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## COMMENT: Self-Incrimination, Preclusion, Practical Effect and Prejudice to Plaintiffs: The Faulty Vision of *SEC v. Graystone Nash, Inc.*

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# COMMENT

## SELF-INCRIMINATION, PRECLUSION, PRACTICAL EFFECT AND PREJUDICE TO PLAINTIFFS: THE FAULTY VISION OF *SEC v. GRAYSTONE NASH, INC.*\*

### INTRODUCTION

The fifth amendment privilege against self-incrimination "in any criminal case" is, by its own terms, anomalous when invoked in a civil case.<sup>1</sup> Although parties may invoke the privilege in civil cases when they fear criminal prosecution,<sup>2</sup> the "aims supporting the privilege simply apply less forcefully in civil than in criminal cases."<sup>3</sup> The less immediate and likely it seems that authorities will use incriminating information in a subsequent criminal proceeding, the less sanctity a court will accord the self-incrimination privilege. The stakes are simply higher for a criminal defendant. Unlike a civil adversary, the government has one predominant interest, that of obtaining a criminal conviction. The defendant may lose his freedom, not just property.<sup>4</sup> Thus, measures to ameliorate the prejudicial

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\* 25 F.3d 187 (3d Cir. 1994) [hereinafter "*Graystone II*"], *rev'd and remanding*, 820 F. Supp. 863 (D.N.J. 1993) [hereinafter "*Graystone I*"].

<sup>1</sup> U.S. CONST. amend. V (in pertinent part, "nor shall [any person] be compelled in any criminal case to be a witness against himself").

<sup>2</sup> *Baxter v. Palmigiano*, 425 U.S. 308, 316 (1976) ("[t]he Fifth Amendment 'not only protects the individual against being involuntarily called as a witness against himself in a criminal prosecution but also privileges him not to answer official questions put to him in any other proceeding, civil or criminal, formal or informal, where the answers might incriminate him in future criminal proceedings'" (quoting *Lefkowitz v. Turley*, 414 U.S. 70, 77 (1973))).

<sup>3</sup> *RAD Servs., Inc. v. Aetna Casualty & Sur. Co.*, 808 F.2d 271, 275 (3d Cir. 1986).

<sup>4</sup> *Baxter*, 425 U.S. at 318-19. The Court noted that the existence of "important state interests other than conviction for crime" in *Baxter* was a factor counseling

effects of an assertion of privilege may be inappropriate in a criminal context, given the need to balance a defendant's liberty interest against the prosecutor's paramount interest in criminal conviction. In a civil action, however, such measures may be appropriate and desirable in the absence of immediate criminal jeopardy and the presence of other important goals on the government's side.<sup>5</sup>

In a recent civil enforcement action case, *SEC v. Graystone Nash, Inc.*,<sup>6</sup> the Third Circuit broadly applied the self-incrimination privilege in a manner inappropriate to the civil context. The court's holding was both inconsistent with Supreme Court precedent<sup>7</sup> and inimical to the purposes and goals of the discovery process.<sup>8</sup> The defendants in *Graystone* allegedly were the principals in a massive securities fraud operation.<sup>9</sup> During discovery, both defendants prioritized their fear of criminal prosecution and invoked the privilege against self-incrimination as their sole response to every substantive request.<sup>10</sup> After the close of discovery, the district court granted the SEC's motion to preclude the defendants from offering any factual support from any source for their denials and defenses in light of the prejudice to the SEC stemming from this total avoidance of discovery.<sup>11</sup> The trial court then reviewed the evidence and

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this lesser insulatory effect. *Id.* at 319.

<sup>5</sup> See *id.* at 318-19; see also *infra* notes 195-200 and accompanying text.

<sup>6</sup> 25 F.3d 187 (3d Cir. 1994).

<sup>7</sup> See generally *Baxter v. Palmigiano*, 425 U.S. 308 (1976). See also *infra* notes 25-30 and accompanying text for a discussion of the Supreme Court's opinion in *Baxter*, limiting the usefulness of the fifth amendment privilege, and *infra* notes 31-42 and accompanying text for a discussion of the line of cases precedent to and following *Baxter*.

<sup>8</sup> See *infra* notes 212-14 and accompanying text for a discussion of the purposes and goals of discovery.

<sup>9</sup> *Graystone II*, 25 F.3d at 189.

<sup>10</sup> *Id.*

<sup>11</sup> *Graystone I*, 820 F. Supp. at 869. The order in *Graystone* is a total preclusion order in that it does not allow any factual support from any source to support denials and defenses on which the defendant has refused to provide discovery. The scope of the order is total in light of the defendants' total avoidance of discovery.

