

WHITE-COLLAR CRIME

Expert Analysis

Judicial Review of Claims of Government Misconduct in Parallel Investigations

Defending an individual who is the subject of parallel civil and criminal investigations is one of the more challenging aspects of white-collar defense practice. The situation is quite common, for example, in securities fraud investigations conducted by the Securities and Exchange Commission and Department of Justice. Parallel investigations raise both pragmatic and legal concerns. As a practical matter, an individual may have to choose between invoking her Fifth Amendment right against self-incrimination, which could have adverse consequences in civil proceedings, or, conversely, not remain silent and make statements detrimental in criminal proceedings. In addition, as a legal matter, parallel investigations pose the danger of prosecutors' behind-the-scenes use of civil investigations as a means of securing evidence they might not otherwise be able to obtain.

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Courts have held that when federal prosecutors use a civil investigation in furtherance of a criminal investigation, fundamental constitutional rights—including a defendant's right against self-incrimination—may be infringed.

self-incrimination—may be infringed. An important procedural question that arises is what preliminary showing a defendant must make in a criminal case to trigger discovery and judicial inquiry into the conduct of federal prosecutors. This issue was addressed in a recent opinion by Judge Jesse Furman in *United States v. Rhodes*, No. 18-cr-887 (S.D.N.Y.), a prosecution for securities

fraud and related offenses in the Southern District of New York.

In this article, we begin with a discussion of the basic limitations on federal prosecutors when they conduct criminal investigations at the same time as related civil enforcement investigations. We then discuss the *Rhodes* case and Judge Furman's decision, which required prosecutors to provide a substantial summary of their interactions with civil investigators before deciding whether further inquiry was warranted. The facts and ruling in *Rhodes* illustrate the importance of being sensitive to possible government overreach during parallel civil and criminal investigations, and of advancing constitutional arguments when appropriate to protect a defendant's rights.

Parallel Civil and Criminal Investigations

In *United States v. Kordel*, the Supreme Court held that the government may conduct parallel civil and criminal investigations without violating due process, so long as it does so in good faith and pursuant to proper procedures. 397 U.S. 1, 11 (1970). Prosecutors may use evidence obtained in a civil investigation in a subsequent criminal proceeding "unless the defendant demonstrates that such use would violate his constitutional rights or

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depart from the proper administration of criminal justice.” *United States v. Teyibo*, 877 F. Supp. 846, 855 (S.D.N.Y. 1995). An individual’s rights would be violated if the government were to (1) bring a civil action “solely to obtain evidence for its criminal prosecution,” or (2) “fail to advise the defendant in its civil proceeding that it contemplates his criminal prosecution.” *Kordel*, 397 U.S. at 11-12 (emphasis added).

In *Kordel*, a corporate executive was convicted of violating the Food, Drug, and Cosmetic Act partly on the basis of earlier answers to interrogatories served on his company by the Food and Drug Administration (FDA) in a civil proceeding. The defendant argued that the use of civil interrogatories to obtain evidence in a nearly contemporaneous criminal prosecution violated his Fifth Amendment right against compulsory self-incrimination.

The Supreme Court rejected the claim, holding that the defendant’s failure to invoke his Fifth Amendment rights in responding to the FDA’s interrogatories foreclosed his claim of having been compelled to give testimony against himself. The Court affirmed the district court’s finding that the FDA had not acted in bad faith in serving interrogatories, which the FDA regularly did in similar cases. *Id.* at 7-10.

Applying *Kordel*, the Second Circuit has set out the procedural steps for a challenge to a prosecutor’s handling of parallel investigations. *United States v. Gel Spice Co.*, 773 F.2d 427, 434 (2d Cir. 1985). In *Gel Spice*, the Second Circuit held that a defendant who seeks discovery regarding potential misconduct in parallel civil and criminal governmental investigations must make “a ‘substantial preliminary showing’ of bad faith before an evidentiary hearing or even limited discovery is to be held.” *Id.* (quoting *United States v. Tiffany Fine Arts*, 718 F.2d 7, 14 (2d Cir. 1983)). This standard recognizes the “special dan-

ger” of the government undermining the rights of a defendant in a criminal investigation “by conducting a *de facto* criminal investigation using nominally civil means.” *Sterling Nat’l Bank v. A-1 Hotels Int’l*, 175 F. Supp. 2d 573, 579 (S.D.N.Y. 2001).

The ‘Rhodes’ Case

In the *Rhodes* case, the defendant Jason Rhodes, a hedge fund manager, was indicted on several charges, including securities and wire fraud, investment adviser fraud, and conspiracy. The government alleges that Rhodes used investor funds to repay other investors, pay hedge fund expenses, and support his lifestyle rather than invest in the hedge fund’s portfolio. No. 18-cr-887, ECF No. 8 (S.D.N.Y.). According to the indictment, Rhodes created false account statements to cover up the misuse of investor funds, which resulted in losses to investors of approximately \$19.6 million. *Id.* ¶ 6.

In March 2019, Rhodes filed a motion seeking discovery regarding possible improper coordination between the SEC and DOJ. *Id.*, ECF No. 29. Rhodes’s chief argument is that DOJ improperly secured personal emails and text messages by means of productions compelled by SEC subpoenas (later turned over to DOJ) instead of a valid search warrant issued by a judge on the basis of probable cause. In support of this contention, Rhodes explained that the SEC had served him with a subpoena for documents in February 2017, after one of Rhodes’s co-founders had pled guilty to fraud charges and shortly before a grand jury returned indictments of co-conspirators in Rhodes’s case. According to Rhodes, DOJ was aware of his role at the hedge fund at the time the SEC first subpoenaed him but nevertheless chose not to charge him. Instead, the government allegedly “laid in wait for nearly two years” while Rhodes produced documents to the

SEC and appeared for SEC testimony. *Id.*, ECF No. 37 at 6.

