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CRIME

Can SEC/DOJ Cooperation Ever Cross the Line?: What Is Left Of *U.S. v. Scrushy* in the Wake of the Ninth Circuit's Reversal of *U.S. v. Stringer*

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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 Securities Act of 1933 and the Securities Exchange Act of 1934, which give the SEC the authority to share any information it obtains during its investigation with the DOJ.[1]

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While parallel civil and criminal proceedings may facilitate the quick resolution of allegations against the accused, in practice, the symbiotic relationship between the SEC and the DOJ has the potential to trap the unwary. For example, it potentially allows federal prosecutors to obtain statements from witnesses who may not have made them had they known they were under criminal investigation. It may also allow prosecutors to learn the basis of the defendant's criminal defenses by receiving a copy of written submissions made to the SEC by individuals unaware that they were in criminal peril.

Parallel civil and criminal investigations, as well as the use of evidence acquired in those civil investigations in subsequent criminal proceedings, have been sanctioned by the U.S. Supreme Court and lower courts, absent a "violation of due process or a departure from

[1] *See* Securities Act of 1933 § 20(b), 15 U.S.C. § 77t(b) (2008) ("The Commission may transmit such evidence as may be available concerning [an apparent violation of the Act] to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter."); Securities Act of 1934 § 21(e), 15 U.S.C. § 78u(d) (2008) (same).

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proper standards in the administration of justice.''[2] The problem becomes determining when a violation of due process or a departure from proper standards in the administration of justice exists. The Supreme Court has had only one occasion to address this issue. Though it provided general examples of when bad faith in parallel proceedings could exist, it did not offer guidance on when, if ever, inter-agency cooperation during parallel investigations becomes so intertwined as to cross the due process line or to depart from the administration of justice. The contours of this jurisprudence are nebulous and have been left for district courts to navigate on a case-by-case basis.

Extensive inter-agency cooperation in parallel investigations was found to constitute bad faith in two cases, *United States v. Scrushy* [3] and *United States v. Stringer*.[4] *Scrushy* and *Stringer* both involved the DOJ directing parts of the SEC investigation for the benefit of its criminal prosecution while taking steps to keep its own investigation confidential. The district court judges in *Scrushy* and *Stringer* did not tolerate this conduct. They held 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 an existing criminal investigation, beyond handing out a standard SEC form that states this could occur.[5] And, the decision not to divulge this information can be so violative of a defendant's constitutional rights that it justifies suppression in subsequent criminal prosecutions of evidence obtained by the SEC and, as held in *Stringer*, even dismissal of the criminal indictment.

Scrushy was never appealed. *Stringer* was and, on April 4, 2008, the Ninth Circuit reversed and remanded *Stringer*, holding that neither the government's decision to ''not conduct the criminal investigation openly,'' nor the steps it took to achieve this, amounted to deceit or affirmative misrepresentations regarding the nature of the investigation. It also held that SEC Form 1662 provided to defendants was sufficient disclosure of the ''possibility that information received in the course of the civil investigation could be used for criminal proceedings.''[6]

This begs the question of what, if anything, is left of *Scrushy* in the wake of the *Stringer* reversal.

Case Law Leading to *Scrushy* and *Stringer*. The Supreme Court has provided some guidance on when the government abuses its authority to conduct parallel proceedings in violation of the right to due process. In the context of explaining why the facts of the case before it did not constitute a ''violation of due process or a departure from proper standards in the administration of justice,'' the Court stated:

> We do not deal here with a case where the Government has brought a civil action solely to obtain evidence for its criminal prosecution or has failed to advise the defendant in its civil proceeding that it contemplates his criminal prosecution . . . nor with any other special circumstances that might suggest the unconstitutionality or even the impropriety of this criminal prosecution.[7]

In the absence of these circumstances, the Supreme Court has found that parallel civil and criminal proceedings are necessary for the public interest.[8] The District of Columbia Circuit reiterated the Supreme Court's recognition of the need for the government's pursuit of parallel proceedings a decade later, holding ''[i]n the absence of substantial prejudice to the rights of the parties involved, such parallel proceedings are unobjectionable under our jurisprudence.''[9]