Preclusion orders also can be tailored where there is less than total avoidance of discovery by allowing a defendant to provide factual support as to areas where discovery has been had. Some courts have precluded the defendant's testimony but have allowed other outside-discovered evidence to be used in support. This Comment argues that this is inappropriate in situations of total avoidance of discovery. See *infra* notes 212-14 and accompanying text.

entered summary judgment for the SEC.<sup>12</sup>

On appeal, the Third Circuit reasoned that such a preclusion order was an inappropriate sanction because it rendered the exercise of the privilege "costly," in contravention of the Fifth Amendment.<sup>13</sup> The court drew this conclusion from its finding that the practical effect of a total preclusion order is equal to that of an entry of judgment for the opposing party.<sup>14</sup> Although the court outlined factors that the district court should consider on remand when selecting a more appropriate equitable remedy, it underestimated the prejudice accruing to plaintiffs faced with a total avoidance of discovery.<sup>15</sup> In so doing, the court focused not on what the SEC was deprived of by defendants' invocation of the privilege, but on the amount of evidence it possessed despite the invocation.<sup>16</sup>

This Comment will maintain that in a civil matter such as *Graystone*, where parties use the fifth amendment privilege to avoid discovery, courts should issue a total preclusion order disallowing any factual support from any source for any of the defendant's denials and defenses. While there is some secondary support for the Third Circuit's view on the constitutionality of total preclusion orders,<sup>17</sup> Supreme Court precedent does not support a finding that total preclusion orders are unconstitutional. Instead, the Constitution requires proscription only where a final penalty or deprivation of rights occurs automatically upon invocation, without intervening steps.<sup>18</sup> Moreover,

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<sup>12</sup> *Graystone I*, 820 F. Supp. at 876. Regarding the appropriateness of the ordered remedies, the court remarked that the evidence of defendant's wrongdoing was "overwhelming" and that their "continued insistence that they did not violate securities laws" was of "particular concern," *id.* at 875 n.14, and that "the problem in this case is finding any activity that was lawful." *Id.* at 876.

<sup>13</sup> *Graystone II*, 25 F.3d at 190-91.

<sup>14</sup> *Id.* at 191.

<sup>15</sup> *Id.* at 193-94.

<sup>16</sup> *Id.*

<sup>17</sup> Frances S. Fendler, *Waive the Fifth or Lose the Case: Total Preclusion Orders and the Civil Defendant's Dilemma*, 39 SYRACUSE L. REV. 1161, 1163 (1988) ("The practical effect of a total preclusion order is to award judgment to the civil plaintiff on a mere showing of a *prima facie* case.").

<sup>18</sup> See, e.g., *Lefkowitz v. Cunningham*, 431 U.S. 801, 807-09 (1977) (striking down a state statute that required an officer of a political party to either waive the privilege or lose his office); see also *Lefkowitz v. Turley*, 414 U.S. 70, 83-85 (1973) (declaring unconstitutional statutes that precluded award of government contracts to any person who fails to waive immunity when called to testify concerning contracts with the state); *Spevack v. Klein*, 385 U.S. 511, 515 (1967)

a more accurate estimate of the prejudice inherent in an invocation of the privilege must take the broader goals and advantages of full and mutual discovery into account. Courts should focus on assessing what information the plaintiff was deprived of, as opposed to that acquired despite the defendant's avoidance of discovery. Courts should then take measures to efficiently and completely counteract any advantage the defendant may have gained.

This approach is preferable for a number of reasons relating to the *raison d'être* for the privilege and the positive effects of its narrow application in a civil context. The self-incrimination privilege should be a shield against criminal liability; courts should compensate parties for incidental benefits accruing to their adversaries who invoke the privilege in a civil matter. Such court orders will enhance the functioning of both the discovery and trial processes by prompting defendants to make earlier assessments of the price of invocation when deciding whether to assert the privilege and by helping courts to determine the scope of an assertion. Total preclusion in cases like *Graystone* enhances the fundamental search for truth in civil litigation. Moreover, total preclusion is consistent with Supreme Court holdings that narrowly construe the insulatory effect of the privilege, and with the other important public and opposition interests at stake in a civil case.

Part I of this Comment will sketch the contours of self-incrimination jurisprudence, focusing on the line of Supreme Court decisions that considered the use of the Fifth Amendment in civil cases. This Part also will review the constitutional proscription against automatic deprivations and discuss the basis of courts' power to remedy the resultant prejudice from even a valid privilege invocation in a civil context. Part II will present the factual background and procedural history of *SEC v. Graystone Nash, Inc.* In Part III, this Comment will analyze the Third Circuit opinion, counter the Third Circuit's refusal to issue a total preclusion order, and advocate the use of appropriately tailored preclusion orders in cases of discovery stonewalling.

Part III also more closely scrutinizes the character of the

*Graystone* defendants and of this civil action, and points out a lack of situational awareness on the part of the court. In this regard, the Comment will maintain that the solicitousness for these pro se defendants underlying the Third Circuit's opinion was inappropriate. The facts of the case point to tactical manipulation by the defendants, not disability or neediness. Furthermore, the court's misperception of the government plaintiff as a monolithic, criminal prosecution-minded entity in this civil context also led it to give undue deference to these defendants. Finally, this Comment concludes that total preclusion orders should be the rule in cases of total avoidance of civil discovery.

