New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 252—NO. 43
TUESDAY, SEPTEMBER 2, 2014

Outside Counsel

Expert Analysis

Parallel Proceedings: Staying the Civil Action

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On July 8, 2014, Rengan Rajaratnam was found not guilty of federal criminal charges that he took part in an insider trading conspiracy involving a network of hedge fund managers and analysts sharing confidential tips. Rajaratnam's acquittal was particularly noteworthy because it was the first defeat of federal prosecutors pursuing insider trading convictions in the Southern District of New York after a string of 81 convictions.[1] Rengan Rajaratnam's older brother, Raj Rajaratnam, founder of the hedge fund Galleon Group, was one of those convicted in the crackdown of insider trading activity. He was sentenced to an incarceratory term of 11 years. For the younger Rajaratnam, his liberty was now reassured following a criminal investigation that lasted years.

However, Rajaratnam must now contend with a SEC civil action commenced on the same underlying facts. That matter was stayed during the criminal proceeding. Not all defendants in parallel proceedings are so fortunate that they can address the civil matter after the criminal case concludes.

Courts have long held there is a particular threat to a defendant's due process rights where a criminal prosecutor and a government civil enforcement agency might share information during a parallel proceeding, thereby working together to undermine a defendant's due process. The government might effectively undermine rights that would exist in a criminal investigation by conducting a de facto criminal investigation using nominally civil means.[2] In Rajaratnam's case, that risk was apparently avoided.

Nevertheless, a stay of the civil proceeding is hardly a foregone conclusion, even if the civil action is commenced by a government agency. Where the action is brought by a private party, a stay should never be taken for granted. The Constitution does not require a stay of civil proceedings pending the outcome of related criminal proceedings.[3] In the absence of a stay, a defendant in a parallel proceeding will be required to defend against the criminal prosecution and choose between either testifying or asserting the Fifth Amendment privilege in the civil matter. Given the sheer number of white-collar prosecutions across Wall Street over the past couple of years and with no end in sight, it is now commonplace for defendants charged by the Department of Justice in white collar cases to face this paradox.

Managing the Civil Case

Many defendants will place their criminal matter as a priority and might, therefore, elect to abdicate defending the civil case, especially when the potential criminal charges appear overwhelming. But, the consequences of that approach can be significant. Defendants released from incarceration will still require assets to support them or their families. If the defendant is acquitted at the end of a lengthy trial, assets will be critical as they rebuild their life. Defendants' families, often the innocent spouses and children left to pick up the pieces, are further impacted where the indicted investment broker, for example, essentially forfeits his defense in the civil case and the civil plaintiff collects on its judgment.

The frequency of parallel proceedings in the current environment, coupled with the take-no-prisoners attitude of private parties frustrated by executive malfeasance, means that defense attorneys are compelled, more so than ever, to grapple with the civil case while defending the criminal matter. Merely resorting to the "old saw" that a defendant should not be placed in the unenviable situation of asserting the Fifth Amendment and suffering the adverse inference or defending in the civil case, thereby exposing him to potential self-incrimination, will not be effective for managing the civil exposure.

Courts in the Southern District have held that the choice of testifying or asserting the Fifth Amendment privilege is not offensive to the Constitution, and the discomfort a defendant finds being in this position does not necessarily rise to the level of a deprivation of due process. The choice may be unpleasant, but it is not illegal.[4] Nowhere does this issue

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become more cumbersome for defense counsel than where the civil plaintiff is a private party, such as a former employer or investors. Courts in the Southern District have held that the potential for prejudice is diminished where a private party, not the government, is the plaintiff in the civil action.[5]

The party seeking the stay has the burden of demonstrating its necessity and faces the challenge that courts in this circuit view the stay as an extraordinary remedy, especially where the defendant is under investigation but not indicted. In fact, both federal courts in the Second Circuit and New York state courts alike have consistently held that even where the defendant is the "subject" of a criminal investigation but has not been indicted, the request for a stay can be denied on that basis alone.[6] In other words, in the current era, counsel is compelled to shape a defense strategy in the civil case, even if it is never fully employed.

Moreover, while an indictment is a substantive factor considered by courts, it should not be viewed as a relief for defense counsel. Even where criminal charges are pending, the burden for obtaining a stay of the civil matter brought by a private party is substantial, whether in New York state or federal courts in this circuit.