Other district courts which have suppressed evidence or dismissed indictments on due process grounds did so where district courts found the government obtained evidence by making false statements to a witness, and when the SEC conducted civil discovery solely as a tool to expand the DOJ's access to incriminating evidence against a particular defendant.[10]

U.S. v. Scrushy. In *Scrushy*, a district court in the Northern District of Alabama suppressed defendant Richard Scrushy's deposition testimony given in a SEC civil investigation, holding it could not be used in the criminal case against him because Scrushy was not made aware of the DOJ's involvement in the SEC investigation nor of the likelihood of criminal prosecution. The SEC's and DOJ's extensive, and furtive, cooperation involved the following: the DOJ asked SEC Senior Accountant Neil Seiden to participate with SEC investigators in the interviews and instructed Seiden on which questions to ask and which subjects to avoid during Scrushy's deposition.[11] Furthermore, though the SEC planned to depose Mr. Scrushy in Atlanta, the DOJ also requested that the venue of Scrushy's deposition be

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[2] *United States v. Kordel*, 397 U.S. 1, 11 (1970). *See also SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1374 (D.C. Cir. 1980).

[3] 366 F. Supp. 2d 1134 (N.D. Ala. 2005).

[4] 408 F. Supp. 2d 1083 (D. Or. 2006), vacated in part, rev'd in part, —- F.3d ——, 2008 WL 901563, at *1 (9th Cir. Apr. 4, 2008).

[5] SEC Form 1662 is a standard four-page form given to all testifying witnesses, alerting them to the fact that information provided to the SEC may be shared with other governmental agencies, such as the DOJ, and that they may invoke their right to counsel and privilege against self-incrimination at any time. This form is routinely attached to SEC subpoenas. A copy of this form may be obtained at http://www.sec.gov/about/forms/sec1662.pdf.

[6] *United States v. Stringer*, —- F.3d ——, 2008 WL 901563, at *1 (9th Cir. Apr. 4, 2008).

[7] *Kordel*, 397 U.S. at 11-12.

[8] *Id.* at 11.

[9] *Dresser*, 628 F.2d at 1374.

[10] *See, e.g., United States v. Rand*, 308 F. Supp. 1231, 1236-37 (N.D. Ohio 1970); *United States v. Carriles*, 486 F. Supp. 2d 599, 615, 619 (W.D. Tex. 2007).

[11] *See Scrushy*, 366 F. Supp. 2d at 1136, 1138-39.

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changed so that Seiden could be present.[12] The district court found the DOJ also requested this change in order to ensure that it would have venue over any possible perjury charges.[13]

The practical implications of the Ninth Circuit's decision are 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.

The district court cited the general rule that '' 'the prosecution may use evidence acquired in a civil action in a subsequent criminal proceeding unless the defendant demonstrates that such use would violate his constitutional rights or depart from the proper administration of criminal justice.' ''[14] In evaluating whether the government's actions departed from the proper administration of criminal justice, the district court considered the prejudice to a defendant testifying in a civil proceeding who does not know that that information can be used against him in a criminal case.[15] Here, the district court determined that:

> Failing to advise Mr. Scrushy or his attorneys about the criminal investigation of which he was a target, and that the deposition had been moved to accommodate the need of the U.S. Attorney's office to bring into the criminal investigation one of the very S.E.C. investigators who was questioning Mr. Scrushy, *and* the change of the deposition's location for venue purposes cannot be said to be in keeping with the proper administration of justice. Our justice system cannot function properly in the face of such cloak and dagger activities by those charged with upholding the integrity of the justice system.[16]

