

BY HARLAN J. PROTASS

## Criminal, SEC Cases: Opposing Discovery Stay Petitions

**I**t's a common scenario. Your client is arrested and charged by the government with securities fraud. Simultaneously, the Securities and Exchange Commission (SEC) files civil fraud charges relating to the same conduct. Both the government and the SEC issue press releases and hold press conferences in which they thank each other for cooperating in the investigation and charging of your client.

Shortly thereafter, the government moves to stay discovery in the SEC action. And it prevails—that is, the court overseeing the SEC action grants the government's discovery stay request, favoring the criminal case over the SEC action.

But it doesn't have to be that way. In fact, defense counsel should generally consider seeking to conduct discovery in parallel SEC actions because (among other things) it provides a window into and numerous opportunities to get a headstart on defending the government's criminal case. It's also objectively fair.

As a primer for defense counsel who are inclined to oppose government discovery stay applications, this article details: (1) the bases generally relied on by the government in support of discovery stay applications and arguments in opposition; and (2) other affirmative arguments as to why courts should permit discovery in SEC actions to proceed notwithstanding parallel criminal cases.

### Government's Arguments

**Government Bases for Civil Discovery Stays and Arguments in Opposition.** The government usually asserts four arguments in support of its applications to stay discovery in SEC actions running parallel to criminal cases: (1) civil discovery makes information available to criminal defendants beyond the narrow scope of criminal discovery; (2) disclosure of the substance of testimony from potential government witnesses facilitates efforts by criminal defendants to manufacture evidence and tailor their testimony and/or defenses to conform with the government's proof; (3) civil discovery impairs the usefulness of potential government witnesses; and (4) permitting a criminal case to proceed ahead of an SEC action narrows the factual and legal questions at issue in the SEC action. Each of these arguments is vulnerable to attack.

**First**, discovery is, in fact, broader in civil actions than in criminal cases, in which, for example, depositions and interrogatories are not available. The generality of that argument, however, renders it unpersuasive



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because it can be made whenever related civil and criminal actions are proceeding simultaneously.

That contention, however, is really a screen for the government's true concern—that criminal defendants are getting some kind of "special advantage" because they would not be entitled to broad civil discovery if they were only facing criminal charges. In situations involving parallel criminal cases and SEC actions, however, defendants are not just facing criminal charges. They are also facing very serious SEC charges, and therefore are "fully entitled to the timely discovery that federal law grants them in defending such an action."<sup>1</sup>

Indeed, to the extent that lawful, relevant discovery in an SEC action "result[s] in the happenstance" that defendants obtain information helpful in defending a criminal case, "there is no cognizable harm to the government...beyond its desire to maintain a tactical advantage."<sup>2</sup> Such a "tactical advantage," however, "is not a proper basis on which a Court should determine" a motion to stay discovery.<sup>3</sup>

If the government believes that potential civil discovery is a serious problem, it easily could persuade the SEC (with which it regularly coordinates its investigations) to wait until the conclusion of its criminal case before bringing civil charges.<sup>4</sup> Simply

put, the fact that "the same circumstances—parties, dates, times, places and events—are involved in the criminal proceeding as in the civil action" should provide no support staying discovery in an SEC action.<sup>5</sup>

**Second**, the government generally asserts that disclosure of the substance of testimony of potential government witnesses facilitates efforts by criminal defendants to manufacture evidence and tailor testimony and/or defenses to conform with the government's proof. Because government stay applications are made so early in the development of a case, they are generally made without any specific support or evidence whatsoever for those claims. Absent that support or evidence, those arguments should be seen for what they are pure speculation.

**Third**, the government generally asserts that civil discovery will impair the usefulness of potential government witnesses. Once again, absent information concerning the identity of those potential government witnesses (something the government does not give) and absent specific argument and/or information as to how such discovery devices would compromise the testimony of any such potential government witness, no court is in the position to consider the question of whether depositions or interrogatories would impair the usefulness of any government witness. Indeed, if the deposition testimony of those potential government witnesses is truthful (which it presumably would be), courts contemplating government stay applications should have no concerns

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regarding the usefulness of such witnesses at any criminal trial.

**Finally**, the government generally argues that adjudication of its criminal case before an SEC action will narrow the factual and legal issues before the court hearing the SEC action. The same, however, could be said for proceeding with discovery in the SEC action. Depositions, document discovery and interrogatories likely will lead to motion practice that will similarly narrow the factual and legal issues before the court hearing the SEC action. Moreover, a concern for judicial economy actually favors civil discovery because of the uncertainty as to when the government's criminal case will conclude.<sup>6</sup> And, to the extent that an SEC action includes defendants not named as defendants in a parallel criminal case and/or asserts claims for violations of law or seeks relief (such as an injunction) not at issue in that criminal case, judicial economy also favors proceeding with civil discovery prior to the conclusion of the criminal case.

**Other Affirmative Reasons**

**Other Affirmative Reasons Courts Should Permit Criminal Cases and SEC Actions to Proceed on Parallel Tracks.** There are at least two affirmative reasons why courts should permit SEC actions and criminal cases to proceed on parallel tracks.

