

FEDERAL CIVIL INVESTIGATIVE DOCUMENTS HELD ADMISSIBLE FOR DEFENDANT IN WHITE-COLLAR CRIMINAL TRIAL

by
Joseph Perry

In *United States v. Gluk*, 831 F.3d 608 (5th Cir. 2016), the US Court of Appeals for the Fifth Circuit issued a significant decision concerning the admissibility of civil investigative documents prepared by a government agency that were relevant in a criminal trial. Vacating the defendants' convictions for securities fraud, the Fifth Circuit held that the district court erred in excluding documents prepared by the Securities and Exchange Commission (SEC)—which were favorable to the defense—because they met the traditional test for admissibility: (1) they met the “public records” exception to the hearsay rule under Federal Rule of Evidence (FRE) 803(8)(A)(iii) and (2) the probative value of the SEC documents outweighed their prejudicial effect.

The prosecution in *Gluk* stemmed from an alleged conspiracy by ArthroCare, a medical device company, and DiscoCare, a related entity, to engage in “channel stuffing.” “Channel stuffing” is a fraudulent scheme whereby one company agrees to purchase products from a co-conspirator in an effort to boost that co-conspirator's quarterly earnings, typically in order to meet Wall Street expectations. If the co-conspirator meets its targeted earnings in the following quarter, the company will return the products it purchased from the coconspirator for a full refund. Here, DiscoCare allegedly entered into this type of an agreement with ArthroCare, purchasing product worth about \$26 million from ArthroCare over several years that DiscoCare never intended to keep. At trial, the government alleged that the defendants—the CEO and CFO of ArthroCare—were knowing participants in the conspiracy.

The defendants sought to refute the government's theory by introducing the results of a SEC civil investigation. The defendants alleged that the SEC documents—two memoranda and a civil complaint—demonstrated that two other individuals had orchestrated the fraud unbeknownst to them. The district court excluded the documents on the ground that they were more prejudicial than probative.

In reversing the district court, the Fifth Circuit engaged in a two-prong analysis. First, the court considered whether the SEC documents qualified as non-hearsay under the “public records” exception pursuant to FRE 803(8)(A)(iii). Rule 803(8) provides that a record or statement of a public office is admissible if “(A) it set out: ... (iii) in a civil case or against the government in a criminal case, factual findings from a legally authorized investigation; and (B) the opponent does not show that the source of information or other circumstances indicate a lack of trustworthiness.” On appeal, the government argued that the memoranda were not “factual findings from a legally authorized investigation” because the Commission did not approve these memoranda at the highest level. Relying on its prior decision in *Smith v. Isuzu Motors, Ltd.*, 137 F.3d 859 (5th Cir. 1998), the Fifth Circuit rejected the government's argument, explaining that a report prepared by a staff member of an agency is admissible under Rule 803(8) so long as the report has not been disavowed by the agency. Here, the Fifth Circuit concluded that the memoranda

were admissible for their truth under Rule 803(8) because the government failed to present any evidence that SEC declined to accept the findings set forth therein.¹

Second, the Fifth Circuit concluded that the district court abused its discretion in excluding the SEC documents as unduly prejudicial under FRE Rule 403. Although the Fifth Circuit acknowledged that a trial judge has broad discretion under Rule 403 to preclude evidence, that discretion is not absolute. In this case, the Fifth Circuit held that, on balance, the jury was entitled to know that SEC—after conducting its own independent investigation—chose not to allege that the defendants engaged in any wrongful conduct.

Prosecutions for securities fraud often coincide with parallel civil investigations by SEC or other sister agencies. *Gluk* instructs the white-collar bar to affirmatively discover the factual findings of any relevant agency to determine whether their findings are inconsistent with the government’s theory of the criminal case.

Joseph Perry is an Associate with Baker Botts L.L.P. in the firm’s New York, NY office.

About WLF and the COUNSEL’S ADVISORY

Washington Legal Foundation (WLF) is the nation’s premier non-profit, free enterprise public-interest law firm and policy center. WLF litigates *and* publishes in order to advocate legal policies that promote economic growth, job creation, and business civil liberties. As a 501(c)(3) tax-exempt organization, WLF relies upon the charitable support of individuals, businesses, associations, and foundations to fund its programs.

This COUNSEL’S ADVISORY represents one of WLF’s eight publication formats. Its purpose is to inform the free-enterprise community about a development in the legal policy world that can be favorably influenced by the immediate involvement of legal experts and business and community leaders.

For more information on Washington Legal Foundation, please contact Constance Larcher, CEO and President, at (202) 588-0302.

¹ The court also held that SEC’s civil complaint was admissible under Rule 803(8) because it unambiguously represented an official action of SEC and similarly there was no evidence that SEC disavowed the complaint in any way.