New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
Web address: http://www.nylj.com
VOLUME 234—NO. 67 WEDNESDAY, OCTOBER 5, 2005 ALM

SOUTHERN DISTRICT CIVIL PRACTICE ROUNDUP

BY EDWARD M. SPIRO

To Stay or Not to Stay

As several recent corporate scandals demonstrate, prosecutors and regulators increasingly coordinate their pursuit of common targets while class-action plaintiffs proceed against those same targets on a parallel track.

In this setting, defendants can find themselves whipsawed between multiple civil lawsuits, regulatory investigations, and even criminal prosecution.

To defendants fighting these multifront battles, a stay of discovery in the civil litigation may provide a welcome, if temporary respite, permitting them to focus their energies on a single defense or to contest the legal sufficiency of the claims against them without having to engage simultaneously in costly and burdensome discovery.

But in other instances, a stay may impose an unwelcome delay, prolonging the taint on a defendant's reputation, preventing efficient resolution of all pending claims and precluding access to information useful in defending the criminal case.

A number of recent decisions of the U.S. District Court for the Southern District of New York grapple with these issues—some in the context of parties seeking stays because of the pendency of criminal proceedings and

others addressing class plaintiffs' requests to be relieved from the automatic stay provision of the Private Securities Litigation Reform Act (PSLRA).[1]

Parallel Criminal Prosecutions

• ***Stays of Civil Proceedings Pending Parallel Criminal Prosecution.*** Differences in the scope of pretrial discovery available in civil and criminal cases mean that when parallel civil and criminal actions proceed simultaneously, the defendant may gain a strategic advantage in the criminal case through the broader discovery available in the civil proceeding. But criminal defendants may also have an interest in staying parallel civil litigation, despite the advantages of broader discovery, in order to avoid the Hobson's choice between possible self-incrimination through deposition testimony or having an adverse inference drawn against them in civil proceedings because they have invoked their Fifth Amendment right not to testify at their depositions. Accordingly, either the prosecutor or the defendant may seek a stay of the civil proceedings to prevent the adversary from exploiting the procedural posture of the case.

In deciding whether to enter a stay, courts in the Southern District generally engage in a multipart inquiry designed to balance the moving party's interests in staying the proceedings against the plaintiff's interests in expeditious resolution of the civil proceedings. That inquiry focuses on: (1) the extent of the overlap between the criminal and civil proceedings; (2) the status of the criminal case; (3) the private interests of the civil plaintiff; (4) the burden on the defendant from proceeding with or delaying the civil litigation; (5) the interests of the courts; and (6) the public interest.[2]

A defendant who is merely under criminal investigation has little chance of obtaining a stay prior to being indicted, because the risk of harm to the defendant is deemed too remote, and the delay of the civil proceedings too prolonged.[3] Traditionally, courts have been more favorably inclined to stay civil proceedings when it is the prosecutor rather than the defendant who is seeking the stay. Prosecutors often argue that a civil stay is necessary to prevent the criminal defendant from circumventing limitations on criminal discovery through the more liberal civil discovery mechanisms.[4]

Exacting Scrutiny

Recently, however, two Southern District

Edward M. Spiro *is a principal of Morvillo, Abramowitz, Grand, Iason & Silberberg and the co-author of "Civil Practice in the Southern District of New York, 2d Ed." (Thomson West 2004).* **Judith L. Mogul** *assisted in the preparation of this article.*

judges have subjected prosecutors' requests for stays to more exacting scrutiny when the civil defendants have objected on the basis that they will be prejudiced by delay of the civil proceedings.

In a pair of decisions filed in *SEC v. Saad*,[5] Southern District Judge Jed S. Rakoff rejected the underlying premise of the government's position that staying discovery in a civil case is necessary to prevent the criminal defendant from getting a "special advantage" through civil discovery. Judge Rakoff had previously agreed to stay the depositions of the civil defendants (who were either defendants or prosecution witnesses in the criminal case), because of the likelihood that they would invoke the Fifth Amendment until the criminal proceedings were concluded. He had refused, however, to stay the depositions of other witnesses (although he recognized that it was possible that certain of these depositions might have to be delayed) and ordered document discovery to proceed. Upon the prosecutor's subsequent request that certain documents be withheld from the defendants until after the criminal trial, Judge Rakoff observed that the practice of seeking a stay of civil discovery in such parallel proceedings "is not without [its] bizarre aspects":