Initially, the government is no innocent victim of the potential civil discovery it seeks to stay. Rather, it clearly knows when it coordinates the filing of criminal charges with the SEC's civil charges that defendants will seek to defend themselves in SEC actions by conducting lawful, relevant discovery. Having deliberately created circumstances that it knows will cause defendants to seek to defend themselves, the government should not be heard to argue that defendants should be precluded from doing so. As the court in *SEC v. Saad* found in denying a government application to stay discovery in a parallel SEC proceeding:

Although applications for a stay similar to the one here made by the U.S. Attorney are not uncommon in such "parallel proceedings" situations, they are not without their bizarre aspects. It is bewildering enough that Congress has decreed that, even though someone facing the potentially ruinous financial penalties of an SEC civil complaint should be accorded substantial discovery in order to defend herself, the same defendant facing

the even more severe penalties of a criminal action should barely receive any discovery at all. *But it is stranger still that the U.S. 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.*<sup>7</sup>

Moreover, the simultaneous filing by the government and the SEC of criminal and civil charges followed almost immediately by a government request for a discovery stay in the SEC action demonstrates that the SEC "never had any intention of providing discovery in [the SEC action] but nonetheless permitted the case to proceed, thereby seeking the advantage of filing its charges without having to support them."<sup>8</sup> 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 the courts.<sup>9</sup>

Simply put, the government, having "made its own bed," should be required to "sleep in it." Or, as Judge John E. Sprizzo put it in connection with a government request to stay discovery in civil litigation arising from the criminal insider trading case against Martha Stewart:

The U.S. Attorney went out and made a public pronouncement about this case. He put it into the public media spotlight. I saw him on television back in June, giving an hour press conference.... So you live by the sword, you die by the sword.<sup>10</sup>

Additionally, the government is unable to satisfy the legal standard for a discovery stay, which involves consideration of: (1) the private interests of the plaintiff in proceeding expeditiously with the civil litigation as balanced against the prejudice to the plaintiff if delayed; (2) the private interests of and burden on the defendants; (3) the interests of the courts; (4) the interests of persons not parties to the civil litigation; and (5) the public interest.<sup>11</sup>

First, the SEC typically takes no position with regard to government discovery stay applications. After all, it coordinates its efforts with and does not want to compromise its relationship with the government. Thus, the private interests of the SEC are, at best, a neutral on this question, particularly in light of the general disfavor of discovery stays and the strong presumption that a federal action, once instituted, should proceed.

Second, the private interests of and

burden on civil defendants strongly supports denial of government stay applications. Among other things, civil defendants: (1) deserve the opportunity to defend themselves against SEC charges—particularly where the SEC undertakes (in coordination with the government) to publicize those charges; and (2) have a strong interest in timely discovery because it is likely to be more accurate than delayed discovery.<sup>12</sup>

Third, the court's interest in efficient resolution of cases pending before it favors denial of government stay applications.<sup>13</sup> Indeed, no prohibition exists against parallel civil and criminal proceedings.

Fourth, as described above, the interests of third parties (i.e., the government) do not favor discovery stays.

And, finally, the public interest strongly supports denial of government discovery stay applications. Among other things: (1) the relief generally sought by the SEC (injunctive relief and damages) is different than the relief sought by the government in criminal cases; and (2) staying civil discovery pending completion of parallel criminal proceedings could result in a lengthy delay in the resolution of the civil action.<sup>14</sup>

**Conclusion**

The government more often than not prevails in obtaining discovery stays in SEC actions running parallel to criminal cases. Indeed, defense counsel regularly does not contest those stay requests. But, to the extent that defense counsel (and their clients) are prepared to fight a two-front war, the government does not have to prevail. After all, the potential upside (a window into the government's criminal case) outweighs the downside (additional time and expense).



1. *SEC v. Saad*, 229 FRD 90, 92 (SDNY 2005).  
 2. *SEC v. Oakford Corp.*, 181 FRD 269, 272-73 (S.D.N.Y. 1998).  
 3. *Id.* at 273.  
 4. *SEC v. Sandifur*, No. C05-1631 C., 2006 WL 3692611, at \*3 (W.D. Wash. Dec. 11, 2006).  
 5. *SEC v. Grossman*, No. 87 Civ. 1031 (SWK), 1987 WL 9192, at \*2 (SDNY March 30, 1987).  
 6. *In re WorldCom, Inc. Sec. Litig.*, Nos. 02 Civ. 3288 (DLC), 02 Civ. 4816 (DLC), 2002 WL 31729501, at \*8 (SDNY Dec. 5, 2002).  
 7. *Saad*, 229 FRD at 91 (emphasis added).  
 8. *Oakford Corp.*, 181 FRD at 271.  
 9. *Id.* at 273.  
 10. "Judge Rejects DOJ's Bid to Stall Civil Suits Against Martha Stewart," *New York Lawyer*, Oct. 9, 2003.  
 11. *SEC v. Jones*, No. 04 Civ. 4385 (RWS), 2005 WL 2837462, at \*1 (SDNY Oct. 28, 2005).  
 12. *Id.* at \*2. See also *SEC v. Treadway*, No. 04 Civ. 3464 (VM) (JCF), 2005 WL 713826, at \*3 (SDNY March 30, 2005).  
 13. *Treadway*, 2005 WL 713826, at \*4 ("The Court shares with all parties an interest in the efficient resolution of the instant action") (citation and internal quotations omitted).  
 14. *Grossman*, 1987 WL 9192, at \*2.