The district court rejected the government's argument that it did not act in ''bad faith'' because it did not make any affirmative misstatements about the existence of the criminal investigation.[17] The district court found it was enough that the government concealed that the SEC civil investigation had become ''inescapably intertwined with the criminal investigation'' and had ''manipulated the simultaneous [criminal and civil] investigations for its own purposes.''[18] Thus, Scrushy's testimony secured during the SEC deposition had to be suppressed.[19]

U.S. v. Stringer. In *Stringer*, a district court in the District of Oregon dismissed criminal indictments against three defendants charged with criminal securities law violations, and, in the event that the Ninth Circuit determined the dismissal of the indictments was in error, suppressed all evidence produced by the defendants in response to SEC subpoenas, holding that the government had abused its authority to conduct parallel proceedings in violation of the due process clause.[20]

The facts of the case are as follows: After the SEC began its civil fraud investigation, the DOJ determined it would likely prosecute Kenneth Stringer III and other targets for criminal securities law violations.[21] Instead of conducting an overt criminal investigation or initiating a criminal proceeding, the DOJ strategized that it would be better to let the SEC draw as much evidence as possible from the defendants before letting its presence be known.[22] However, the DOJ did not simply review the documents turned over to it by the SEC, but actively involved itself in the SEC investigation, regularly discussing investigative strategy with the SEC, advising the SEC on the type of information needed for a successful criminal prosecution, instructing the SEC how to take deposition testimony to create the best possible record for a criminal false statements case, and directing the location of SEC interviews for venue purposes.[23]

Fearing that the targets' knowledge of the DOJ's intention to bring criminal charges would stay the SEC action and deter the parties from reaching settlement, the two agencies determined that the DOJ's presence should be ''suppressed'' and the SEC actively concealed the fact that it was working with the DOJ.[24] It did so by instructing court reporters not to mention the DOJ's involvement to defendants' attorneys and asking one prosecutor to avoid being near SEC interviews.[25] When Stringer's attorney directly asked whether the SEC was ''working in conjunction with any other department of the United States, such as the U.S. Attorney's Office,'' the SEC investigator responded in a manner the district court found to be ''evasive and misleading,'' stating that it was against SEC policy to comment, and referred the attorney to SEC Form 1662.[26] The agencies determined that when the DOJ would finally '' 'surface,' '' or convene a grand jury and issue indictments, it would do so with '' 'no notice.' ''[27]

Defendants ultimately testified before the SEC, and later argued that their due process rights were violated

[12] *See id.* at 1138-40.
[13] *See id.*
[14] *Id.* at 1138 (citing *United States v. Teyibo*, 877 F. Supp. 846, 855 (S.D.N.Y. 1995) (citing *United States v. Unruh*, 855 F.2d 1363, 1374 (9th Cir. 1987) (citing *Kordel*, 397 U.S. at 12-13))).
[15] *See id.* at 1139-40.
[16] *Id.* (emphasis in original).
[17] *See id.* at 1140.
[18] *Id.*
[19] *See id.*
[20] *See Stringer*, 408 F. Supp. 2d at 1089-90.
[21] *See id.* at 1085, 1088.
[22] *See id.* at 1085.
[23] *See id.* at 1086, 1088.
[24] *See id.* at 1086.
[25] *See id.* at 1086-87, 1089.
[26] *Id.* at 1087, 1089.
[27] *Id.* at 1086 (internal citations omitted).

Note to Readers

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because they were not advised that the DOJ was using the SEC to gather information for a criminal prosecution.[28] The government argued that parallel proceedings are acceptable and that SEC Form 1662, given to defendants, provided adequate notice of the possible use of their testimony in a criminal prosecution.[29]

The district court found that these were not parallel proceedings, nor did the government intend them to be.[30] On the contrary, the district court found that the DOJ made a strategic choice to ''spen[d] years hiding behind the civil investigation to obtain evidence, avoid criminal discovery rules, and avoid constitutional protections,'' rather than ''conduct a parallel criminal investigation.''[31] As the government failed to advise the defendants that it anticipated their criminal prosecution, the district court found the active, covert role the DOJ played in the SEC investigation to be ''an abuse of the investigative process.''[32] On these facts, the district court concluded that the case ''clearly falls within the scenario contemplated by the Supreme Court as a 'violation of due process or a departure from proper standards in the administration of justice.' ''[33]