#### I. THE FIFTH AMENDMENT SELF-INCRIMINATION PRIVILEGE IN CIVIL CASES AND THE POWER OF COURTS TO REMEDY PREJUDICE FROM INVOCATION AND WAIVER

##### A. *"Nor Shall [Any Person] Be Compelled in Any Criminal Case to Be a Witness Against Himself"*<sup>19</sup>

The fifth amendment privilege against self-incrimination receives much more deferential treatment when invoked in a criminal case than it does when invoked in a civil case. In a criminal proceeding, the Supreme Court has definitively held that to permit the fact-finder to draw any inference of guilt from a defendant's refusal to testify under the protection of the privilege is a violation of the Fifth Amendment.<sup>20</sup> Equally important, the state<sup>21</sup> may not compel self-incriminating testimony from a person.<sup>22</sup> In connection with civil proceedings, in

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<sup>19</sup> U.S. CONST. amend. V (in pertinent part).

<sup>20</sup> See, e.g., *Griffin v. California*, 380 U.S. 609 (1965) (court's and prosecutor's comments on the defendant's failure to testify violated self-incrimination clause of Fifth Amendment).

<sup>21</sup> This includes both federal and state actors. See *Malloy v. Hogan*, 378 U.S. 1, 6 (1964) (self-incrimination clause incorporated via the Fourteenth Amendment's Due Process Clause).

<sup>22</sup> Compulsion may take many forms, from judicial, see generally *Hoffman v. United States*, 341 U.S. 479 (1951) (criminal contempt threat to privilege invokers unconstitutional), to physical or psychological, see generally *Miranda v. Arizona*, 384 U.S. 436 (1966) (information gained from criminal suspect by interrogation without first informing him of his right to remain silent may not be used against him).

a line of cases culminating in *Baxter v. Palmigiano*, the Court has held that the first of these rules is not applicable; an adverse inference may be drawn in a civil context.<sup>23</sup> Further, although protection against compulsion of testimony has remained viable, the Court has implied that this protection does not apply with the same force in civil cases as it does in criminal cases.<sup>24</sup>

In *Baxter*, Palmigiano, an inmate of the Rhode Island Adult Correctional Institution, was summoned before a prison Disciplinary Board for "inciting a disturbance and disruption of prison operations, which might have resulted in a riot."<sup>25</sup> In this non-criminal proceeding, he invoked the privilege despite the Board's warnings that the invocation could be used as evidence against him. The Board subsequently used that inference and other evidence to impose disciplinary confinement.<sup>26</sup> The Court framed the constitutional question in two ways: whether the adverse inference drawn from his invocation was repugnant to the Fifth Amendment; and whether the choice itself was unconstitutional testimonial compulsion, in effect making Palmigiano choose between waiving the privilege or having disciplinary sanctions imposed.<sup>27</sup> Regarding the first contention, the Court enunciated "the prevailing rule that the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them."<sup>28</sup> This rule is in direct opposition to the rule in criminal cases.<sup>29</sup> As to the second contention, although the Court reiterated that the privilege still provides protection against compulsion of testimony in non-criminal contexts,<sup>30</sup> the Court construed "compulsion"

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<sup>23</sup> 425 U.S. 308, 318 (1976); see also Deborah S. Bartel, *Drawing Negative Inferences Upon a Claim of the Attorney-Client Privilege*, 60 BROOK. L. REV. 1355 (1995).

<sup>24</sup> For a good overview of the Fifth Amendment in general, and its invocation in civil cases in particular, see Elkan Abramowitz & Jed S. Rakoff, *The Fifth Amendment Privilege in Civil Litigation: Assertion, Waiver, and Consequences*, 137 CRIM. L. & URBAN PROBS. 211 (1985).

<sup>25</sup> *Baxter*, 425 U.S. at 312-13 (citations omitted).

<sup>26</sup> *Id.* at 316-17.

<sup>27</sup> *Id.* at 318-19.

<sup>28</sup> *Id.* at 318.

<sup>29</sup> See *supra* note 20 and accompanying text.

<sup>30</sup> "[T]he Fifth Amendment not only protects the individual against being involuntarily called as a witness against himself in a criminal prosecution but also

narrowly.

