

The Collateral Consequences of a Parallel Investigation, or “Excuse Me, Can I Talk to You, Please?”

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Introduction

Many litigators may find themselves defending allegations that their client violated an administrative regulatory scheme such as the Securities Exchange Act of 1934, the Clean Water Act, or the federal tax laws. Civil attorneys must consider the possibility that their



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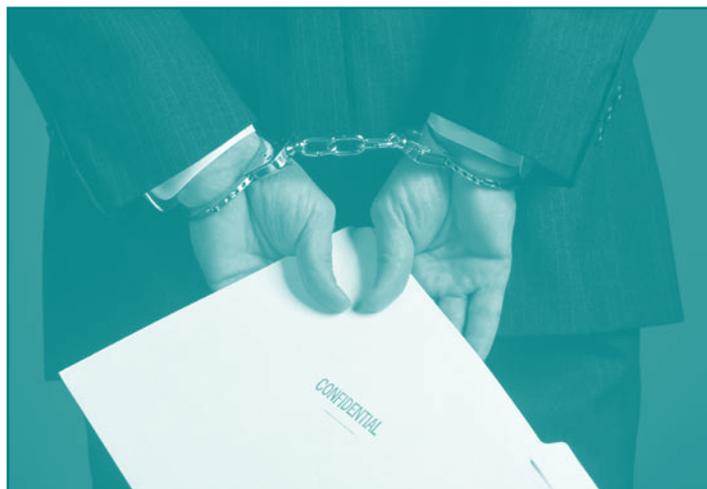
civil case may involve criminal prosecution since the administrative regulatory schemes include criminal penalties for violations of the same provisions. As a matter of public policy, certain offenses will carry an increased risk of criminal prosecution where there is evidence of falsification of data, concealment of evidence, or repeated violations by the same individual or company. And since the civil authorities can share their findings with the criminal authorities (so long as certain criteria are met), the practitioner will need to assess whether cooperation at an early stage is the imperative to avoid debarment and other serious penalties or whether the value gained by cooperation is outweighed by the risk of disclosing possibly incriminating evidence.

When representing a client under investigation for such violations, there is often a tension between the natural impulse to cooperate with authorities to avoid litigation or civil penalties

and the need to protect oneself by asserting the Fifth Amendment and other constitutional rights. To determine which approach is most advantageous, it is important to understand the risks the client faces should he choose to cooperate with civil

authorities without analyzing the ramifications of a potential simultaneous criminal investigation.

Government sources essentially define parallel proceedings as independent, simultaneous investigations, enforcement actions or prosecutions involving allegations and parties that are substantially the same.¹ For example, the Securities and Exchange Commission (“SEC”) and the Department of Justice (“DOJ”) can simultaneously investigate and prosecute violations of securities law to pursue both civil and criminal penalties. A parallel proceeding is legitimate if it is conducted in good faith.² That is to say, the civil and administrative investigation must be justified by genuine civil enforcement case purposes. Put differently, the civil discovery process may not be used as a pretext to gather information for a criminal investigation. Yet even where the civil investigation may have been



initiated for a legitimate administrative or regulatory purpose, one must look to the manner in which information is subsequently developed and shared between the two separate agencies to determine whether an otherwise proper parallel proceeding has merged into a single improper prosecution.

In the civil enforcement context alone, the stakes for the individual or corporation under investigation are high. For instance, corporations who do not cooperate may face stiffer penalties.³ The civil agency can debar individuals or entities to prevent them from receiving federal funds or from bidding on government contracts. For both individuals and corporations, this could mean the loss of livelihood. Succumbing to the coercive force of threatened government sanction, individuals may choose to cooperate fully to avoid the penalties, even though cooperation increases the risk of crimi-

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nal prosecution because the individual may (wittingly or unwittingly) disgorge incriminating evidence.

