

May 2008 / Special Alert

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

## Ninth Circuit's Decision Raises Critical Issues for Companies and Individuals Confronted with a Government Civil Investigation

Recently, in *U.S. v. Stringer*, the Ninth Circuit issued an important decision, which involved several issues that companies and individuals must consider when contacted by a federal official conducting a civil investigation.<sup>1</sup> Two issues presented by this decision warrant discussion. Part I, which is set forth below, addresses the possibility of coordinated civil and criminal investigations in which civil investigators gather incriminating evidence from unaware targets of the criminal probe to aid the criminal prosecution. Part II, which will be issued later, will examine when and how the interests of the company and individual officers might diverge, and the need for individuals (and their counsel) to safeguard the individuals' interests because the "best" approach to inquiries received from civil investigators may not be the same for the company and the individual.

### Cooperators with Civil Investigations Beware: More Danger May Be Lurking Beneath the Surface

In *Stringer*, the Ninth Circuit held that it is permissible for federal prosecutors to conduct a criminal investigation in tandem with an SEC civil investigation with which the targets of the criminal probe are cooperating, not disclose the existence of the criminal investigation to the targets, and use the fruits of the civil investigation in the criminal prosecution, provided that the targets of the criminal investigation receive generic warnings that any information provided to the SEC may be provided to prosecutors and that the government's agents do not make any affirmative misrepresentations to

the targets or their counsel.<sup>2</sup> This decision reaffirms the need to carefully consider all of the potential pros and cons, including the potential criminal ramifications, before cooperating with a civil investigation.

Although the issue of parallel criminal and civil government investigations has long been recognized, the parameters of permissible government conduct are not well defined. In *U.S. v. Kordel*, the Supreme Court held that parallel investigations conducted in good faith did not violate due process, even if the information garnered in the civil investigation was shared with the prosecutors.<sup>3</sup> But the Court also implied that under certain circumstances a criminal investigation may be unconstitutional, observing that *Kordel* was not a situation in which the government brought a civil action "solely to obtain evidence for its criminal prosecution," "failed to advise the [civil defendant] that it contemplates his criminal prosecution," or involved "any other special circumstances that might suggest the unconstitutionality or even impropriety of this criminal prosecution."<sup>4</sup> The Supreme Court has not addressed this issue since *Kordel*,<sup>5</sup> leaving lower courts to fill-in the parameters of acceptable government conduct on a case-

<sup>2</sup> 2008 WL 901563, at \*1–3.

<sup>3</sup> *U.S. v. Kordel*, 397 U.S. 1, 11–12 (1970).

<sup>4</sup> *Id.* at 11–12. See also *U.S. v. Robson*, 477 F.2d 13, 18 (9th Cir. 1973) (stating that affirmative misrepresentations by government agents as to the nature or existence of parallel proceedings or the use of trickery or deceit in conducting the investigations may violate due process).

<sup>5</sup> *Stringer*, 2008 WL 901563, at \*6.

by-case basis. Because the inquiry depends heavily on the facts of each case, it is unsurprising that some of the lower courts confronted with such issues have found no fault with the government's conduct,<sup>6</sup> while others have concluded that the government acted improperly.<sup>7</sup>

This gray area between permissible parallel investigations and civil investigations that are merely a pretext to obtain evidence for criminal prosecution presents significant risks for those confronted with civil investigations that carry the prospect of criminal charges. The differences in the discovery rules applicable to civil actions brought by government agencies and criminal prosecutions by the Department of Justice provide an incentive for prosecutors to lie low while a civil investigation unfolds. In civil litigation, the government has a full panoply of discovery tools at its disposal, including depositions of the company and individuals to build its case. In the criminal context, because the government must notify targets of the investigation before obtaining testimony from them, it often fails to obtain testimony from a target. The differences in discovery rules caused the government attorneys in *Stringer* to proceed with the SEC's civil

<sup>6</sup> See, e.g., *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1379–80, 1384–87 (D.C. Cir. 1980) (*en banc*) (affirming district court's decision to deny motion to quash SEC subpoena and deny motion for a protective order prohibiting SEC from sharing the fruits of its civil discovery with the Department of Justice because parallel criminal investigation by grand jury did not preclude SEC from pursuing a civil investigation it had commenced in good faith); *U.S. v. Mahaffy*, 446 F. Supp. 2d 115, 123–27 (E.D.N.Y. 2006) (denying motion to suppress statements made to the SEC because there was no evidence to suggest that the SEC's civil investigation was intertwined with the Department of Justice's criminal investigation or that the defendant was a target of the criminal investigation until after he spoke with the SEC).

