that the limits on criminal discovery are intended to guard against specific concerns, which include:

1. ‘the broad disclosure of the essentials of the prosecution’s case may lead to perjury and manufactured evidence;
2. the revelation of the identity of prospective witnesses may create the opportunity for intimidation; and
3. the criminal defendants may unfairly surprise the prosecution at trial with information developed through discovery, while the self-incrimination privilege would effectively block any attempts by the government to discover relevant evidence from the defendants.’³⁰

The *Cioffi* court reasoned that the US Attorney’s request for a general stay did not present sufficient particularised facts to

conduct the required balancing of interests: ‘Without specific discovery requests and specific objections before it, the Court simply cannot evaluate the validity and strength of the government’s concerns relative to the defendants’ interest in a prompt resolution of the allegations against them.’³¹ The *Cioffi* court thus decided to allow discovery to go forward in the civil action, while also allowing the US Attorney to object to particular discovery requests if objectionable requests were to arise.³²

Some courts outside of New York have also followed this approach. For example, in *SEC v. Fraser*, the SEC alleged that the defendants violated securities laws through an accounting scheme that was intended to inflate the company’s financial results and overstate its income.³³ The government filed a parallel criminal case and then moved to intervene and to stay the civil action pending resolution of the criminal case.³⁴ The court weighed the defendants’ interests against those of the government.³⁵ The defendants argued that they had an interest in the speedy resolution of both cases.³⁶ The government argued that its criminal case would be undermined if the civil case proceeded because the information obtained through the civil discovery rules would ‘essentially hand the defendant[s] a road map to the United States’ case, allowing them to tailor their defense to what others say about them’.³⁷ The court found that the government’s blanket assertions were insufficient to establish the ‘substantial prejudice’ that would warrant granting a stay.³⁸ Instead, the court concluded that the preferred course of action would be to evaluate the government’s specific objections to discovery requests, where appropriate.³⁹

Similarly, in *SEC v. Sandifur*, the court rejected the government’s motion for a stay of discovery related to the depositions of several individuals relevant to both the

civil and criminal cases.⁴⁰ The government argued that a stay was necessary to protect the integrity of the criminal case and to ensure that the defendant could not use the civil discovery process to obtain more information than he could through criminal discovery. Citing Judge Rakoff's decision in *Saad*, the *Sandifur* court found that if the government had thought expansive discovery was a serious problem, 'it could have easily avoided it by waiting until after the criminal matter was resolved to institute civil proceedings'.⁴¹ But, the court concluded, since the government decided to file both actions concurrently, it placed the defendants in a position of facing both serious criminal and civil charges, and giving defendants a strong interest in resolving both matters.⁴²

In *SEC v. Kornman*, the court adopted a magistrate judge's denial of the government's request to stay a civil case.⁴³ The government argued that it would likely be prejudiced 'if the criminal defendant, who is also the defendant in this civil suit, were furnished with an opportunity to use the civil discovery process to, for instance, take depositions to obtain information learned through the government's criminal investigation or to obtain information that would otherwise not be available to him through the criminal discovery process'.⁴⁴ The magistrate judge had denied the government's motion, concluding that 'the government had not met its burden of establishing "substantial and irreparable prejudice" if a stay in the present action is not entered'.⁴⁵ After the District Court affirmed the magistrate's denial of a stay, the SEC moved to voluntarily dismiss the civil case without prejudice. Although the court granted the SEC's dismissal motion, it agreed with the defendant's argument that the motion 'is an attempt to circumvent the magistrate judge's denial of the [stay] and the court's denial of the [appeal]'.⁴⁶ The court noted that both the

magistrate judge and the District Court itself had already rejected — in the context of the stay motion — the SEC's identical contention that the defendant was attempting to use discovery in the civil case to circumvent limitations on criminal discovery. The court registered its dismay, saying: 'The court is not pleased with this apparent legal legerdemain. The SEC is attempting to "have its cake, and eat it too"'.⁴⁷ The District Court did agree to voluntarily dismiss the enforcement action, but only on the condition that the defendant be allowed to conduct the same discovery the Court had previously permitted by denying a discovery stay.