In *Baxter* and in the *Spevack-Garrity-Turley-Cunningham* line of cases,<sup>31</sup> the Court articulated a test to determine when unconstitutional compulsion has occurred. The question in each case was whether a particular government mandate or action was so "costly"<sup>32</sup> that it unconstitutionally compelled the defendant to waive the self-incrimination privilege.<sup>33</sup> These cases all involved situations where "refusal to submit to interrogation and to waive the Fifth Amendment privilege, standing alone and without regard to the other evidence, resulted in loss of employment or opportunity to contract with the state[, where] failure to respond to interrogation was treated as a final admission of guilt."<sup>34</sup> The defendants in these cases faced choices between a waiver of the privilege or forfeiting a job,<sup>35</sup> disbarment,<sup>36</sup> cancellation of state contracts and prohibition from doing state business in the future,<sup>37</sup> or loss of a political party office and a bar from holding political or public office for a period of time.<sup>38</sup>

The Court has articulated a test to determine when unconstitutional compulsion has occurred. The test, set out in *Lefkowitz v. Cunningham*, assesses the appropriateness of actions taken by the government in civil cases by examining whether "refusal to waive the Fifth Amendment privilege leads automatically and without more to the imposition of sanctions."<sup>39</sup> For example, the Board action in *Baxter* was consti-

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privileges him not to answer official questions put to him in any official proceeding, civil or criminal, formal or informal, where the answers might incriminate him in future criminal proceedings." *Baxter*, 425 U.S. at 316.

<sup>31</sup> Hereinafter referred to as the "*Spevack* line."

<sup>32</sup> *Spevack v. Klein*, 385 U.S. 511, 515 (1967). "Costly," as used here, mandates that a certain threshold level of compulsion exist prior to a finding of unconstitutionality. See *Graystone II*, 25 F.3d at 191.

<sup>33</sup> See *Lefkowitz v. Cunningham*, 431 U.S. 801, 803-04 (1977); *Lefkowitz v. Turley*, 414 U.S. 70, 75-76 (1973); *Spevack*, 385 U.S. at 512-13; *Garrity v. New Jersey*, 385 U.S. 493, 497 (1967).

<sup>34</sup> *Baxter*, 425 U.S. at 318.

<sup>35</sup> *Garrity*, 385 U.S. at 497 (police officers told that they would be fired if they did not testify in an internal investigation).

<sup>36</sup> *Spevack*, 385 U.S. at 512-13 (lawyer disbarred because he invoked the privilege rather than testifying at a disciplinary proceeding).

<sup>37</sup> *Turley*, 414 U.S. at 75-76 (by operation of New York law).

<sup>38</sup> *Cunningham*, 431 U.S. at 803-04 (by operation of New York law).

<sup>39</sup> *Id.* at 808 n.5. In *Baxter*, a six-to-two majority favored the preceding views. In dissent, Justice Brennan maintained that the adverse inference was impermissi-



tutionally permissible, as the production of other evidence necessarily preceded the imposition of a penalty.<sup>40</sup> Conversely, in cases where the court found constitutionally infirm penalties, the penalty directly and immediately followed invocation,<sup>41</sup> "without more,"<sup>42</sup> and as such was constitutionally proscribed. In sum, the test focuses on whether refusal to waive the privilege results in automatic deprivation of another right or privilege. The Court forbade only those government measures or actions taken in consequence of privilege that lead ineluctably, without more, to penalty. This frees courts to use equitable powers to take measures to redress harm to the interests of civil parties caused by an adversary's assertion of the privilege.

### B. *The Power of the Court to Compensate for Inequities*

The purpose of broad pre-trial discovery of factual issues is to promote "a fair contest with the basic issues and facts disclosed to the fullest practicable extent."<sup>43</sup> Privileges hinder the conduct of a fair contest by impairing the adverse party's access to evidence, information reasonably calculated to lead to evidence and other intelligence that otherwise would be discoverable. If neither party invokes a privilege there is no resulting prejudice for the court to remedy. If a party invokes a privilege, however, and the court finds the invocation groundless, overbroad or otherwise faulty, and therefore potentially prejudicial, the court may compel discovery and has broad discretion to enforce that order.<sup>44</sup> *Graystone* falls between these two ex-

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ble, at least where "a government official puts questions to an individual with the knowledge that the answers might tend to incriminate him." *Baxter*, 425 U.S. at 333-34 (Brennan, J., dissenting). Further, Justice Brennan argued that the adverse inference was a method of unconstitutional testimonial compulsion, maintaining that the point of the line of cases cited by the majority "was not that compulsion resulted from the automatic nature of the sanction, but that a sanction was imposed that made costly the exercise of privilege." *Id.* at 331-32. He would have tested for unconstitutional compulsion in *Baxter* by a less-exacting standard, finding compulsion if the "disciplinary penalty was imposed to some extent, [even] if not solely, as a sanction for exercising the constitutional privilege." *Id.* at 332.

<sup>40</sup> *Baxter*, 425 U.S. at 317-18.

<sup>41</sup> See *supra* notes 34-39 and accompanying text.

<sup>42</sup> *Cunningham*, 431 U.S. at 808 n.5.

<sup>43</sup> *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545, 549 (S.D.N.Y. 1985) (quoting *United States v. Procter & Gamble*, 356 U.S. 677, 682 (1958)).

