

**COURT OF APPEALS APPROVES COVERT
COORDINATION BETWEEN SEC AND DOJ**

Violations of federal securities laws are frequently subject to both civil enforcement by the Securities and Exchange Commission (“SEC”) and criminal prosecution by the Department of Justice (“DOJ”) in simultaneous proceedings. Because the civil and criminal enforcement investigations often involve the same parties and the same conduct, the two governmental agencies regularly share information and coordinate their investigative efforts. This type of inter-agency cooperation is explicitly permitted by the federal securities laws, which give the SEC the authority to share any information it obtains during its investigation with the DOJ. Additionally, the Supreme Court and lower courts have approved so-called parallel civil and criminal investigations, as well as the use of evidence acquired in civil investigations in subsequent criminal proceedings, absent a “violation of due process or a departure from proper standards in the administration of justice.” United States v. Kordel, 397 U.S. 1, 11 (1970).

A recent Ninth Circuit opinion decided on April 4, 2008 addressed the permissibility of covert investigative coordination between the SEC and DOJ, concluding that under the facts of that case, where the two agencies covertly collaborated, there was no violation of the defendants’ rights. *United States v. Stringer*, --- F.3d---, 2008 WL 901563, at *1 (9th Cir. Apr. 4, 2008). In *Stringer*, the appellate court reversed the district court ruling, 408 F. Supp. 2d 1083 (D. Ore. 2006), and essentially gutted the district court’s reasoning in the HealthSouth case from another jurisdiction, *United States v. Scrushy*, 366 F. Supp. 2d 1134 (N.D. Ala. 2005). These district court opinions had concluded that, when the SEC and DOJ work so closely together that the two investigations effectively merge, the SEC has an affirmative duty to inform witnesses in a civil proceeding of the existing criminal investigation, and the SEC’s failure to so advise justifies both suppression of evidence obtained by the SEC in subsequent criminal prosecutions as well as dismissal of the criminal indictment.

In *Stringer*, the Ninth Circuit squarely rejected the rationale of these earlier opinions. The court held that the government’s decision “not to conduct the criminal investigation openly,” and the steps it took to keep its investigation secret, did not amount to deceit or affirmative misrepresentations and was therefore permissible. It further held that a standard four-page SEC form (known as “SEC Form 1662”) was sufficient disclosure of the “possibility that information received in the course of the civil investigation could be used for criminal proceedings.” This form is given to all testifying witnesses and routinely attached to SEC subpoenas, and serves to alert witnesses that information provided to the SEC may be shared with other governmental agencies. The form expressly advises witnesses that they may invoke their right to counsel and privilege against self-incrimination at any time.

The SEC/DOJ collaborations at issue in *Scrushy* and in *Stringer* were factually similar, and are instructive of what defendants may expect in an SEC investigation. In both cases, the DOJ i) actively concealed its interest in the SEC investigation in order to obtain evidence that it otherwise may not have been able to obtain through a criminal investigation, where witnesses

may be more reluctant to make statements; ii) requested the SEC to change the location of depositions in order to attain venue over any potential perjury prosecutions; and iii) strategized with SEC interviewers over the subject matter and form of the questions. In *Stringer*, the SEC went so far as to instruct court reporters not to mention the DOJ's involvement to defendants' attorneys and refused to directly answer defense counsel's question as to whether the SEC was "working in conjunction with any other department of the United States, such as the U.S. Attorney's Office." In neither *Scrushy* nor *Stringer* was the defendant explicitly told that he was the target of a criminal investigation.

In *Scrushy*, the district court strongly criticized the government's "cloak and dagger activities" and, in doing so, suppressed the former HealthSouth executive's SEC deposition testimony. Similarly, the lower court in *Stringer* attacked the DOJ for spending "years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections," and for failing to warn defendants of the possibility of criminal prosecution beyond presenting them with SEC Form 1662. Based on these findings, the *Stringer* court dismissed the criminal indictments against the defendants and ruled that, in the event the Ninth Circuit determined the dismissal of the indictments was in error, all evidence produced by the defendants in response to SEC subpoenas was to be suppressed.

The Ninth Circuit took a wholly different view of the government's collaboration in *Stringer*, premised upon its conclusion that the government "did not hide from the defendants the possibility—even likelihood-of [a criminal] investigation." It held that it is proper for the government to undertake simultaneous criminal and civil investigations where a standard SEC Form is provided that "fully disclose[s] the possibility that information received in the course of the civil investigation could be used for criminal proceedings." Significantly, it stated that the government is "free to make" the "decision not to conduct the criminal investigation openly." The court squarely rejected aspects of the district court opinion in *Stringer*. It rejected the district court's holding that use of the evidence provided to the SEC would violate defendants' Fifth Amendment rights against self-incrimination, finding that the standard SEC Form 1662 put defendants on sufficient notice of both the possibility of a criminal proceeding and that they had the right to refuse the SEC's request for information. Furthermore, because defendants testified without invoking their privilege against self-incrimination, they waived that privilege and forfeited any claims that use of their testimony violated the Fifth Amendment.

The Ninth Circuit also rejected any notion that the government used the civil investigation "solely to obtain evidence for a subsequent criminal prosecution," in violation of the Due Process Clause of the Fifth Amendment. It concluded that because "the SEC began its civil investigation first and brought in the U.S. Attorney later," it is unlikely that "the government began the civil investigation in bad faith," and it "must conclude the SEC interviewed the defendants in support of a bona fide civil investigation." Finally, the Ninth Circuit also rejected the district court's holding that the government engaged in "trickery and deceit" in order to lull the defendants into turning over incriminating evidence, finding instead that that the SEC's response to defense counsel about whether *Stringer* was a target of a criminal investigation was not false or misleading, and that the SEC's request that the court reporters not mention the DOJ's involvement at most "indicates an intent to prevent disclosure to defendants of the actual criminal investigation."

In short, the Ninth Circuit's decision approves of the DOJ directing an SEC investigation and condones the DOJ and SEC collaborating "to prevent the disclosure to defendants of the actual criminal investigation." Although the Ninth Circuit's reversal of *Stringer* did not technically overturn the *Scrushy* decision because *Scrushy* arose outside of the Ninth Circuit's jurisdiction, the reversal equally erodes the rationale of the *Scrushy* court. In practice, the Ninth Circuit's reversal will make it exceedingly difficult, if not impossible, to successfully make the arguments first accepted by the *Scrushy* and *Stringer* district courts. That is not to say that defendants caught between SEC and DOJ parallel proceedings are left without any ability to challenge the coordination. However, the arguments they advance will have to be made under narrower and more egregious facts than existed in *Stringer* and *Scrushy*, for example, where the criminal investigation was started before the civil one, and the civil investigation was initiated only as a guise for criminal discovery.

The practical implications of the Ninth Circuit's decision are therefore significant. One must assume that where an individual is being investigated by the SEC, he is also being investigated by the DOJ, even if the DOJ is not noticeably present. Such awareness will allow clients to make informed decisions about whether to provide testimony to the SEC and whether and in what detail to lay out their defenses in written submissions to the SEC.

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