Not all district courts have agreed with this recent shift in judicial attitudes toward civil stays. For example, in *SEC v. Nicholas*,⁴⁸ the court declined to follow the reasoning of *Saad* and *Oakford*. There, the defendants argued that the government brought simultaneous civil and criminal cases against them in order to gain tactical and public relations advantages and should not have done so if there was a concern that the defendants could use civil discovery to their advantage in the criminal case.⁴⁹ The court found that this argument overlooked the SEC's duty to bring civil enforcement actions upon discovery of securities violations and its role to 'protect the integrity of the public markets and ensure truthful corporate disclosures'.⁵⁰ The court also concluded that the narrow criminal discovery rules that the US Attorney sought to impose on the defendant did not give the government an unfair advantage but, rather, were purposely more limited in order to protect the integrity and truth-seeking function of the criminal process.⁵¹

Similarly, in *SEC v. Gordon*, the court agreed with the *Nicholas* court's reasoning in deciding to grant a stay.⁵² There, the SEC and the US Attorney, acting on the same day, filed civil and criminal charges

against the defendant for an alleged stock manipulation scheme. The US Attorney then moved to intervene in the civil action and stay the civil proceedings and all civil discovery.⁵³ The court applied the *Worldcom* six-factor test⁵⁴ to rule that a stay was appropriate because the parallel civil and criminal cases overlapped, Gordon had already been indicted and a stay was in the interest of both the SEC and the public.⁵⁵ The court also found without merit the defendants' argument that the government and the SEC intentionally brought their cases on the same day in order to seek publicity, concluding that the SEC and government both 'act to protect the public from securities fraud and safeguard the integrity of the public markets'⁵⁶ and it was therefore appropriate to notify the public of the status of their investigations by publicising them. The court rejected the defendant's argument that preventing him from taking advantage of civil discovery was not a legitimate reason for a stay, noting that many courts had granted stays for precisely this reason.⁵⁷ The court also concluded that the defendant had failed to demonstrate how he would be harmed by a stay, particularly because a stay would remove the distraction of having to simultaneously defend both proceedings and because allowing both cases to proceed would undoubtedly implicate the defendant's Fifth Amendment rights.⁵⁸ Finally, the court ruled that its own interests of 'efficient administration and judicial economy'⁵⁹ favoured a stay that would avoid duplicating resources and wasting judicial time.

EFFECT OF RECENT TRENDS

Recent cases reflect that federal judges are becoming less likely to grant government requests for blanket stays of civil discovery. A defendant opposing the government's request for a stay should emphasise a

strong interest in the speedy resolution of both the civil and criminal cases. A defendant may also note that the SEC — having chosen to bring a civil enforcement action — should not be permitted to sit back and wait for the parallel criminal action to be completed. Similarly, a defendant may point out that the more limited right to discovery in criminal cases should not hamstring the accused's right of defending the parallel civil action, particularly where the delay from a stay of the civil action could hinder the defendant's ability to gather useful information in a timely matter. Courts now appear more willing to allow discovery to proceed, subject to the government's right to object to particular discovery requests. In objecting to particular discovery requests, the government, rather than making general assertions of prejudice, should be prepared to show that granting the request in the civil case would directly and actually threaten the integrity of the criminal case. At a minimum, neither the government nor the defendant should any longer assume that a federal judge will simply rubber stamp the government's request for a blanket stay of a parallel civil action.

CONCLUSION

It is apparent that the law in the area of stays of parallel proceedings is evolving, with courts paying greater attention to the extent of the strong reach the government has in enforcement actions. It remains to be seen whether this trend will continue to take hold around the country or whether it will be generally limited to federal courts in New York and a limited number of districts that have adopted Judge Rakoff's reasoning. It is clear, however, that parties involved in such stay motions need to be more attentive to the particularised interests on both sides of the equations.

