

Outside Counsel

Expert Analysis

The Perils of Partial Stays In Parallel Proceedings

After much reluctance, Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York recently adjourned the SEC trial against the *Galleon* defendants for alleged insider trading.¹ Although no party opposed the U.S. Attorney's Office motion to adjourn the SEC trial, Judge Rakoff balked at such an adjournment because of the "strong public interest in having cases of this kind move forward promptly."² What tipped the balance toward adjournment was an order by the U.S. Court of Appeals for the Second Circuit staying another Judge Rakoff order which directed certain defendants to turn over to the SEC wiretap recordings produced to the defendants in the parallel criminal action.

That the Second Circuit not only agreed to hear an interlocutory appeal on a discovery issue, but then imposed a stay of a discovery order, is rare. The *Galleon* case highlights the types of unique issues that may arise in the future as courts become more willing to craft alternatives to complete stays of discovery in parallel civil actions. These types of complicated issues arising from partial stays are more likely to occur in the future in light of the Department of Justice's new stated policy of not seeking to stay parallel SEC actions.³

The Perils

Parallel civil and criminal proceedings present challenges to defendants and prosecutors alike.

Defendants litigating parallel civil and criminal actions face not only the financial burden of defending criminal and civil actions simultaneously, but also the Hobson's choice of either (a) waiving the Fifth Amendment privilege and risking self-incrimination, or (b) asserting the Fifth Amendment privilege and facing a host of adverse consequences.⁴

Prosecutors are primarily concerned that defendants may impair their criminal case by using broad civil discovery to obtain evidence to which they would not otherwise have timely access.

Both sides can also achieve tactical advantages to going forward with at least some discovery. Prosecutors, through cooperation with the SEC, can use civil proceedings to receive advance notice of a defendant's strategy and testimony. Defendants can use broader civil discovery to obtain evidence

DONALD A. CORBETT is a partner in *Dickstein Shapiro's securities—litigation, regulatory, and compliance—practice.* ELLIOTT Z. STEIN is an associate in the firm's *white collar litigation practice.* Both are resident in the New York office.



By
**Donald A.
Corbett**



And
**Elliott Z.
Stein**

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The 'Galleon' Cases

In *Galleon*, the USAO requested that depositions of cooperators and defendants in the SEC action be stayed until after the completion of the criminal trial against many of the same defendants. Neither the SEC nor the defendants objected to the USAO's request for a limited stay

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of discovery, and Judge Rakoff ordered a stay of all but document discovery pending his decision on adjourning the SEC trial, which the USAO had also requested.

But allowing document discovery to proceed in the SEC action resulted in a unique discovery dispute surrounding the wiretaps produced to defendants in the criminal case. In an unusual twist, the SEC sought to obtain via civil discovery evidence produced in the criminal action. Rejecting defendants' objection to the SEC request, Judge Rakoff ordered the defendants to produce the wiretaps to the SEC.⁵ Defendants filed an interlocutory appeal of that order to the Second Circuit.

Although rare for the Court of Appeals to hear interlocutory appeals—let alone on discovery issues—the Second Circuit agreed to hear the defendants' appeal of Judge Rakoff's order. Rarer still, the Second Circuit stayed Judge Rakoff's order pending appeal.⁶ It was that stay which, for Judge Rakoff, ultimately tipped the balance towards

adjourning the SEC trial.

The *Galleon* case serves as a reminder that allowing non-deposition discovery to proceed carries its own set of risks. The *Galleon* investigation is notable for its extensive use of wiretap recordings, a law enforcement tool usually reserved for organized crime, drug, and terrorism cases. Following the arrests of the *Galleon* defendants, the government declared that it intends on using wiretaps and other electronic surveillance more frequently in white collar cases.⁷ As the use of electronic surveillance becomes more commonplace in white collar investigations, one should expect to see similar discovery issues as that in *Galleon* arise again in the context of parallel proceedings.

Factors Courts Consider

Courts have discretion to stay civil proceedings in the interests of justice. The factors courts typically consider when deciding whether to stay a civil case in light of the parallel criminal proceeding are: (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's interests.⁸

As Judge Rakoff has noted, the basic goal is to avoid prejudice to the parties, and the determination ultimately reduces to balancing the private parties' interest in a prompt resolution of the civil action with the government's interest in preserving the integrity of the criminal proceeding.⁹

As an alternative to staying an entire civil proceeding, courts can impose more limited relief, including ordering partial stays. One form of partial stay that a court can order is to allow document discovery to proceed but to stay depositions and interrogatories until the resolution of the criminal proceeding. This is what the court did in *Galleon*.

Alternatively, a court can grant a partial stay as to indicted defendants while allowing discovery to proceed against unindicted defendants.¹⁰ A court can also grant a partial stay as to certain unindicted defendants while allowing discovery to proceed against certain other unindicted defendants.¹¹ One court found that a partial stay—at least as to a central figure in the civil case—was inequitable to other parties and stayed the entire case.¹² A court can also allow discovery to proceed subject to particular objections by the USAO.¹³

Private Interests and Burden on the Plaintiff. In a parallel civil litigation between two private parties, the interests of the parties are typically at odds—the private civil plaintiff usually advocates moving forward whereas the defendant usually seeks some form of stay. If the plaintiff faces undue delay in being able to advance its case, the court is less likely to stay the civil case.¹⁴

In contrast, when the plaintiff in the parallel proceeding is the SEC—as in *Galleon*—the SEC historically could be counted on to support the USAO's position.