Challenges in State Court

A motion filed in New York state court is brought pursuant to CPLR 2201. The Appellate Division First Department has a long history of affirming Supreme Court denials of CPLR 2201 motions in the context of parallel proceedings, including where criminal charges are pending. Factors evaluated by the court for a 2201 motion include the risk of inconsistent adjudications; application of proof and potential waste of judicial resources. Additionally, a "compelling factor" considered by the court is whether the defendant has invoked his or her constitutional right against self-incrimination.[7] Unfortunately, for the defendant, merely invoking the Fifth Amendment is not a sufficiently "compelling factor" to warrant a stay of his or her civil matter.

In 2009, in *Fortress Credit Opportunities v. Walter Netschi*, the defendant filed a motion for a stay of the action and a stay of discovery pending a federal criminal investigation and argued that the assertion of the privilege against self-incrimination was a proper basis for precluding discovery.[8] The Supreme Court denied the motion and the Appellate Division affirmed, holding that "assertion of the privilege…is an insufficient basis for precluding discovery" and that the motion court "was not obligated to stay the civil matter" in any event.[9]

> The Constitution does not require a stay of civil proceedings pending the outcome of related criminal proceedings.

In 2002, in *Access Capital v. DeCicco*, the Appellate Division held that the defendant was not entitled to a "stay" pending resolution of a related criminal proceeding on grounds that he had asserted in the civil litigation his privilege against self-incrimination.[10] Distinguishing the court's holding in an earlier decision, *Britt v. International Bus. Servs.*, from the facts before it, the DeCicco court stated that "a discretionary stay is appropriate to avoid prejudice to another party that would result from the assertion of the privilege against self-incrimination by a witness."[11]

In *Britt*, the movant requested a stay pending resolution of a criminal proceeding against a witness who already indicated he would assert his Fifth Amendment privilege in the civil case.[12] The movant argued that the witness' testimony was "critical and necessary" to defend himself in the civil action and without it he would be unable to assert a competent defense. The court held that the prejudice the plaintiff might experience was not as severe as that of the movant without a stay. By contrast, in *DeCicco*, the defendant was the only person affected by his decision to invoke the Fifth Amendment privilege. In other words, the "compelling factor" is the scope of prejudice to a third party created by a person invoking the Fifth Amendment privilege.

The DeCicco court also provided critical perspective on the appellate court's interpretation of the scope of the Fifth Amendment protection. In pertinent part, the court stated: "While a party may not be compelled to answer questions that might adversely affect his criminal interest, the privilege does not relieve the party of the usual evidentiary burden attendant upon a civil proceeding; nor does it afford any protection against the consequences of failing to submit competent evidence."[13]

In other words, the court held that the defendant's assertion of the Fifth Amendment privilege does not require the court to issue a stay and, where the privilege is invoked, the plaintiff is not prevented from moving for summary judgment (and the court from granting it) given the choice of the invoking defendant to refrain from introducing evidence.

Stay Motion in Federal Court

The posture of federal courts on stay motions in parallel proceedings is similar to what can be found in state court practice, if not slightly more pronounced. In 2012, the U.S. Court of Appeals in the Second Circuit, in *Louis Vuitton Malletier v. LY USA*, underscored the court's perspective in this area: (a) a stay of a civil case to permit conclusion of a related criminal prosecution is an extraordinary remedy; (b) the U.S. Constitution "rarely, if ever, requires such a stay;" (c) a defendant has no absolute right not to be forced to choose between testifying in a civil matter and asserting his Fifth Amendment privilege; and (d) the existence of a civil defendant's Fifth Amendment right arising out of a related criminal proceeding does not strip the court in the civil action of its broad discretion to manage its docket. The take-away for defense counsel filing a stay motion in federal

court is that a stay order is no easy feat.