REFERENCES

- (1) See Gibson Dunn, *Annual Review of SEC Enforcement 2009: A Year of Changes, with More to Come* (12th January, 2010), <http://www.gibsondunn.com/publications/Pages/AnnualReviewofSECEnforcement2009.aspx>.
- (2) *SEC v. Goldman Sachs & Co., et al.*, No. 10 Civ. 3299 (S.D.N.Y. filed 16th April, 2010).
- (3) *SEC v. Bernard L. Madoff, et al.*, No. 08 Civ. 10791 (S.D.N.Y. filed 11th December, 2008).
- (4) *United States v. Madoff*, No. 09 Cr. 213, (S.D.N.Y. filed 10th March, 2009).
- (5) *SEC v. Daniel Bonventre*, No. 10 Civ. 1576 (S.D.N.Y. filed 26th February, 2010).
- (6) *United States v. Bonventre, et al.*, No. 10 Cr. 228 (S.D.N.Y. filed 24th March, 2010).
- (7) *SEC v. Galleon Mgmt., et al.*, No. 09 Civ. 8811 (S.D.N.Y. filed 16th October, 2009).
- (8) *United States v. Rajaratnam*, No. 1:09 Cr. 1184 (S.D.N.Y. filed 15th December, 2009).
- (9) Fed. R. Civ. P. 26(b)(1).
- (10) Fed. R. Crim. P. 16(a)(1)(E).
- (11) See *Baxter v. Palmigiano*, 425 U.S. 308 (1976).
- (12) *United States v. Kordel*, 397 U.S. 1, 12 n. 27 (1970) (internal citations omitted).
- (13) See *In re WorldCom, Inc. Sec Litig.*, Nos. 02 Civ. 3288, 02 Civ. 4812, 2002 WL 31729501, at *4 (S.D.N.Y. 5th December, 2002).
- (14) Fed. R. Civ. P. 24(b)(2).
- (15) See Steven M. Witzel and David B. Hennes, *New And Balanced Approach To Discovery In Parallel Proceedings: New York Federal Courts Reject Government Requests For Broad Stays*, Practising Law Institute, 1765 PLI/Corp. 401, at 2 n. 2 (9th October, 2009) (citing Second Circuit cases).
- (16) Thomas C. Newkirk & Christopher Deal, *Judges Look Behind The Screen Questioning SEC Stays In Parallel Proceeding*, 1791 PLI/Corp. 729, 735 (17th February, 2010).
- (17) *SEC v. Oakford Corp.*, 181 F.R.D. 269, 270 (S.D.N.Y. 1998).
- (18) *Ibid* at 273.
- (19) *Ibid*.
- (20) *Ibid*.
- (21) *Ibid*.
- (22) *SEC v. Saad*, 229 F.R.D. 90, 91 (S.D.N.Y. 2005).
- (23) *Ibid*.
- (24) *Ibid* at 92.
- (25) *Ibid* at 91.
- (26) *Ibid*.
- (27) *Ibid* at 92.
- (28) See Witzel & Hennes, ref. 15 above, at 2 n. 5 (citing *SEC v. Chakrapani*, No. 09 Civ. 325, Hearing Tr. at 14, 28 (S.D.N.Y. 29th July, 2009); *SEC v. Cuti*, No. 08 Civ. 8648, Hearing Tr. at 58 (S.D.N.Y. 20th January, 2009); *SEC v. Cioffi*, No. 08 Civ. 2457, 2008 WL 4693320 (E.D.N.Y. 23rd October, 2008); *SEC v. Collins & Aikman Corp.*, No. 07 Civ. 2419, Hearing Tr. at 24 (S.D.N.Y. 6th September, 2007)); see also *United States v. Financial Industry Regulatory Authority (FINRA)*, 607 F. Supp. 2d 391 (E.D.N.Y. 9th April, 2009).
- (29) See 2008 WL 4693320.
- (30) *Ibid* at *2.
- (31) *Ibid*.
- (32) *Ibid*.
- (33) *SEC v. Fraser*, No. 2:09 Civ. 443, 2009 WL 1531854 (D. Ariz. 1st June, 2009).
- (34) *Ibid* at *1.
- (35) *Ibid*. at *2.
- (36) *Ibid*.
- (37) *Ibid*.
- (38) *Ibid* at *4.
- (39) *Ibid*.
- (40) *SEC v. Sandifur*, No. 05 Civ. 1631, 2006 WL 3692611 (W.D. Wash. 11th December, 2006).
- (41) *Ibid*. at *3.
- (42) *Ibid*.
- (43) *SEC v. Kornman*, No. 3:04 Civ. 1803, 2006 WL 1506954 (N.D. Tex. 31st May, 2006).
- (44) *Ibid* at *1.
- (45) *Ibid* at *2.
- (46) *Ibid* at *4.
- (47) *Ibid*.

- (48) See, for example, *SEC v. Nicholas*, 569 F. Supp. 2d 1065 (C.D. Cal. 2008).
- (49) *Ibid* at 1071.
- (50) *Ibid*.
- (51) *Ibid* at 1071-72.
- (52) *SEC v. Gordon*, No. 09 Civ. 61, 2009 WL 2252119 (N.D. Okla 28th July, 2009).
- (53) *Ibid* at *3.
- (54) See ref. 13 above.
- (55) *Gordon*, 2009 WL 2252119, at *4.
- (56) *Ibid* at *5.
- (57) *Ibid*.
- (58) *Ibid*.
- (59) *Ibid*.