<sup>44</sup> See FED. R. CIV. P. 37(b); see also *National Hockey League v. Metropolitan*

tremes: the *Graystone* defendants validly invoked a privilege but, either inherently or as a result of late waiver, that invocation prejudiced the opposing party.

On what does the court base its power to compensate the opposing party for its disadvantage? The singular nature of the self-incrimination privilege colors the answer to this question. There are a number of possible bases for orders to compensate a party for prejudice arising from an invocation of the self-incrimination privilege. Some courts and commentators have attempted to find a basis for the power in either Rule 26 or 37 of the Federal Rules of Civil Procedure.<sup>45</sup> Reliance on Rule 37 is problematic.<sup>46</sup> Both Rule 26 and what has been called a "general power of the courts to prevent the cat-and-mouse approach to civil litigation,"<sup>47</sup> however, provide bases for preclu-

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Hockey Club, 427 U.S. 639, 643 (1976).

<sup>45</sup> Rule 26(c) provides that the court "may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression or undue burden." FED. R. CIV. P. 26(c) (emphasis added). Rule 37 applies in cases of failure to obey a court order regarding discovery, FED. R. CIV. P. 37(b)(2), or for failure to respond to discovery. FED. R. CIV. P. 37(d). An order "refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting that party from introducing designated matters in evidence," FED. R. CIV. P. 37(b)(2)(B), among others, may be made.

<sup>46</sup> Rule 37, by its terms, requires that there be an "order" or a "failure" prior to sanctions being imposed. See FED. R. CIV. P. 37. Nevertheless, one court has held that the express power to preclude in Rule 37 may be used, regardless of whether a motion to compel has actually been made. *United States v. 901 N.E. Lakewood Drive*, 780 F. Supp 715 (D. Or. 1991). In *Lakewood Drive*, the court reasoned that a motion to compel under Rule 37 was available and could be granted, even though the court might be powerless to enforce it by contempt or another sanction impermissible under the Fifth Amendment. *Id.* at 720-21. Since it *could* have been granted, and the defendant resisting discovery had given "no indication that she would waive her Fifth Amendment privilege," the court held preclusion to be an appropriate sanction for the uncomplished-with, imaginary order to compel discovery. *Id.* at 721.

This approach has some bases in common with the position of this Comment—that there is an inherent, equitable power of the courts to police the fairness of the discovery and trial process. See *infra* notes 52-57 and accompanying text. It tacitly acknowledges that total preclusion is constitutionally permissible, and that prejudice inheres in the total avoidance of discovery by invocation of the self-incrimination privilege. It is difficult to ignore the plain terms of Rule 37, however, which provide that sanctions may be imposed for orders made and not complied with or other "failures"—not for presumed non-compliance with orders that arguably could have been made. A more direct route to the same destination is available in courts' equitable power.

<sup>47</sup> *United States v. Talco Contractors, Inc.*, 153 F.R.D. 501, 507 (W.D.N.Y. 1994).

sion orders to remedy prejudice from privilege invocations.

Rule 26 of the Federal Rules of Civil Procedure gives courts broad power to devise protective orders to combat prejudice arising during discovery.<sup>48</sup> One commentator has suggested that "[b]ecause the invokers [of the privilege] have not violated any discovery rules, the authority for barring the testimony arises under Fed. R. Civ. P. 26(c) . . . , which authorizes any order needed to protect a party from oppression."<sup>49</sup> The wording of the rule, "*any* order which justice requires,"<sup>50</sup> appears to allow the court great latitude. Some of the orders enumerated in Rule 26, however, suggest that the primary aim of the rule-makers may have been to protect those from whom discovery is sought, by providing:

- (1) that the . . . discovery not be had; (2) that the . . . discovery may be had only on specified terms and conditions, . . . ; (3) that the discovery may be had only by a method of discovery other than that selected by the party seeking discovery; (4) that certain matters not be inquired into, or that the scope of the . . . discovery be limited to certain matters; (5) that discovery be conducted with no one present except persons designated by the court; (6) that a deposition after being sealed be opened only by an order of the court; . . .<sup>61</sup>

Notwithstanding this focus, the preliminary language gives courts, at a party's request, broad authority to police unfair prejudice arising from discovery.

The best grounding for the power to issue preclusion orders lies in courts' inherent equitable power to safeguard the fair-contest interest. In *Graystone*, the Third Circuit, echoing other courts, did not look to the Federal Rules of Civil Procedure, but simply stated that "[i]n a civil trial, a party's invocation of the privilege may be proper, but it does not take place in a vacuum; the rights of the other litigant are entitled to consideration as well."<sup>62</sup> Although courts often do not enumerate a statutory basis for preclusion, their language shows a general desire to avoid unfair shifts in the balance of power

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<sup>48</sup> See FED. R. CIV. P. 26.