> It is bewildering enough that Congress has decreed that, even though someone facing the potentially ruinous financial penalties of an SEC civil complaint should be accorded substantial discovery in order to defend herself, the same defendant facing the even more severe penalties of a criminal action should barely receive any discovery at all. But it is stranger still that the U.S. Attorney's Office, having closely coordinated with the SEC in bringing simultaneous civil and criminal actions against some hapless defendant, should then wish to be relieved of the consequences that will flow if the two actions proceed simultaneously.[6]

Judge Rakoff held that the documents at issue were "unquestionably relevant" to the civil defendants, both on their face and for their value in preparing for the depositions of nonparty witnesses. Accordingly, he ordered that they be turned over to the defendants in the civil case.

In another ruling issued a month later, Judge Rakoff denied the prosecution's application to postpone the depositions of two nonparty witnesses, but acknowledged that the parties were "understandably, somewhat unclear" as to the standards for reaching that determination.[7]

There is a growing skepticism, among judges, for the gamesmanship attendant to litigation involving stays.

Although declining to define the universe of circumstances in which a delay might be appropriate, he offered several examples that might qualify, including: (1) where there is genuine reason for believing a witness may be subject to harassment, intimidation, or obstruction; (2) where the witness's role in the criminal trial is as a rebuttal witness to refute a defense the government suspects is fabricated, rather than as part of the government's case-in-chief; or (3) where a witness who is material to the criminal case has only peripheral relevance in the civil matter. Judge Rakoff explained that if these, or other equivalent circumstances were present, the court would then balance the potential harm from permitting the depositions to go forward against the delay of the civil proceedings, giving particular weight to ensuring that the civil defendants are not materially prejudiced in their ability to defend the civil case.

'SEC v. Treadway'

Southern District Magistrate Judge James C. Francis IV was similarly concerned with the interests of the civil defendants in avoiding undue delay of civil proceedings in his decision in *SEC v. Treadway*.[8] In that case, the New York State Attorney General's Office sought to stay the depositions of two witnesses in an SEC enforcement action until those witnesses had completed their anticipated testimony in two separate criminal trials. Although there was no overlap between the defendants in the civil and criminal proceedings, both cases concerned alleged irregularities in the trading practices of Canary Capital Partners. The SEC complaint charged two officers of a family of mutual funds with participating in a fraudulent scheme which favored Canary over other fund investors by permitting it to engage in market timing. The criminal actions charged brokers from two institutions with permitting Canary to use their facilities to engage in late trading.

Magistrate Judge Francis held that a stay was warranted until after the witnesses had testified in the first trial, but declined to extend the stay until they had testified in the second. He found significant overlap between the SEC complaint and the charges in the first criminal case, including an allegation in the indictment that the defendant had facilitated market timing transactions for Canary, and more importantly, that some of the transactions that formed the basis of the late trading criminal charges were identical to transactions charged in the SEC's market timing complaint.

Magistrate Judge Francis recognized that the pendency of the civil litigation posed an economic burden on the defendants and a "cloud on their careers and their personal lives." He concluded, however, that to stay the witness depositions until after their testimony in the first criminal trial would have only a minimal effect on the civil defendants because the criminal trial was scheduled to start a full month before the discovery cut-off in the civil case and would thus not delay final disposition of the civil proceeding.

By contrast, he found that because the

second criminal trial was not slated to begin until four months after the completion of discovery in the civil case, the civil defendants' interest in an expeditious resolution of the civil litigation would be impaired by a longer stay. He also noted that there was no direct factual overlap between the civil allegations and the criminal charges in the second prosecution. Finally, he observed that because the witnesses were likely to be subject to exhaustive cross-examination in the first criminal case, the second criminal defendant would gain no particular advantage through access to the deposition transcripts in the civil proceeding.