Private Interests of and Burden on the Defendants. Generally, in a parallel civil litigation where the plaintiff is a government agency, courts are more likely to find that the defendant is burdened, and are therefore more likely to stay the civil case.¹⁵ However, Judge Rakoff, has noted the strangeness of the USAO requesting a stay of a parallel SEC action despite the USAO “having closely coordinated with the SEC in bringing simultaneous civil and criminal actions against some hapless defendant,” and denied the USAO's motion for a complete stay of discovery in a parallel SEC proceeding.¹⁶

Courts are also more willing to stay the civil action if there is substantial overlap between the issues in the criminal case with those in the civil case, because self-incrimination is a more likely risk if there is a significant overlap. But complete overlap between the issues is not necessary for a stay.¹⁷

Interests of the Courts. A court can often maximize its judicial efficiency by staying the civil case, at least in part. For example, the conviction of a defendant can significantly narrow the issues in dispute in the overlapping civil case. Even in the event of an acquittal, staying the civil action can streamline later civil discovery because transcripts from the criminal case will be available to the civil parties. In the absence of a stay, a court can get bogged down by having to make numerous rulings concerning Fifth Amendment privileges.¹⁸

In proposing that the *Galleon* criminal trial precede the SEC trial, the USAO argued that “while the outcome of the parallel civil trial can do nothing to resolve the issues to be tried in the criminal case, the outcome of the criminal trial can determine or significantly narrow the issues in the civil case, where non-mutual collateral estoppel would apply if the defendants are convicted.”¹⁹

Interests of Persons Not Parties to the Civil Litigation. There are important differences in the discovery available to defendants in civil proceedings and criminal proceedings. Generally, a defendant in a criminal action is entitled to less discovery than is available in a civil action. For example, under the Jencks Act, the government need not produce statements of a government witness or prospective government witness until after the witness has testified on direct examination at trial.²⁰ Furthermore, depositions are rarely available in a criminal proceeding.²¹

Given these differences in discovery obligations, prosecutors—as they did in *Galleon*—often seek stays of discovery in parallel civil actions to prevent defendants from expanding the scope of discovery available to them in the criminal case.

But to obtain such a stay prosecutors may have to do more than merely claim that defendants will gain some sort of tactical advantage by obtaining discovery earlier than they normally would under

the Federal Rules of Criminal Procedure.²² The often stated intent behind the limits on criminal discovery is to safeguard against: (1) tailoring of testimony; (2) intimidation of witnesses; and (3) unfair surprise by defendants at trial with information developed through discovery, while using the privilege against self-incrimination to block the government's efforts to obtain discovery.²³

Some courts have required the government to provide specific evidence of witness intimidation or manufacturing of evidence in the particular case at issue before staying discovery, particularly in white collar cases where the government often produces witness statements in advance, albeit close to the eve, of trial.²⁴

In the absence of an indictment, there is a less compelling argument for requesting a stay of civil discovery. Nevertheless, issuing such a stay is within the court's power.²⁵

Public's Interests. The public has a strong interest in the prosecution of criminal cases. As a result, courts are more willing to stay a civil case if

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the U.S. Attorney's Office is seeking the stay.²⁶

On the other hand, the public has an interest also in the prompt resolution of civil claims, particularly in securities-related litigation.²⁷ In *Galleon*, Judge Rakoff noted “the strong public interest in having cases of this kind move forward promptly.”²⁸

Conclusion

Parallel proceedings present complicated issues because of the number of parties and non-parties with competing interests. As evident from the discussion above, there are a number of factors a court will consider when deciding whether to stay a parallel civil action, as well as a variety of remedies a court can fashion. But, as the *Galleon* case shows, even a partial stay designed to safeguard a defendant's Fifth Amendment rights may run into its own set of problems.

1. SEC v. *Galleon Mgmt., LP*, No. 09 Civ. 08811(JSR), Order (SDNY March 24, 2010).
2. *Id.*

3. Jonathan Stempel, “U.S. Top Cop: SEC to No Longer Delay Civil Cases,” May 4, 2010 (quoting Assistant Attorney General Lanny Breuer: “[j]ust because there's a civil action... and a parallel criminal action, the days are gone where the civil action will necessarily be stayed until the criminal action is over”).

4. *Baxter v. Palmigiano*, 425 U.S. 308 (1976) (defendants asserting their Fifth Amendment rights in a civil action risk having the jury draw an adverse inference from that assertion).

5. *Galleon*, No. 09 Civ. 08811(JSR), Memorandum Order (SDNY Feb. 9, 2010).