The district court further found that dismissal or suppression of the voluntary testimony is appropriate where the government engages in deceit, trickery or intentional misrepresentation.[34] Referencing the instructions to the court reporters, instructions to the prosecutor to avoid being near SEC interviews, and the SEC investigator's evasive answer, the district court concluded the government ''engaged in deceit and trickery to keep the criminal investigation concealed,'' justifying dismissal and suppression.[35]

The district court further held that defendants' failures to invoke their Fifth Amendment privilege against self-incrimination in the civil investigation could not constitute a waiver of this privilege because the defendants were not made aware of the DOJ's involvement.[36] The district court therefore held that the use of evidence obtained by the SEC during its civil investigation in the subsequent criminal investigation would violate the defendants' Fifth Amendment right against self-incrimination.[37]

In the end, the district court found the government's actions to be '' 'so grossly shocking and so outrageous as to violate the universal sense of justice,' '' that the extreme sanction of dismissal of the indictment was appropriate.[38]

The Ninth Circuit did not agree.

The Ninth Circuit's Reversal of *Stringer*. In a ruling on April 4, 2008, the Ninth Circuit showed judicial tolerance for the government's conduct in *Stringer*, matter-of-factly holding that ''[t]here is nothing improper about the government undertaking simultaneous criminal and civil investigations,'' that providing SEC Form 1662 ''fully disclosed the possibility that information received in the course of the civil investigation could be used for criminal proceedings,'' and that the government was ''free to make'' the ''decision not to conduct the criminal investigation openly.''[39]

The Ninth Circuit first rejected the district court's holding that use of the evidence provided to the SEC would violate defendants' Fifth Amendment right against self-incrimination. It reasoned that SEC Form 1662 put defendants on sufficient notice of both the criminal proceeding and their right to refuse the SEC's request for information.[40] Because defendants testified without invoking this privilege, they waived it and forfeited any claims that use of their testimony violates the Fifth Amendment.[41]

The Ninth Circuit then went on to reject the district court's holding that the government's conduct in the parallel investigations violated the Fifth Amendment's Due Process Clause. The Ninth Circuit couched the issue as whether ''the district court properly concluded that the government used the civil investigation solely to obtain evidence for a subsequent criminal prosecution, in violation of due process.''[42] 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.''[43] Thus, there was no violation of due process.

Finally, the Ninth Circuit 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.[44] The appellate court first noted that the government had not made any affirmative misrepresentation or ''furnished defendants with any false information concerning the existence of a criminal investigation.''[45] To the contrary, the Ninth Circuit pointed out that the SEC had advised the defendants of the possibility of a criminal prosecution via SEC Form 1662.[46] Additionally, the Ninth Circuit did not find the facts on which the district court relied to amount to affirmative misrepresentations. First, the appellate court did not find the SEC investigator's response to defendant's attorney to be false or misleading.[47] Further, it reasoned the SEC's request that the court reporters not mention the DOJ's involvement to defendants' attorneys at most ''indicates an intent to prevent disclosure to defendants of the actual criminal investigation.''[48] Given that the defendants and their attorneys ''should have . . . known'' of the possibility of criminal investigation, the appellate court reasoned that the request to the court reporters ''did not mislead or misinform defendants about the existence of an investigation.''[49]

Ultimately, because the Ninth Circuit was satisfied that the government ''did not hide from the defendants