In a criminal complaint against Rhodes, DOJ relied on information gathered by the SEC, including text messages Rhodes had produced pursuant to SEC subpoena. Rhodes was later indicted on criminal charges, including securities fraud, but, unusually, the SEC did not file a civil complaint. Rhodes now argues that, under these circumstances, the district court should infer that DOJ “used the civil discovery process in the SEC proceeding [solely] to develop the criminal case against [Rhodes,] in violation of his due process rights,” *id.*, ECF No. 29 at 9, and thus should order broad discovery to the defense relating to the prosecutors’ dealings with the SEC.

DOJ opposed the motion, arguing that Rhodes had offered “mere conjecture” that there “*may* have been improper coordination.” *Id.*, ECF No. 32 at 8 (emphasis added). In the government’s view, Rhodes has not alleged any misleading representations to Rhodes or his counsel concerning an ongoing criminal investigation when Rhodes received and responded to the SEC’s subpoena. The government also noted that Rhodes understood he faced possible criminal prosecution throughout the SEC’s investigation, as made plain by his invocation of his Fifth Amendment rights during SEC testimony.

The District Court’s Order

On June 18, 2019, following a hearing and the government’s submission of an affidavit, Judge Furman ordered the government to provide additional information regarding the prosecutors’ coordination with and involvement in the SEC’s civil investigation for the court’s *in camera* review. *Id.*, ECF No. 47.

As an initial matter, the court noted that both parties had invoked

the wrong standard for determining whether Rhodes should be allowed to conduct discovery. Relying on decisions addressing claims of selective prosecution, Rhodes argued that he was entitled to discovery if he provided “some evidence tending to show the existence” of the essential elements of a due process violation. *Id.*, ECF No. 37 at 5 (quoting *United States v. Armstrong*, 517 U.S. 456, 469 (1996)). The government pointed to a standard typically applied in suppression cases—i.e., that discovery is appropriate only “if the moving papers are sufficiently definite, specific, detailed, and non-conjectural to enable the court to conclude that contested issues of fact ... are in question.” *Id.*, ECF No. 32 at 8 (quoting *United States v. Mahaffy*, 446 F. Supp. 2d 115, 127 (E.D.N.Y. 2006)). Judge Furman rejected both positions and applied the test set forth in *Gel Spice*, 773 F.2d at 434, which called on the district court to determine whether Rhodes had made a “substantial preliminary showing” of bad faith by the government.

The court held that, on the present record, Rhodes had failed to make that showing, but observed that the Second Circuit had adopted the “substantial preliminary showing” standard in *Gel Spice* against the backdrop of (1) multiple affidavits of government lawyers concerning the relationship between the civil and criminal investigations at issue, and (2) documents given to the district court for in camera review. *Rhodes*, No. 18-cr-887, ECF No. 47 at 2. In the *Rhodes* case, in contrast, the government had submitted only a single affidavit by one of the Assistant U.S. Attorneys responsible for DOJ’s criminal prosecution. The affidavit was limited to that AUSA’s knowledge and attested that he “neither directed nor requested the issuance of [the SEC’s subpoena]” and that he “had no role in formulating the [subpoena’s]

content.” *Id.*, ECF No. 44-1 ¶ 6. Because the affidavit did not say anything about the knowledge or involvement of others involved in the criminal investigation, Judge Furman found that the affidavit did “nothing to advance the ball.” *Id.*, ECF No. 47 at 2.

Accordingly, Judge Furman ordered the government to “make a more substantial showing *in camera*.” *Id.* Specifici-

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cally, the court directed the government to submit a detailed affidavit that sets forth “the nature and extent of any and all communications between the SEC and those involved in the criminal investigation of Rhodes,” along with copies of any substantive communications. *Id.* at 2-3. Only after reviewing these materials in camera would the court decide whether the requested discovery is warranted. *Id.* The government submitted its supplemental affidavit and exhibits in camera on July 1, 2019. *Id.*, ECF No. 48.

Conclusion

In white-collar criminal matters, parallel investigations are routine. In addition to a grand jury investigation, federal or state civil enforcement authorities—e.g., the SEC, CFTC and New York State Attorney General or Department of Financial Services—may conduct their own civil investigations, and a company often conducts an internal investigation. The multiplicity of investigations poses an inherent danger: that prosecutors could use non-

criminal investigations to secure statements or tangible evidence that might otherwise not be available to them.

This issue was recently addressed in the context of a company internal investigation in *United States v. Connolly*, 2019 WL 2120523, at *1 (S.D.N.Y. May 2, 2019). Chief Judge Colleen McMahon held that the extensive involvement by the CFTC, SEC, and DOJ in an internal investigation conducted by counsel for Deutsche Bank—combined with the government’s failure to conduct a meaningful investigation of its own—meant that the bank and its counsel “were *de facto* the Government.” Because the government “outsourced” its investigation, the government in a criminal prosecution could not use statements an employee had given during interviews with the bank’s counsel—under the threat of termination—because the statements were effectively compelled in violation of the employee’s Fifth Amendment rights. *Id.* at *14.

As the *Rhodes* case illustrates, the issue of misusing non-criminal investigations also arises in the context of a parallel investigation conducted by civil enforcement authorities. Proving any such misuse may be very difficult, but the recent order in *Rhodes*, requiring prosecutors to provide details about their dealings with civil investigators, lays out a procedural path by which the government may be called upon to describe the coordination between prosecutors and civil enforcement authorities. This case highlights the importance of being alert to possible misuse of civil investigations by prosecutors and pursuing discovery and judicial relief when appropriate.