The PSLRA Automatic Stay

Defendants almost universally embrace the protection offered by the stay provision of the PSLRA, which provides that in securities actions all discovery and other proceedings are automatically stayed while a motion to dismiss is pending unless particularized discovery is necessary to preserve evidence or prevent undue prejudice to a party. Predictably, litigation surrounding the appropriateness of lifting the stay has centered around what constitutes undue prejudice, which has been defined as "improper or unfair treatment amounting to something less than irreparable harm."[9]

In 2002, Southern District Judge Denise L. Cote granted the motion by the lead plaintiff in *In re WorldCom Sec. Litig.*[10] to lift the automatic stay, citing the disadvantages the putative investor class would face if the stay were to remain in effect, in light of what she found to be the unique circumstances of that case. Specifically, she noted that the defendants had already produced the requested documents to both the United States Attorney's Office and the SEC, as well as WorldCom's Creditors Committee, and that those documents would imminently also be produced to plaintiffs in an Employee Retirement Income Security Act (ERISA) action relating to the same underlying facts.

Because the other proceedings against WorldCom were "moving apace," she concluded that without access to the documents already in the hands of the other parties, the securities plaintiffs "would be prejudiced by [their] inability to make informed decisions about [their] litigation strategy in a rapidly shifting landscape." She further reasoned that those plaintiffs would be "severely disadvantaged" in court-ordered settlement discussions as the only major interested party without access to documents that formed the core of the proceedings.

In the wake of *WorldCom*, defendants in securities fraud actions now routinely find themselves opposing arguments by plaintiffs seeking to lift the automatic stay in order to obtain documents that have already been produced to another entity. Southern District Judge Peter K. Leisure's decision in *Taft v. Ackermans*[11] is a recent case in point. The plaintiffs in that class-action fraud case were purchasers of common stock in a joint venture between Qwest Communications and a Dutch fiber-optic company. After the defendants moved to dismiss the complaint, plaintiffs brought a motion to lift the automatic stay to permit them to obtain a draft report commissioned in the Netherlands by the bankruptcy trustees of the joint venture. Relying on WorldCom, they argued that they risked undue prejudice if Qwest were to settle the trustees' Racketeer Influenced and Corrupt Organizations Act (RICO) action and the draft report was suppressed as a condition of the settlement.

Judge Leisure found this threat of prejudice too attenuated because there was no evidence that settlement discussions were even under way in the RICO case. He went on to observe that even if that action were settled, the report would still be subject to discovery under the broad reach of Rule 26 so that the court could "almost certainly" order its production regardless of any agreement between the RICO litigants to keep it confidential. He contrasted the posture of this case to *WorldCom*, noting that class plaintiffs had not been directed to participate in any settlement discussions "in which other parties will be better informed of the facts of the case." Concluding that the plaintiffs had not shown that they would suffer undue prejudice without immediate access to the report, he denied their motion to lift the stay.

Conclusion

The decisions discussed above reflect a growing skepticism, at least among some judges, for the gamesmanship attendant to litigation involving stays. Whether in the context of related criminal and civil cases, or a request to lift the automatic stay in a PSLRA—governed action, courts are looking for a detailed showing of actual prejudice to inform their balancing of the competing interests at stake.

1. 15 USC §§77z-1(b)(1) & 78u-4(b)(3)(B).
2. See, e.g., *In re WorldCom, Inc. Sec. Litig.*, 2002 WL 31729501, at *4 (SDNY Dec. 5, 2002) (Cote, J).
3. See, e.g., *Karimona Investments, LLC v. Weinreb*, 2003 WL 941404, at *3 (SDNY March 7, 2003) (Katz, M.J.); *Sterling National Bank v. A-1 Hotels Int'l, Inc.*, 175 FSupp2d 573, 577 (SDNY 2001) (Lynch, J.).
4. See, e.g., *SEC v. Doody*, 186 FSupp2d 379 (SDNY 2002) (Kaplan, J.). See also *SEC v. Chestman*, 861 F2d 49, 50 (2d Cir. 1988) (per curiam) (recognizing government's "discernible interest in intervening in order to prevent discovery in the civil case from being used to circumvent the more limited scope of discovery in the criminal matter").
5. 229 FRD 90 (SDNY 2005); 2005 WL 2059494 (SDNY Aug. 26, 2005).
6. 229 FRD at 91.
7. 2005 WL 2059494, at *1.
8. 2005 WL 713826 (SDNY March 30, 2005).
9. *In re Vivendi Universal, S.A. Sec. Litig.*, 381 FSupp2d 129, 130 (SDNY 2003) (Berman, J.) (quoting *Vacold LLC v. Cerami*, 2001 WL 167704, at *6 (SDNY Feb. 16, 2001)).
10. 234 FSupp2d 301 (SDNY 2002).
11. 2005 WL 850916 (SDNY April 13, 2005).