[28] *See id.* at 1087.
[29] *See id.*
[30] *See id.* at 1087-88.
[31] *Id.* at 1089, 1088.
[32] *Id.* at 1088.
[33] *Id.* (quoting *Kordel*, 397 U.S. at 11).
[34] *See id.* at 1089.
[35] *Id.* at 1089-90.
[36] *See id.*
[37] *See id.* at 1090.
[38] *Id.* at 1089 (quoting *United States v. Smith*, 924 F.2d 889, 897 (9th Cir. 1991)).
[39] *Stringer*, 2008 WL 901563, at *1.
[40] *See id.* at *7.
[41] *Id.*
[42] *Id.*
[43] *Id.* at *8.
[44] *Id.* at *8-9.
[45] *Id.* at *4.
[46] *See id.* at *9.
[47] *See id.* at *10.
[48] *Id.*
[49] *Id.*

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the possibility—even likelihood—of [a criminal] investigation,'' it sanctioned both the DOJ's enmeshment with the SEC's investigation as well as the DOJ's and the SEC's joint ''intent to prevent disclosure to defendants of the actual criminal investigation.''[50]

What Is Left of *Scrushy* in the Wake of the *Stringer* Reversal? The district court opinions in *Scrushy* and *Stringer* both stand for similar principles of law: that bad faith encompasses situations where SEC/DOJ cooperation amounts to a single investigation—for example, where the DOJ directs or otherwise manipulates the SEC's investigation for its own purposes, that when such bad faith occurs, the government has an obligation to inform witnesses that they will likely be prosecuted, and that SEC Form 1662 is insufficient to reveal this cooperation to the witness.

The Ninth Circuit's reversal of *Stringer* effectively overturns these principles. It indicates that: 1) it will not be considered bad faith for the government to use the SEC civil investigation as a stalking horse to obtain information for its criminal prosecution while conducting its own clandestine investigation, as long as the government does not engage in outright deceit or fail to convey the possibility of criminal prosecution to defendants via something akin to SEC Form 1662; 2) SEC Form 1662 is sufficient to provide notice of the possibility of criminal prosecution from defendants, regardless of whether the government takes drastic measures to keep the criminal investigation confidential; and 3) if the civil investigation is commenced before the criminal investigation, no measure of DOJ involvement with the SEC investigation will amount to a finding that the civil investigation was commenced solely to obtain evidence for a criminal prosecution.

Although the Ninth Circuit's reversal of the *Stringer* decision did not technically overturn the *Scrushy* decision, as they are in different jurisdictions, in practice, *Stringer*'s reversal will make it more difficult, if not impossible, to raise *Scrushy*-like arguments outside the Ninth Circuit. This is because the government's conduct in *Scrushy* was not sufficiently different or more egregious than its conduct in *Stringer*. Both cases involved extensive DOJ interference with the SEC's enforcement action, such as the DOJ changing the location of SEC depositions in order to attain jurisdiction over potential perjury prosecutions, actively hiding behind the SEC to ensure its presence was not known, and strategizing with SEC interviewers about how they asked questions. Thus, in the end, it is unlikely there is anything factually distinct about *Scrushy* that would salvage it from the wake of *Stringer*'s reversal.

What is Left for White Collar Practitioners to Argue in the Face of Newly-Sanctioned Enmeshed Parallel Proceedings? Assuming that the Ninth Circuit's decision effectively overruled *Scrushy*, there are still arguments that can be made on behalf of defendants caught in between parallel proceedings. However, these arguments will have to be made under narrower and more egregious facts than existed in *Scrushy*. Defendants can still seek to attack their indictments or suppress their SEC testimony where: 1) the SEC deceived a defendant into believing that a criminal investigation was not going to be conducted;[51] 2) the defendant was not provided with SEC Form 1662 (which is an unlikely scenario because it is standard SEC practice to furnish this document) or any standard warning at the beginning of the SEC deposition testimony; or 3) the criminal investigation was started before the civil investigation and the civil investigation was initiated as a guise for criminal discovery.

The practical implications of the Ninth Circuit's decision are 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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[50] *Id.* at *3, 10.

[51] On this point, it would be good practice for white collar practitioners to make it a point to routinely ask the SEC whether a criminal investigation is actually occurring or likely to occur. To the extent that the SEC denies this, an affirmative concealment/deceit argument can be crafted and is likely to obtain results.