

Parallel Proceedings: Establishing the Boundaries

By Jonathan S. Feld, Michael J. Diver, and Gail H. Kim

An investigation by the SEC is always cause for great concern by corporations, executives and their attorneys. In recent years, there has been reason for even greater concern due to prosecutors' increased focus on corporate fraud and the resulting increase in "parallel proceedings." Parallel proceedings involve simultaneous or successive investigations and/or litigation of separate criminal and civil actions by different government agencies arising out of the same set of facts. This trend requires defense counsel to assess whether corporations and individuals may be subjects of a criminal investigation in cases that would not have given rise to such scrutiny several years ago.

Faced with possible criminal liability, clients and counsel must carefully evaluate and weigh the potential benefits of cooperating in an SEC civil investigation versus the very real possibility of furnishing incriminating information to the government for use in a criminal proceeding. To make matters worse, this decision must often be made very early in the investigative process, when defense counsel has an imperfect or incomplete set of facts.

LIMITATIONS ON PARALLEL PROCEEDINGS: THE *STRINGER* AND *SCRUSHY* DECISIONS

In recent opinions, courts have scrutinized the government's conduct in parallel proceedings, particularly with respect to the government's attempted use in criminal proceedings of information obtained through

civil investigations. *United States v. Scrusby*, discussed more fully in the January 2006 issue of this newsletter, was the first federal district court case that appeared to establish limitations on the Department of Justice's (DOJ) role in parallel proceedings. 366 F.Supp.2d 1134 (N.D. Ala. 2005). In *Scrusby*, Judge Karon Bowdre ruled that the SEC's and DOJ's corporate fraud investigations involving Richard Scrusby had improperly merged when the DOJ and SEC staff conferred and exchanged information. The *Scrusby* decision, together with the *Stringer* decision discussed below, provide guidance about when the government's pursuit of parallel proceedings abuses the investigatory process and violates an individual's constitutional rights.

THE *STRINGER* DECISION

United States v. Stringer stands out as the second case that attempts to draw boundaries between civil and criminal proceedings. No. CR 03-432-HA, 2006 WL 44193 (D. Oregon Jan. 9, 2006). The district court dismissed all 50 counts of conspiracy and securities fraud against J. Kenneth Stringer, Mark Samper, and William N. Martin (the Stringer Defendants) because the information they had provided to the SEC during the course of an enforcement investigation, which was then used in a subsequent criminal proceeding, was obtained in violation of the Fourth and Fifth Amendments. The court also rested its decision upon a finding that the government failed to address a known conflict of interest during the course of the investigation.

The SEC investigated the Stringer Defendants, former executives of FLIR Systems, Inc. (FLIR), for

accounting irregularities. Shortly after the SEC commenced its investigation, a DOJ attorney met with an SEC enforcement staff member and requested access to SEC files regarding its investigation. During this meeting, the DOJ attorney indicated to the SEC staff member that the Stringer Defendants were the subjects of a DOJ criminal investigation. The SEC and DOJ met throughout the SEC's investigation to exchange information and discuss case strategy. The federal agencies jointly decided to delay the criminal investigation while the SEC's investigation continued because the agencies believed it was premature to disclose the existence of the criminal investigation and that doing so would impede the SEC's ongoing civil investigation.

In dismissing the indictments against the Stringer Defendants, the court held that the SEC's and DOJ's investigations were not parallel proceedings because the DOJ identified potential criminal liability and targets early in its investigation, but then chose to postpone its investigation and gather information through the SEC's investigation. In so doing, the court distinguished the government's conduct in *Stringer* from properly conducted civil and criminal investigations, where the DOJ may delay its investigation to review the SEC's investigative record in order to make an informed decision as to whether to pursue a criminal investigation.