6. SEC v. *Galleon Mgmt., LP*, No. 10-0462-cv (Lead) (2d Cir. March 24, 2010) (order granting stay pending appeal).

7. DOJ Press Release, Manhattan U.S. Attorney Charges Hedge Fund Managers, Fortune 500 Executives, and

Management Consulting Director in \$20 Million Insider Trading Case, available at <http://www.justice.gov/usao/nys/pressreleases/October09/hedgefundinsidertradingpr.pdf> (Oct. 16, 2009) (“Today, tomorrow, next week, the week after, privileged Wall Street insiders who are considering breaking the law will have to ask themselves one important question: Is law enforcement listening?”).

8. SEC v. *Jones*, 2005 WL 2837462 (SDNY Oct. 28, 2005). These factors are presented in different iterations by different courts. SEC v. *Treadway*, 2005 WL 713826 (SDNY March 30, 2005).

9. SEC v. *Saad*, 384 F.Supp.2d 692 (SDNY 2005).

10. *In re WorldCom Inc. Sec. Litig.*, 2002 WL 31729501 (SDNY Dec. 5, 2002).

11. SEC v. *Credit Bancorp, Ltd.*, 129 F.Supp.2d 263 (SDNY 2001).

12. SEC v. *Downe*, 1993 WL 22126 (SDNY Jan. 26, 1993).

13. SEC v. *Cioffi*, 2008 WL 4693320 (EDNY Oct. 23, 2008) (“The far more sensible approach is to allow discovery to go forward, but to allow the U.S. Attorney to object to particular requests”).

14. Compare *Trustees of Plumbers Pipefitters Nat'l Pension Fund v. Transworld Mech. Inc.*, 886 F.Supp. 1134 (SDNY 1995) (granting motion to stay because “the prejudice to the plaintiffs in the civil case is reduced since the criminal case will likely be quickly resolved due to Speedy Trial Act considerations”), with *In re Gaming Lottery Sec. Litig.*, 2000 WL 322951 (SDNY March 28, 2000) (denying motion for stay because “[t]his case is a four years old class action...and...many plaintiffs will be prejudiced if it should not proceed to trial”).

15. Compare SEC v. *HealthSouth Corp.*, 261 F.Supp.2d 1298 (N.D. Ala. 2003) (staying civil proceeding because “this is a case where the government has undoubtedly manipulated simultaneous criminal and civil proceedings, both of which it controls”), with *In re Anicom Inc. Sec. Litig.*, 2002 WL 31496212 (N.D. Ill. Nov. 8, 2002) (denying defendant's motion to stay because “the civil action was not brought by the government”).

16. *Saad*, 229 F.R.D. 90 (SDNY 2005).

17. *Treadway*, 2005 WL 713826 (“While...there are clear legal distinctions, there is nevertheless significant factual overlap” tipping in favor of granting a stay).

18. *Saad*, 229 F.R.D. at 91 (“[T]here is a high likelihood that invocations of the Fifth Amendment privilege will play havoc with the orderly conduct of all...of these depositions”).

19. *United States v. Rajaratnam*, 09 Cr. 1184(RJH), Government's Status Report (SDNY Feb. 16, 2010).

20. 18 USC §3500.

21. Fed. R. Crim. P. 15(a).

22. SEC v. *Oakford Corp.*, 181 F.R.D. 269 (SDNY 1998) (“there is no cognizable harm to the government in providing such discovery beyond its desire to maintain a tactical advantage”).

23. SEC v. *Cuti*, No. 08 Civ. 08648(JGK), Hearing Tr. at 8, 54 (SDNY Jan. 20, 2009); *Cioffi*, 2008 WL 4693320; *WorldCom*, 2002 WL 31729501 (observing that U.S. Attorney “has a significant interest in preserving the usefulness of cooperating defendants as Government witnesses”).

24. SEC v. *Chakrapani*, Nos. 09 Civ. 325, 09 Civ. 1043, Hearing Tr. at 26-28 (SDNY July 29, 2009); *Saad*, 229 F.R.D. at 92 (the U.S. Attorney's argument “thus reduces to the near-frivolous position that, in some wholly speculative way, it would be prejudiced by having the SEC give these notes to the defendants a month or two sooner than they would otherwise receive them”).

25. SEC v. *Beacon Hill Asset Mgmt., LLC*, 2003 WL 554618 (SDNY Feb. 27, 2003) (granting discovery stay pending completion of grand jury investigation); *Downe*, 1993 WL 22126 (granting pre-indictment stay of all discovery).

26. *Downe*, 1993 WL 22126 (“The Court finds the argument presented by the United States Attorney to be compelling under the circumstances of the instant case.”); *In re Ivan F. Boesky Sec. Litig.*, 128 F.R.D. 47 (SDNY 1989) (“the public interest in the criminal case is entitled to precedence over the civil litigant”).

27. *Arden Way Assocs. v. Boesky*, 660 F.Supp. 1494 (SDNY 1987) (denying defendant's motion to stay because the “public interest in the integrity of securities markets militates in favor of the efficient and expeditious prosecution of these civil litigations”).

28. *Galleon*, No. 09 Civ. 08811(JSR), Order at 1 (SDNY March 24, 2010).