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A legal update from Dechert's White Collar and Securities Litigation Group

Federal Courts Show Unease with Government Strategies in Parallel Proceedings

In two recent decisions, *United States v. Stringer* and the *United States v. Scrushy*, federal judges have harshly criticized the government for the way in which it conducted parallel criminal and civil investigations. It remains to be seen whether these cases represent a trend and whether their reasoning will be upheld by appellate courts. At the very least, they signal judicial unease with government investigative tactics that may affect how the government approaches parallel investigations.

Parallel investigations present a minefield for lawyers representing both companies and individuals. Prosecutors may use any statement or other information produced in a civil or regulatory matter in a later criminal case. While corporations do not have a right to assert Fifth Amendment protections, directors, officers, and employees do.

The assertion of the Fifth Amendment may protect individuals' interests in a later criminal proceeding, but may spell disaster for the civil or regulatory proceeding, as an adverse inference may be drawn against the company and the individual. Often there is no "good" choice, but rather a choice between the lesser of two evils.

Background

Courts have long recognized that the same course of action may give rise to both criminal proceedings and civil or administrative actions.[1] But courts have not clearly articulated the "rules of the road" that the government must follow in conducting parallel criminal and civil investigations. In *United States v. Kordel*, a 1970 case in which the defendants faced both a civil suit from the Food and Drug Administration and federal criminal charges, the Supreme Court considered the constitutional protections available to individuals facing parallel criminal and civil investigations.

In *Kordel*, the defendant was served interrogatories to answer for the civil case while the criminal case was still pending, and was forced to choose between either asserting Fifth Amendment protections and refusing to answer the interrogatories. The defendant answered the civil interrogatories, and those answers were subsequently used to convict the defendant in the criminal action.

The Supreme Court upheld this conviction, holding that the defendant had not been forced to answer the interrogatories. The Court noted that the result might have been different if the defendant had been unaware of the criminal proceeding at the time that he answered the civil interrogatories.[2] The Supreme Court gave only the vaguest guidance for evaluating government conduct in parallel investigations, stating that in the present case there has been no "departure from the proper administration of criminal justice."[3]

In *S.E.C. v. Dresser Industries*,[4] the defendants directly challenged the use of parallel civil and criminal investigations by the SEC and the DOJ. The D.C. Circuit rejected this challenge and endorsed parallel civil and criminal investigations, stating that "[e]ffective enforcement

1 *United States v. Kordel*, 397 U.S. 1 (1970).

2 *Id.* at 8.

3 *Id.* at 11.

4 *Securities and Exchange Commission v. Dresser Industries, Inc.*, 628 F.2d 1368 (DC Cir. 1980).

of the securities laws requires that the SEC and Justice be able to investigate possible violations simultaneously." The court cited *Kordel*, but articulated the applicable standard in a different way, stating that courts should not intervene in parallel investigations unless "the nature of the proceedings demonstrably prejudices substantial rights of the investigated party or of the government."[5] The court noted, however, that there may be situations in which it is appropriate to stay the civil investigation to preserve an individual's Fifth Amendment rights.[6]

United States v. Stringer

On January 9, 2006, a federal district court in Oregon dismissed the securities fraud and conspiracy indictments that had been brought against two defendants. The dismissal was based upon the court's finding that the SEC and the DOJ had violated the defendants' Fifth Amendment due process rights.[7]

In *Stringer*, the SEC and the DOJ conducted a joint investigation into alleged inflation of revenues at FLIR Systems, Inc. ("FLIR"), achieved through allegedly fraudulent revenue recognition and accounting practices. The defendants, employees of FLIR, did not assert their Fifth Amendment rights in connection with an SEC civil investigation only to discover after the end of the civil investigation that the DOJ had worked closely with the SEC throughout the investigation and had considered the FLIR executives virtually from the outset to be targets of a criminal investigation.

The defendants alleged that the close working relationship between the DOJ and SEC had been willfully hidden, and that the DOJ had strategically waited to announce the criminal investigation in order to obtain evidence through civil discovery. Conversely, the government claimed that the SEC and DOJ investigations were merely the sort of parallel proceedings that courts have consistently approved since 1970. The court ruled that hiding the existence a DOJ investigation in order to obtain evidence through civil discovery met the standard of "so grossly shocking and so outrageous as to violate the universal sense of justice" required to dismiss the indictments outright.

The court found that sandbagging the defendants by concealing the existence of a criminal investigation violated the defendants' due process rights. During the early stages of the SEC's investigation, Assistant U.S. Attorneys in Oregon identified the defendants as likely prosecution targets. After several meetings between the SEC and the Assistant U.S. Attorneys, "it was decided that the criminal investigators would continue to allow the civil investigators to handle the investigation."[8]

The Oregon U.S. Attorney's Office told the SEC which individuals it considered targets of its investigation and directed the SEC to gather the types of evidence that would be needed to prosecute a false testimony case against one or more of these targets.[9] The prosecutors and SEC enforcement staff discussed the appropriate time at which the criminal investigation could "surface" without jeopardizing the cooperation between the civil and criminal investigators.[10]

The defendants attempted to discover whether they were targets of criminal prosecution during civil depositions. While the SEC never made misstatements of fact, it was evasive in its answers, referring the defendants to the "routine uses" language in the Form 1662 that all testifying witnesses are given and refusing to discuss any potential criminal investigation.[11]

The court held that this warning, "given to every individual, whether or not a target, prior to testifying," was insufficient given the active role that the Oregon U.S. Attorney's Office played in the SEC investigation.[12] According to the court, "[t]he USAO spent years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections."[13] The court went on to hold that this conduct satisfies the standard of "grossly shocking or outrageous" required to dismiss the indictments outright.