<sup>49</sup> Robert Heidt, *The Conjurer's Circle—The Fifth Amendment Privilege in Civil Cases*, 91 YALE L.J. 1062, 1130 n.248 (1982). Professor Heidt was specifically referring to the power of courts to preclude in cases of late waiver.

<sup>50</sup> FED. R. CIV. P. 26(c) (emphasis added).

<sup>61</sup> *Id.*

<sup>62</sup> *Graystone II*, 25 F.3d at 191.

between the parties like the kind often brought about by invocation of the self-incrimination privilege. These unfair shifts are inimical to the fair-contest goals of discovery and thus subject to equitable adjustment.<sup>53</sup>

The self-incrimination privilege has little value beyond its value to the privileged party, to either opposing parties or society. This circumscribed value militates toward strict equitable scrutiny by courts in civil cases. The privilege is unlike others because, by definition, invocation is permissible only if the party has reasonable grounds to believe that an answer "would support a conviction or furnish a link in the chain of evidence needed to prosecute the claimant for a crime."<sup>54</sup> The privilege invoker foresees criminal proceedings and, looking beyond the civil proceeding, prioritizes a concern for possible criminal punishment over a concern for civil liability. The direct advantages from assertion of the self-incrimination privilege accrue only to the defendant,<sup>55</sup> and then only within a

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<sup>53</sup> See *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553 (1st Cir. 1989). In *Gutierrez-Rodriguez*, the First Circuit stated that

[c]ourts have not been afraid to bar a party from testifying where doing so was necessary to prevent the "thwarting [of] the purposes and policies of the discovery rules."

. . . .  
The Federal Rules contemplate . . . "full and equal mutual discovery in advance of trial" so as to prevent surprise, prejudice and perjury. . . . The court would not tolerate nor indulge a practice whereby a defendant by asserting the privilege against self-incrimination during pre-trial examination and then voluntarily waiving the privilege at the main trial surprised or prejudiced the opposing party.

*Id.* at 576 (quoting *Duffy v. Currier*, 291 F. Supp. 810, 815 (D. Minn. 1968)); see also *Wehling v. CBS*, 608 F.2d 1084, 1088 (5th Cir. 1980) ("We recognize, of course, that the [privilege invoker] is not the only party to this action who has important rights that must be respected."); *Graystone I*, 820 F. Supp. at 869 ("Fairness dictates this rule. . . . [A]ny other rule would flout the courts and their discovery process.").

<sup>54</sup> *Hoffman v. United States*, 341 U.S. 479, 486 (1951).

<sup>55</sup> The self-incrimination privilege arguably may provide other, indirect benefits to society. It may be seen as a bastion against the abuse of governmental power, or as conferring a generalized heightening of basic human dignity and freedom. All of the privileges noted also further similar ideals. See *supra* note 56 and accompanying text. Unlike the self-incrimination privilege, however, they have relationships underlying them that confer considerable direct benefits to society as a whole outside of the criminal context. The fifth amendment privilege safeguards only certain activities, and even those society has deemed criminal. Moreover, other privileges may by definition be invoked solely for dignity reasons. Conversely, the self-incrimination privilege may only be asserted in the case of a reasonable fear

judicial context.

While the benefits of the self-incrimination privilege are limited strictly to the criminal milieu, the broad value of other privileges provides no such attenuation. Other privileges—attorney-client, doctor-patient, priest-penitent—serve other salutary purposes in both criminal and civil cases, and to society as a whole. These extra-judicial benefits ameliorate their derogatory effect on the information-gathering process, as set forth by Wigmore.<sup>56</sup> All of these other privileges protect relationships between professionals and their clients; relationships that, to a varying degree, are at the core of peoples' professional, personal and spiritual lives. These privileges exist because society has a broad interest in fostering the free communication indispensable to these relationships. Society at large gains no such direct benefits from the existence of the self-incrimination privilege, the effect of which is limited to the prophylactic protection against compulsion of and use of compelled testimony in criminal trials. Thus, the strong public interest in the civil truth-finding process justifies courts' use of their equitable powers to effectively compensate for imbalances.<sup>57</sup>

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of criminal prosecution. In sum, the mere existence of these indirect benefits does not warrant the expansive treatment accorded to the far more broadly valuable privileges discussed *infra* pp. 11-12.

<sup>56</sup> See Note, *Making Sense of the Rules of Privilege Under the Structural (Il)logic of the Federal Rules of Evidence*, 105 HARV. L. REV. 1339, 1343-45 (1992) (expounding Wigmore's rationale for existence of relational privileges); see also Michael L. Waldman, *Beyond Upjohn: The Attorney-Client Privilege in the Corporate Context*, 28 WM. & MARY L. REV. 473 (1987) (discussing the usefulness to business of the attorney-client privilege); Maureen B. Hogan, Note, *The Constitutionality of an Absolute Privilege for Rape Crisis Counselling: A Criminal Defendant's Sixth Amendment Rights Versus a Rape Victim's Right to Confidential Therapeutic Counseling*, 30 B.C. L. REV. 411, 420-25 (1989) (balancing value of the proposed privilege outside the criminal context versus a defendant's constitutional rights, and arguing that rape crisis counselling fits the Wigmore rationale for relational privileges); Rorie Sherman, *N.J. Supreme Court Weakens Priest-Penitent Privilege: Legislature Is Expected to Act Quickly to Restore the Sanctity of the Confessional*, NAT'L L.J., June 13, 1994, at A15.