The Coordination between Civil and Criminal Authorities

Practitioners also need to be aware that it is often policy within the federal civil administrative agency to notify the criminal authorities of potential criminal activity. Some agencies will furnish the criminal authorities with pleadings and hearing summaries even before making a criminal referral.⁴ After a formal criminal referral has been made, the inter-agency coordination may even increase. For example, some civil investigators are directed to keep the United States Attorney advised on all aspects of the civil case, once a referral has been made.⁵

Significantly, any information obtained as a result of legitimate civil discovery may be—and often will be—shared with criminal enforcement agents. Indeed, federal law enforcement agencies will undertake joint investigations and collaborate when prosecuting civil and criminal violations.⁶ As EPA policy states, there is no legal bar to using administrative mechanisms for purposes of investigating suspected criminal matters, so long as the agents do not intentionally mislead a person about the possibility that information gathered will be used in the criminal enforcement context.⁷ Notably, however, in any joint investigation, “civil and criminal attorneys must each have a good faith basis for every information-gathering action taken, independent of the investigatory needs of their counterparts.”⁸

The civil authorities have expansive investigatory powers. The SEC, for example, may investigate and commence informal or formal enforcement actions. If it undertakes a formal investigation, a Formal Order of Private Investigation is required. Through this formal investigation, it has the power to compel testimony of witnesses and production of documents

from anywhere within the United States. Further, according to SEC rules, all documents and information are non-public.⁹ Yet SEC rules allow for the sharing of information with other government agencies. This rule is significant because it allows the DOJ to obtain this non-public information. Moreover, it is now common practice for the SEC to coordinate its investigation with the DOJ. SEC staff members are regularly detailed to the Justice Department to assist in criminal investigations and prosecutions of securities violations.¹⁰ Given this close cooperation between federal agencies, parallel proceedings present both the opportunity for the government to conduct efficient investigations and to abuse the investigative process if the rules are not followed.

When a government agency initiates an investigation, the penalties that the government can impose, should it decide to pursue an enforcement action, are sufficiently severe that many defendants have no choice but to yield to the demands of the staff investigators, knowing full well that any information gathered might be shared with other government agencies.¹¹ Nevertheless, no defendant who is heading toward a criminal trial wants to be unwittingly put in a position of providing testimony in a civil action that will later be used against him in the criminal case. It is important, therefore, to determine the full scope of the investigation facing the defendant before he testifies because a defendant cannot make a full knowing and voluntary waiver of his Fifth Amendment rights if he is misled about the true, dual nature of the investigation or proceeding. As one district court explained, “it is unrealistic to suppose that defendant will be on guard against incriminating himself when he is unaware that criminal proceedings are contemplated.”¹²

Although a defendant has a consti-

tutional right not to provide compelled testimony, in the civil arena, assertion of the Fifth Amendment privilege comes at a price.¹³ Indeed, the decision to take the fifth in a civil proceeding will not go unpunished. If he invokes his right to be free from providing compelled testimony in the civil action based on the uncertainty of criminal proceedings, the judge or jury is permitted to draw an adverse inference against one who refuses to testify.¹⁴ Moreover, refusing to provide evidence may potentially preclude the defendant from presenting evidence on his behalf.¹⁵ In a civil case, courts have held, the defendants cannot have it both ways. By hiding behind the protections of the Fifth Amendment as to his contentions, the defendant may give up the right to prove them.¹⁶

Outlining the Contours of Proper Parallel Proceedings

Courts that have considered the constitutional questions raised by simultaneous civil and criminal investigations or proceedings in the enforcement of federal law provide some guidance for practitioners seeking to define the contours of proper or legitimate parallel proceedings. In *United States v. Kordel*, the Supreme Court enunciated some standards for evaluating the propriety of parallel proceedings.¹⁷ Put simply, *Kordel* stated that the government cannot bring a civil action solely to obtain evidence for a criminal prosecution, adding that it may be an abuse of process should the government “fail[] to advise the defendant in its civil proceeding that it contemplates his criminal prosecution.”¹⁸ Notably, the Supreme Court acknowledged that where there are parallel proceedings, there may be “special circumstances that might suggest the unconstitutionality or even the impropriety of [the] criminal prosecution.”¹⁹ The question that remains after *Kordel* is what are those “special circumstances”?

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Significantly, at the core of the opinion in *Kordel* is the notion that the government must not act in such a manner as to subvert the “fundamental fairness” requirement of the due process clause or depart from the proper standards in the administration of justice. One component of fairness is that individuals have a right to expect candor from the government.