District courts in this circuit often utilize a six-factor test in deciding a stay motion: (1) extent to which the issues in the criminal case overlap with those presented in the civil case; (2) the status of the criminal case; (3) interests of the plaintiff; (4) interests of and burden on the defendant; (5) interests of the court; and (6) the public interest.[14] The Second Circuit has cautioned that these factors can be nothing more than a rough guide. A plausible constitutional argument is presented only, if, at minimum, denying a stay would cause "substantial prejudice" to the defendant. As the Second Circuit wrote in *Louis Vuitton*: "In the more common case, the Fifth Amendment privilege is implicated by the denial of stay, but not abrogated by it."[15]

Decisions in the Southern District of New York certainly demonstrate an embrace of this interpretation of the Fifth Amendment in parallel proceedings. Contrary to what might be intuitive for criminal defense attorneys, implications for a defendant's Fifth Amendment privilege do not always trump the interests of the plaintiff to recover in the civil proceeding. For example, in 2003, in *Karimona Investments v. Weinreb*, the Southern District denied movant's request for a stay and noted that the expense of defending against a grand jury investigation or criminal trial increases the risk that the plaintiff could succeed in the civil matter without being able to collect on any judgment.

Moreover, the Southern District has repeatedly upheld the general view that a defendant's conduct resulting in a criminal charge should not be availed of by him as a shield against a civil suit and prevent a plaintiff from expeditiously advancing its claim.[16] As an alternative, the Southern District, as well as the Second Circuit, has promoted alternative forms of relief, such as tailored stays, protective orders postponing the indicted defendant's testimony and sealing confidential material, while permitting other discovery to proceed.[17] Failure to take advantage of alternatives in the first instance might be viewed as part of a larger effort for overall delay and obfuscation.[18]

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Conclusion

That the defendant in a parallel proceeding can simply keep at bay the civil action on the basis of his or her Fifth Amendment right against self-incrimination is mythical, except in extreme circumstances. In fact, in securities markets, registered brokers facing pending criminal charges that are also sued in Financial Industry Regulatory Authority (FINRA) arbitration cannot obtain a stay, in certain circumstances, without a court order (or consent of the plaintiff). That means the broker must go to court and make an argument for "substantial prejudice" in the absence of the stay. That might be challenging and expensive.

The take-away for defense counsel is that the civil matter must be seriously addressed. The implications of the criminal matter do not outweigh the civil exposure in every instance. If nothing else, the implications of both aspects of the parallel proceeding must be weighed in shaping the totality of the defense strategy.

1. Christopher M. Matthews, "Acquittal Deals U.S. A Rare Court Defeat," Wall Street Journal, July 9, 2014, at C1.
2. See *Sterling National Bank v. A-1 Hotels Intern.,* 175 F.Supp.2d 573 (SDNY 2001).
3. *Arden Way Associates v. Ivan Boesky*, 660 F.Supp. 1494, 1496 (SDNY 1987) (citing *Securities & Exchange Commission v. Dresser Indus.*, 628 F.2d 1368, 1375 (D.C. Cir.).
4. *United States of America v. District Council of New York City*, 782 F.Supp. 920, 925 (SDNY 1992).
5. *JHW Greentree Capital v. Whittier Trust*, No. 05 Civ. 2985 (HB), 2005 WL 1705244 (SDNY 2005).
6. See, e.g., *Karimona Investments v. David Weinreb*, No. 02CV1792WHPTHK, 2003 WL 941404, *3 (SDNY 2003). See also, *Stuart v. Tomasino*, 148 A.D.2d 370, 373 (1st Dept. 1989).
7. *Britt v. International Bus. Servs*., 225 AD2d 143 (1st Dept. 1998).
8. *Fortress Credit Opportunities v. Walter Netschi*, 59 AD3d 250 (1st Dept. 2009).
9. Id.
10. *Access Capital v. DeCicco*, 302 A.D.2d 48 (1st Dept. 2002).
11. Id. at 52.
12. *Britt*, 255 AD2d at 144.
13. *DeCicco*, 302 AD2d at 51.
14. *Louis Vuitton Malletier v. LY USA*, 676 F.3d 83, 99 (2012).
15. *Louis Vuitton*, 676 F.3d at 100.
16. See, e.g., *Travelers Casualty v. Vanderbilt*, No. 01 CIV. 7927, 2002 WL 844345, *4 (SDNY 2002).
17. *Fendi Adele S.R.L. v. Ashley Reed Trading*, No. 06 Civ. 0243, 2006 WL 2585612 (SDNY 2006).
18. See *Louis Vuitton*, 676 F.3d at 102.

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