<sup>57</sup> Courts often rationalize expansion of constitutional privileges by valuing them more highly than those based upon common law. See, e.g., *Graystone II*, 25 F.3d at 192. Increased vigilance is indeed desirable, but only in guaranteeing availability of constitutional privileges within their proper scope. Deference to expansive claims of privilege justified largely on the basis of the constitutional nature of the claimed privilege is not required by the Constitution.

## II. SEC v. GRAYSTONE NASH, INC.

### A. *The District Court Opinion*<sup>58</sup>

#### 1. Facts and Procedure

Culminating an investigation that had begun in 1989, on June 30, 1991, the SEC filed a complaint in federal court, charging the defendants as principals in a complex, wide-ranging and lucrative securities fraud operation.<sup>59</sup> The defendants relied on the privilege against self-incrimination throughout the three-year duration of the SEC's involvement in this matter, first invoking the privilege during the investigatory phase on June 12, 1990.<sup>60</sup> During telephone depositions on June 10

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<sup>58</sup> *Graystone I*, 820 F. Supp. 863 (D.N.J. 1993). Graystone Nash "traded corporate securities in the over-the-counter market, creating markets for securities it previously had underwritten in public offerings." *Id.* at 866. At the district court level, three defendants of an initial total of seven remained: President and Chairman of the Board Thomas Ackerly, Vice President Richard Adams and Vincent Ackerly, Thomas's brother, who was actively involved in securities trading. *Id.* Two others, Shawn Crane and Robert Rock, had final judgments of permanent injunction entered against them, in which they neither admitted nor denied any of the allegations of the complaint and agreed to "produce documents and make [themselves] available for interviews and . . . testify at any depositions, trials or hearings in this action or in any related . . . actions or proceedings." Consent and Undertakings of Robert L. Rock at 1-2, *Graystone I*, 820 F. Supp. 863 (Final Judgment of Permanent Injunction and Other Relief). Note that neither of these parties had made any admissions nor waived the Fifth Amendment and, as such, still can invoke the privilege in response to any requests the SEC makes. The court entered default judgments against the corporation and a last defendant, Dennis Williams, who was enjoined and ordered to disgorge approximately \$14 million. See Order for Issuance of a Bench Warrant and To Show Cause, filed Dec. 11, 1992, *Graystone I*, 820 F. Supp. 863.

<sup>59</sup> Graystone had 35 franchised branch offices around the country for which the defendants had overall responsibility as corporate officers. Through a program of coercion of customers and manipulation of the securities in which they made a market, the defendants allegedly realized illicit trading gains of over \$60 million over the course of 18 months. See *Graystone I*, 820 F. Supp. at 866-68 for more detail. The causes of action alleged against them included violations of various provisions of the Securities Act, the Exchange Act and certain SEC rules and regulations promulgated thereunder, which proscribe fraudulent activity, the offering and sale of unregistered securities, prospectus violations and improper purchases during distributions. *Id.*

<sup>60</sup> Memorandum and Order dated July 23, 1993 at 3, *Graystone I*, 820 F. Supp. 863 (order denying both defendants' motions to stay disgorgement order and Adams's motion to stay injunctive relief, pending appeal).

and June 22, 1992, each of the defendants, who were representing themselves, invoked the privilege in response to each substantive request, thereby totally avoiding discovery.<sup>61</sup> Four months later, after the close of discovery,<sup>62</sup> on October 23, 1992, the SEC filed motions for an order of preclusion and for summary judgment against the still silent defendants.<sup>63</sup> The preclusion request sought to bar the defendants from introducing evidence as to issues about which they had previously invoked the privilege, including "respective roles, remuneration and decisionmaking authority at Graystone."<sup>64</sup> Finally, on December 14, 1992, almost two months after the SEC's motions had provided extensive detail about the evidence in its possession, and two and one-half years after the defendants first relied on the privilege, the defendants answered by filing responses and affidavits disputing these points,<sup>65</sup> attacking the evidence given by former Graystone employees,<sup>66</sup> and asserting lack of scienter.<sup>67</sup>

## 2. Hearing and Decision

On January 25, 1993, the District of New Jersey heard argument on the motions to preclude and for summary judgment.<sup>68</sup> During the three months elapsed since the SEC had filed its motions, the defendants had made no attempt to supplement their minimal response to the motions,<sup>69</sup> nor had

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<sup>61</sup> *Graystone I*, 820 F. Supp. at 869. The Third Circuit elaborated on the defendants' recalcitrant nature. The court stated that they "refused to answer questions other than those pertaining to their names, addresses, current employment and telephone numbers." *Graystone II*, 25 F.3d 187, 189 (3d Cir. 1994).