Lower courts examining the propriety of parallel proceedings since *Kordel* have found that it is a “flagrant disregard of individuals’ rights” to “deliberately deceive, or even lull” someone into incriminating oneself in the civil context when “activities of a criminal nature are under investigation.”²⁰ In other words, a government agent must not affirmatively mislead the defendant into believing that an investigation is exclusively civil in nature and will not lead to criminal charges.²¹ Put simply, they cannot lie about the status of an investigation.²² Government agents cross this line when they anticipate bringing criminal charges against a subject of a civil investigation, fail to advise individuals that they anticipate their criminal prosecution, and then employ a strategy to conceal the criminal investigation.²³

More specifically, when staff from the separate civil and criminal agencies (i) meet regularly, (ii) identify targets, (iii) share documents, (iv) cooperate in establishing jurisdiction for false statement cases, (v) discuss information needed for a criminal prosecution, and/or (vi) actively shield their intentions behind the guise of a civil prosecution to obtain evidence not otherwise available through criminal discovery,²⁴ the government “engages in an obnoxious form of using parallel proceedings.”²⁵ Even in those cases where the civil authorities have initiated a legitimate civil enforcement investigation, a subsequent government prosecution based on deceit or trickery concerning the existence of the criminal

proceeding is improper.²⁶

Additionally, the government may overstep its bounds when it identifies an individual as a subject or a target of the investigation, yet fails to alert him of the possibility of criminal exposure. Some will argue, however, that a standard, routine warning (given to all witnesses) alerting the defendant that his testimony may be shared with the criminal authorities is sufficient to insulate the government from any challenge as to the propriety of the two investigations. But when the defendant is the subject or target of the investigation such boilerplate warnings may be insufficient. In *United States v. Thayer*, the court found these warnings meaningless when the defendant was unaware that investigators were focusing on his conduct. In this context, “the giving of the warning can not have much significance where the defendant was, so to speak, then within the sights of the Government and did not receive an explanation of the true import of the [] inquiry.”²⁷ Put simply, the government’s failure to inform the defendant that he is a target or subject of a criminal investigation may depart from the proper standards in the administration of justice and violate defendant’s due process rights.²⁸

Practice Tips

Where the defendant faces the possibility of providing information in a civil proceeding that could later be used against him in a separate criminal case, the government is in a unique position to obtain potentially incriminating information, which it will make full use of in a criminal prosecution. Therefore, if the client’s potential for criminal exposure is significant, it may be in his best interest to invoke his right against self-incrimination. Of course, this decision must be weighed against the impact it will have on the civil matter, such as the likelihood of an adverse inference being

drawn against the defendant. The defendant, however, may choose to cooperate because of the preferential treatment he may later receive from the criminal authorities. In the criminal case, the prosecution will likely rely on “cooperating witnesses” and will, therefore, offer the best deals to those individuals who provide meaningful information early in its investigation.

Given the risks flowing from a regulatory investigation, it is incumbent on counsel to make full use of any protections available to the client who faces possible parallel proceedings. One such protection is the proffer agreement. In those cases where counsel is aware of potential criminal liability and civil authorities require that the client provide a statement and produce documents, the practitioner can try to negotiate a proffer agreement that will allow the disclosure of information while at the same time protect against the direct use of his statement as well as the “testimonial” aspect of his document production.²⁹ In essence, the government agrees to review what the client has to offer on the condition that it will not directly use the client’s statements. In the case of a document production, the government agrees that it will not use the act of production to prove that the documents were ever in the client’s possession or control. It should be noted that standard proffer agreements allow the government to use derivative evidence and permit use of the prior statement for impeachment purposes.