The government will likely appeal the decision, and it is not clear that another court would find the manner in which this joint investigation was pursued to be unacceptable. The defendants' attorneys were well aware of the risk of a criminal investigation. Moreover, SEC staff

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5 *Id.* at 1377.

6 *Id.* at 1376.

7 *United States v. Stringer*, No. 03-432-HA, 2006 WL 44193 (D. Or. Jan. 9, 2006) (unpublished).

8 *Stringer*, 2006 WL 44193 at *2.

9 *Id.*

10 *Id.* at *3.

11 *Stringer*, 2006 WL 44193 at *4.

12 *Id.* at *5.

13 *Id.* at *6.

did not lie to them. And while "outrageous government conduct" has been recognized as a theoretical ground for dismissal of an indictment, it has virtually never been used successfully.[14]

United States v. Scrushy

In *Scrushy*, the government charged Richard Scrushy, the former CEO of HealthSouth, with perjury for giving allegedly false testimony during a SEC deposition.[15] The court suppressed Mr. Scrushy's SEC testimony because it found that the government's conduct of a parallel civil and criminal investigation "depart[ed] from the proper administration of justice." Having suppressed the testimony upon which the perjury charge was based, the court dismissed the charge.

The government's conduct in *Scrushy* appeared to be blatant, but not as "outrageous" as the conduct in *Stringer*. In *Scrushy*, the existence of a criminal investigation was apparent at the time of the defendant's deposition. The court found that off-the-record coordination between the SEC and the DOJ was what had "departed from the proper administration of justice."[16] The court noted that two days before Mr. Scrushy's SEC deposition, there was a conference call between the U.S. Attorney's office in Birmingham and attorneys in the SEC's Atlanta office. On the call, two assistant U.S. Attorneys told the SEC staff not to oppose Mr. Scrushy's request to move the deposition from Atlanta to Birmingham. They also told the SEC not to suggest the move so as not to tip off Mr. Scrushy to the existence of a criminal investigation directed at him.

According to the court, the assistant U.S. Attorneys wanted to establish venue for the perjury charge in Alabama (presumably so that Mr. Scrushy could be tried in Birmingham for perjury along with other substantive charges that the government might bring). The court also found that it was improper for the assistant U.S. Attorneys to ask the SEC to tailor its questioning of Mr. Scrushy in a way that would continue to conceal the existence of a criminal investigation directed at Mr. Scrushy.[17] The government decided not to appeal the court's decision.

What is significant about the *Stringer* and *Scrushy* rulings is that they put federal criminal and civil enforcement officials on notice that at least some courts are willing to scrutinize the way these investigations are conducted and challenge the government when its conduct violates the court's sense of fair play. Prosecutors and SEC enforcement staff already appear to be mindful of these decisions, and as a result should be more willing to make clear the status of parallel investigations.

Where it is tactically advantageous to do so, counsel should ask:

- Whether that civil enforcement agency has contacted federal or state criminal enforcement officials about the conduct being investigated
- Whether there is an active criminal investigation into the conduct being investigated
- Whether the client is a target or subject of any existing criminal investigation[18]

Civil discovery may also be fertile ground for investigating the coordination that has taken place between the criminal prosecutors and civil enforcement lawyers.

These two decisions demonstrate that some courts are still willing to put a check on government enforcement techniques. Nonetheless, federal, criminal, and civil enforcement authorities still have broad discretion in the conduct of parallel investigations. Time will tell whether *Scrushy* and *Stringer* represent a trend that will lead to clear limitations on government coordination of parallel investigations, or an aberration that appellate courts will quickly correct.

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14 *See, e.g.*, *United States v. Smith*, 924 F.2d 889 (9th Cir 1990) (not outrageous government conduct where an undercover agent encouraged a patient in a drug treatment facility to deal drugs); *United States v. Angela Nolan-Cooper*, 155 F.3d 221 (3d Cir 1998) (not outrageous government conduct for an agent to have a sexual relationship with the target of a criminal investigation that the agent is conducting).

15 *United States v. Scrushy*, 366 F.Supp.2d 1134 (N.D. Ala. 2005).

16 *Id.* at 1140.

17 Before Mr. Scrushy's SEC deposition, he and his attorney were also given the standard Form 1662 "routine use" notice that information learned during the deposition may be made available to prosecutors.

18 There are, of course, some situations in which counsel may be reluctant to do anything to "suggest" to the SEC staff that a criminal investigation may be warranted.

Practice group contacts

If you have questions regarding the information in this update, please contact one of the attorneys listed or any Dechert attorney with whom you are in regular contact. Visit us at www.dechert.com/financialserviceslit or www.dechert.com/whitecollar.

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