The court also ruled that deliberately concealing the existence of the criminal investigation from the Stringer Defendants constituted an abuse of the investigative process.

continued on page 2

Boundaries

continued from page 1

For example, the court found that the DOJ advised the SEC staff of its interest in false-testimony prosecutions and instructed the SEC staff on how to create the best record for such cases. Also, the court found the SEC staff evaded answering *Stringer*'s direct questions about the existence of a criminal inquiry by referring to the general disclosures provided to all individuals testifying before the SEC. The court noted that the SEC staff even went so far as to ensure that the court reporter would not reveal to the *Stringer* Defendants the DOJ's involvement in the investigation.

THE CONFLICT-OF-INTEREST

RULING IN *STRINGER*

The court also ruled on a conflict of interest question, emphasizing the need for defense counsel to have a heightened awareness of potential conflicts of interest when the government pursues parallel civil and criminal investigations. During the SEC investigation, FLIR and defendants Samper and *Stringer* were represented by the same law firm. After obtaining consent from the *Stringer* Defendants, the law firm continued to represent FLIR throughout the DOJ's criminal investigation. However, as a result of FLIR's cooperation in the criminal investigation, the government learned, from the law firm, of an additional possible charge that the DOJ brought against Samper. The court held that the government should have identified the conflict of interest and was under an obligation to bring the conflict to the attention of the court or even move for disqualification of counsel because the SEC and DOJ

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were the only parties who knew, at the time the conflict first arose, that a criminal prosecution would most likely occur.

IMPLICATIONS OF *STRINGER*

The *Stringer* court rejected the government's attempt to use the civil discovery process to further a criminal prosecution and held that the federal government may not pursue parallel proceedings where the prosecution is deliberately delayed and/or concealed so as to maximize the benefits to prosecutors from the civil discovery process. In short, by using the SEC as its stalking horse and exploiting the law firm's conflict of interest, the DOJ abused the investigation process. The court found that the DOJ's behavior warranted the dismissal of the whole indictment because prosecutors "spent years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections." 2006 WL 44193, at *6.

EFFECTS OF THE *STRINGER* AND *SCRUSHY* DECISIONS

The *Stringer* and *Scrusby* decisions begin to establish procedural boundaries within which the government should conduct parallel civil and criminal investigations. Federal agencies cannot deliberately delay a criminal investigation with the intention of building a criminal case entirely upon the fruits of a civil investigation. Neither may they merge their inquiries to the point where the criminal investigation utilizes the civil discovery process to avoid long-established safeguards in criminal proceedings. The *Stringer* and *Scrusby* decisions also make clear that federal agencies conducting civil investigations, like the SEC, cannot conceal the "existence of parallel proceedings or otherwise use trickery or deceit" in order to obtain information from individuals. 2006 WL 44193, at 5. Finally, the *Stringer* decision establishes that the government sometimes must prevent conflicts of interest in the context of parallel investigations of corporate wrongdoings.

Of course, neither *Stringer* nor *Scrusby* prohibits federal agencies from conducting parallel proceedings

or from exchanging information and conferring on litigation strategies. While it remains to be seen whether the decisions will have a significant impact on the government's conduct in parallel proceedings, one potential effect of the decisions is that the DOJ may be inclined to disclose and actively pursue an investigation independent of the SEC at an earlier phase of their investigative process.

PRACTICE CONSIDERATIONS

What lessons do *Stringer* and *Scrusby* present to defense counsel representing corporations and individuals that are subject to an SEC investigation involving possible criminal wrongdoing? First, counsel should consider engaging both the SEC and DOJ in a dialogue early in the investigative process to determine whether, and to what extent, there is criminal interest in the case. The *Stringer* and *Scrusby* decisions may assist counsel in obtaining valuable information from the government in this regard, because the decisions underscore the need for government agencies conducting civil investigations to refrain from deliberately concealing the existence of a criminal investigation. The *Stringer* decision also strongly cautions counsel to discuss clearly with clients the fact that joint representation of a corporation and its individual employees in a civil enforcement proceeding may present a conflict of interest if the DOJ initiates or has initiated a criminal investigation. Most importantly, these cases serve as a warning to lawyers advising clients to provide information to the SEC because any incriminating evidence might be used against the client in a criminal case.