In summary, simultaneous civil and criminal proceedings pose problems for defendants that a single criminal prosecution does not. Separate civil and criminal government agencies can pool resources, share information, and make joint tactical decisions when investigating violations of federal law. And when done appropriately, they can do all this without compromising an individual’s

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constitutional rights. Therefore, it is up to the practitioner to be alert to the possibility of parallel proceedings and identify all the agencies who may be involved in the matter under investigation. Should the client face dual prosecution, counsel should weigh the risks and benefits of the following options: (i) contacting the criminal authorities to negotiate proffer agreements binding both the civil and criminal authorities; (ii) becoming a cooperating witness; (iii) invoking the Fifth Amendment privilege; or (iv) seeking a stay of civil discovery while the criminal case is pending. With timely knowledge of all the facts and parties involved in the proceedings, counsel can assist the client in adopting an appropriate strategy in the civil case, and if necessary, can approach the criminal authorities early to negotiate a favorable deal. □

Endnotes:

- 1 For purposes of this article, the term "parallel proceedings" refers to all stages of the government agency's case, from the dual investigations through the filing of a civil complaint or criminal indictment.
- 2 *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1374 (D.C. Cir. 1980) (en banc); *United States v. Basurto*, 497 F.2d 781, 793 (9th Cir. 1974).
- 3 See generally U.S. Dept. of Justice, Jan. 20, 2003 Memorandum from Deputy Attorney General Larry Thompson, titled "Principles of Federal Prosecution of Business Organizations."
- 4 U.S. Trustee Manual, Vol. 5: Chapter 5-13.4.2: Parallel Proceedings.
- 5 *Id.* at Chapter 5-13.4.3.
- 6 The sharing of information is not automatically a two-way street. Civil authorities are not automatically entitled to obtain grand jury materials. The civil enforcement attorneys must make an application to the court for release of the materials subject to the limitations of Federal Rule of Criminal Procedure 6(e).
- 7 U.S. Environmental Protection Agency, June 21, 1994 Memorandum from Steven A. Herman on Parallel Proceedings Policy.
- 8 Environment and Natural Resources Division, Directive 99-21, Integrated Enforcement Policy, Sec. IV(b) <<http://www.usdoj.gov/enrd/integrated.htm>>.
- 9 See SEC Rules Relating to Investigations, Rule 2.
- 10 *U.S. Securities and Exchange Commission GPR: 1999 Annual Performance Report* at 6 <<http://www.sec.gov/about/gpra1999-2000.shtml>>. The SEC staff will make the non-public information available through a formal order "granting access" to the other agency.
- 11 The SEC can fine offenders and ban them from participating in the financial services industry altogether or from serving on the board of directors of a publicly traded corporation.
- 12 *United States v. Rand*, 308 F. Supp. 1231, 1237 (N.D. Ohio 1970).
- 13 The privilege against self-incrimination is not limited to oral testimony but can also apply to requests for production of documents. An individual can invoke his Fifth Amendment privilege when compelled to turn over documents that are incriminating or that may lead to inculpatory evidence if the act of production itself implies an assertion of fact. *United States v. Hubbell*, 530 U.S. 27 (2000).
- 14 *Baxter v. Palmigiano*, 425 U.S. 308, 318 (1976); *United States v. Solano-Godines*, 120 F.3d 957, 962 (9th Cir. 1997).
- 15 *SEC v. Benson*, 657 F. Supp. 1122, 1129 (S.D. N.Y. 1987).
- 16 *Id.*
- 17 *United States v. Kordel*, 397 U.S. 1 (1970).
- 18 *Id.* at 11.
- 19 *Id.*
- 20 *United States v. Grunewald*, 987 F.2d 531, 534 (8th Cir. 1993).
- 21 *United States v. Robson*, 477 F.2d 13, 18 (9th Cir. 1973).
- 22 *SEC v. ESM Government Securities, Inc.*, 645 F.2d 310, 316 (5th Cir. 1981); *United States v. Stringer, et al.*, 408 F. Supp.2d 1083, 2006 WL 44193 (D. Or. Jan. 9, 2006).
- 23 *Stringer*, n. 22, *supra*. See also *United States v. Scrushy*, 366 F. Supp.2d 1134, 1140 (N.D. Ala. 2005).
- 24 *Id.*
- 25 *United States v. Rand*, 308 F. Supp. 1231, 1234 (N.D. Ohio 1970).
- 26 *United States v. Tweel*, 550 F.2d 297, 299 (5th Cir. 1977).
- 27 214 F. Supp. 929 (D. Colo. 1963). See *United States v. Stringer*, n. 22 *supra*, at 1088 (finding such warnings to be inadequate when the civil and criminal agencies actively conceal the existence of the criminal authorities' involvement).
- 28 *Id.* at 932-33.
- 29 See note 13, *supra*.