<sup>7</sup> See, e.g., *U.S. v. Tweel*, 550 F.2d 297, 298 (5th Cir. 1977) (holding that IRS violated Fourth Amendment by deceiving defendant into believing a criminal investigation was civil in nature, and remanding to the district court to determine whether evidence admitted at trial was tainted by the constitutional violation); *U.S. v. Scrushy*, 366 F. Supp. 2d 1134, 1137 (N.D. Ala. 2005) (concluding that the "Government departed from the proper administration of criminal justice" by improperly merging a civil investigation being conducted by the SEC and a criminal investigation being conducted by the U.S. Attorney's Office, and granting criminal defendants' motion to suppress his S.E.C. deposition); *U.S. v. Posada Carriles*, 486 F. Supp. 2d 599, 614–20 (W.D. Tex. 2007) (dismissing criminal indictment due to government's deception of granting unqualified alien a naturalization interview for the sole purpose of gathering information for use in a criminal prosecution against him).

investigation while the criminal prosecutors hid in the shadows.

And now that this approach has the Ninth Circuit's stamp of approval, we can expect that it will be employed more frequently in the future.

### ***U.S. v. Stringer***

In *Stringer*, the SEC began investigating possible civil securities fraud violations against FLIR Systems Inc. and three of its officers. About two weeks after opening its investigation, the SEC met with the local U.S. Attorney's Office to coordinate its investigation with a possible criminal investigation. Within days of that meeting, the U.S. Attorney's Office and the FBI opened a criminal investigation. At the outset of its investigation, the U.S. Attorneys' Office identified two of the three FLIR officers as targets of the criminal investigation and considered the third to be a potential target. The U.S. Attorney's Office informed the SEC of these determinations.

Although they had opened an investigation, federal prosecutors elected not to reveal themselves to the targets of the criminal investigation because the company and the targets had demonstrated a willingness to cooperate with the SEC's ongoing civil investigation. The prosecutors hoped to benefit from information provided by the targets to the SEC. The prosecutors feared that if they "surface[d]," the criminal targets would cease cooperating with the SEC, likely hindering a possible settlement between the SEC and the defendants and depriving the U.S. Attorney's office of any information the targets would have voluntarily provided.<sup>8</sup> The investigations continued in this fashion for more than two years.

But during that time the prosecutors did more than simply observe the SEC's civil investigation. They worked with the SEC behind the scenes: meeting regularly, discussing strategy, exchanging information, requesting that interviews be conducted in their jurisdiction to establish jurisdiction for possible criminal charges based on any false statements made, advising what information was needed for a successful criminal prosecution, and specifically instructing the SEC on how best to gather evidence for false statement cases.<sup>9</sup> For its part, the SEC helped conceal the prosecutors' involvement from the targets of the in-

<sup>8</sup> 408 F. Supp. 2d at 1087–88.

<sup>9</sup> *Id.* at 1088.

vestigation. The SEC's attorney instructed the court reporters who handled the depositions of the targets and other witnesses not to divulge the involvement of the U.S. Attorney's Office.<sup>10</sup> And when counsel for one of the targets expressly inquired as to whether the SEC was working in conjunction with the U.S. Attorney's Office in any jurisdiction, counsel for the SEC answered that as set forth in Form 1662 there are routine uses of information obtained in the SEC's investigation and that the SEC's policy is not to respond to questions like that but to direct defense counsel to the other agencies with which defense counsel was concerned.<sup>11</sup> When asked which U.S. Attorney's Office defense counsel should inquire to, the SEC's attorney responded that was a matter for defense counsel's discretion.<sup>12</sup>

Confronted with these facts, the district court dismissed the criminal charges against the three officers. The district court surmised that these investigations were not the "parallel" investigations contemplated by the Supreme Court in *Kordel*, but a single investigation in which the SEC took the lead so that witnesses would be more cooperative, constitutional rights would not be invoked, and the rules of criminal discovery would not be triggered.<sup>13</sup> The district court concluded that it was an "abuse of the investigative process" to conceal the criminal investigation from the targets with the intent of obtaining information from them through the SEC's civil investigation.<sup>14</sup> The district court also found that the government did not advise defendants that it anticipated their criminal prosecution, which was one of the potentially unconstitutional situations contemplated in *Kordel*. And that while the government agents made no affirmative misrepresentations, they nevertheless resorted to deceit and trickery to conceal the criminal investigation by not providing a "straight" answer to questions about the U.S. Attorney's involvement.<sup>15</sup> Ultimately, the district court concluded that the government's conduct was "grossly shocking" and "outrageous" and justified dismissing the criminal charges.<sup>16</sup> The district court

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<sup>10</sup> *Id.* at 1089.

<sup>11</sup> *Id.* at 1087, 1089.

<sup>12</sup> *Id.* at 1087.

<sup>13</sup> *Id.* at 1087–88.

<sup>14</sup> *Id.* at 1088.

<sup>15</sup> *Id.* at 1088–89.

<sup>16</sup> *Id.* at 1089 (internal citations omitted).

also concluded that under the circumstances the defendants could not have voluntarily waived their Fifth Amendment rights by providing testimony to the SEC because they were unaware of the involvement of the U.S. Attorney's Office, uninformed of their status as targets of a criminal investigation, and, in that context, the boilerplate terms of Form 1662, which are provided to all witnesses (whether a target or not), were insufficient to render their waiver knowing and voluntary.<sup>17</sup>

The Ninth Circuit reversed. Loosely tracking the scenarios of possible unconstitutional conduct set forth in *Kordel* and its own decisions, the Ninth Circuit concluded that: (1) the civil investigation had not been commenced for an improper purpose; (2) defendants voluntarily waived their Fifth Amendment right against self-incrimination when they testified before the SEC because they were on notice that any information they provided to the SEC could be used in criminal proceedings against them; and (3) no one affiliated with the government made any affirmative misrepresentations.<sup>18</sup> Under those circumstances, the Ninth Circuit concluded that there was nothing improper or deceitful about conducting civil and criminal investigations in tandem and not disclosing the existence of the criminal investigation.<sup>19</sup>

Addressing the first scenario articulated in *Kordel*, the Ninth Circuit held that the civil investigation was not commenced for any improper purpose.<sup>20</sup> It deemed it significant that the SEC initiated the investigation and later brought the prospect of criminal wrong doing to the attention of the U.S. Attorney. The Ninth Circuit also concluded that, pursuant to its enforcement powers, the SEC had conducted a bona fide civil investigation which resulted in sanctions. And that the interviews of the targets of the criminal investigation were in support of the SEC's investigation and not merely a pretext to obtain evidence for the criminal investigation.

The Ninth Circuit noted, and then ignored, the second scenario articulated in *Kordel*—whether the government infringed on constitutional rights by failing to advise the defendants that it contemplated their criminal prosecution.<sup>21</sup> While the SEC had informed

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<sup>17</sup> *Id.* at 1089–90.

<sup>18</sup> 2008 WL 901563, at \*7–10.

<sup>19</sup> *Id.* at \*1.

<sup>20</sup> *Id.* at \*8.

<sup>21</sup> *Id.* at \*6.

the defendants that any information they provided to the SEC could be shared with prosecutors and used in a criminal action, it did not advise defendants that they were already the targets of an active criminal investigation that would likely result in prosecution. The Ninth Circuit side-stepped the thorny issue of whether the notice that criminal prosecution was a “possibility” was sufficient under *Kordel* when the government knows that criminal prosecution is more than possible, it is likely and intended. It framed the inquiry as whether defendants knowingly and voluntarily waived their Fifth Amendment rights when testifying before the SEC, not whether the government’s conduct had run afoul of *Kordel*. The answer to the Ninth Circuit’s question was easy: the defendants had waived their Fifth Amendment rights because the SEC, through Form 1662 and oral statements prior to the defendants’ testimony, had put the defendants on notice of the possibility of criminal prosecution.<sup>22</sup>

Finally, unlike the district court, the Ninth Circuit concluded that the government had not used trickery or deceit or any other improper means in conducting its investigation. Although recognizing that using deceit or trickery to obtain evidence may implicate constitutional protections, the Ninth Circuit concluded that government agents were not obligated to disclose the existence of a criminal investigation, as long as they did not make any affirmative misrepresentations.<sup>23</sup> Under that standard, the Ninth Circuit concluded that there was nothing improper about the SEC’s attorney’s answers to defense counsel’s question about the involvement of the U.S. Attorney’s Office.<sup>24</sup> In the Ninth Circuit’s view, counsel for the SEC had not made any affirmative misrepresentations in directing defense counsel to the language of Form 1662 and advising him that he should direct his inquiries to other government agencies and offices of his choosing.<sup>25</sup> And while conceding that requesting the court reporters not to disclose the involvement of the U.S. Attorney’s Office to defense counsel indicated an intent to conceal the existence of the criminal investigation from the defendants, the Ninth Circuit concluded that this did not mislead or misinform the defendants about the existence of a criminal investigation because defendants and their counsel should have been

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<sup>22</sup> *Id.* at \*7.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at \*9.

<sup>25</sup> *Id.*

well aware of the possibility of a criminal investigation from the language of Form 1662.<sup>26</sup>

## Conclusion

*Stringer* is another reminder that corporations and individuals confronted with a civil investigation by a government agency often find themselves at a cross-roads. Should companies open their doors and books and explain exactly what went wrong and why, perhaps even waiving attorney-client privilege? Or should they resist, forcing the agency to do its own work, follow appropriate discovery procedures, and litigate the myriad issues (such as privilege) that can arise? Should individuals cooperate with such investigations? Should they force the government to divulge whether a criminal investigation is underway, and risk bringing about an investigation that did not exist and was not contemplated?

Unfortunately, there are no easy answers to these questions and the many others that arise. The “best” path in a particular instance will depend on the circumstances. What is clear is that before deciding on which path to take, companies and individuals must do their best to learn and understand what happened to attract the government’s scrutiny and then, in light of their understanding, evaluate all of the potential risks and benefits associated with cooperating, including the risk that the civil investigation may be just the tip of the proverbial iceberg with an even more dangerous criminal investigation lurking just below the surface.

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*Part II of this alert, which is forthcoming, will examine when and how the interests of individuals may diverge from the interests of the company, and the need for individuals (and their counsel) to protect the individual’s interests because the “best” approach for the company may conflict with the individual’s interest.*



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<sup>26</sup> *Id.* at \*9–10.

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