<sup>62</sup> Order Revising Pretrial Schedule, filed May 19, 1992, *Graystone I*, 820 F. Supp. 863 (order of U.S. Magistrate Judge Pisano reiterating that "discovery must be completed on or before September 1, 1992").

<sup>63</sup> *Graystone II*, 25 F.3d at 189.

<sup>64</sup> *Graystone I*, 820 F. Supp. at 869 & n.8.

<sup>65</sup> *Graystone II*, 25 F.3d at 189.

<sup>66</sup> See *Graystone I*, 820 F. Supp. at 866.

<sup>67</sup> *Graystone II*, 25 F.3d at 189.

<sup>68</sup> *Id.*

<sup>69</sup> Thomas Ackerly submitted a sworn document that stated that he was under criminal investigation, and "therefore . . . unable to testify in this matter and [that he] asserted [his] Fifth Amendment privilege." Certification of Thomas V. Ackerly at 1-2, filed Dec. 14, 1992, *Graystone I*, 820 F. Supp. 863. He offered to testify after the criminal investigation was concluded, given the overwhelming evidence of wrongdoing against him. He also contended that the SEC was deflecting

they volunteered to submit to discovery, nor given any indication that their response constituted a waiver of the privilege. The court opened the hearing with a cautionary note to the defendants, stating that they would not be allowed to use their invocation of the privilege as a "sword."<sup>70</sup> The court warned them that in a civil action the "court does not have to give . . . the same deference that you're entitled as if there's some pending criminal case" and that it could "dismiss answers or . . . grant the relief of a plaintiff, *where you have chosen to take the Fifth Amendment*."<sup>71</sup> The defendants did not recant their invocation of the privilege at this point, but stated that they understood the judge's warning.<sup>72</sup>

After the SEC outlined the extensive evidence against the defendants, the court noted the seeming dilemma created by defendants' invocation in this civil action—that they essentially had to choose between combatting the civil case and minimizing their criminal exposure.<sup>73</sup> The SEC responded that one possible justification for imposing this burden is that otherwise the defendants could delay resolution of the case and frustrate the government's enforcement actions, all for fear of "someday"

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his requests for documents and although he had not the "wherewithal" to attend depositions of others, he believed that given the opportunity to examine them at trial he would be able to show the court that their testimony "is not worthy of belief." *Id.* He gave no indication that he was willing to provide facts at a meaningful time or to otherwise waive the privilege and submit to examination himself; he gave ample indication, however, that he would like to attack the sufficiency and credibility of the SEC's case without dropping the shield of privilege.

Richard Adams incorporated the legal arguments made by Ackerly and provided certain factual contentions. He averred that he had a total lack of responsibility for trading and management of the firm, lack of ownership interest in the firm, minimal compensation as shown on tax returns, that he participated in testimony before the National Association of Securities Dealers ("NASD"), of which the SEC had obtained copies (from the NASD) and he attacked the evidence offered by other former employees of Graystone. His affidavit, however, appears to be unsworn, and therefore can carry no weight. Affidavit of Richard Adams, filed Dec. 14, 1992, *Graystone I*, 820 F. Supp. 863. Vincent Ackerly's opposing document, also unsworn, incorporates Thomas Ackerly's legal contentions and denies any knowledge of wrongdoing or responsibility in management or trading decisions of the firm. Defendant Vincent R. Ackerly's Request for Denial of Motion for Summary Judgment, filed Dec. 14, 1992, *Graystone I*, 820 F. Supp. 863.

<sup>70</sup> Transcript of Proceedings of January 25, 1993 at 2, *Graystone I*, 820 F. Supp. 863 (D.N.J. 1993) [hereinafter "Transcript of Proceedings"].

<sup>71</sup> Transcript of Proceedings, *supra* note 70, at 2 (emphasis added).

<sup>72</sup> Transcript of Proceedings, *supra* note 70, at 3.

<sup>73</sup> Transcript of Proceedings, *supra* note 70, at 5-6.



being indicted for the same activities.<sup>74</sup> The court then restated the defendants' choice, saying "when you look at the lesser of two evils, to be barred from the securities industry is a lesser evil than to be forthcoming at a deposition and potentially expose yourself to criminal conviction and imprisonment."<sup>75</sup> In other words, the defendants had prioritized the threat of incurring criminal liability over the possibility that the court would preclude them from offering factual support for their defense in the civil action, thereby increasing the defendants' risk of losing that action.

The defendants then spoke on their own behalf.<sup>76</sup> One defendant, Thomas Ackerly, complained of insufficient access to the SEC's evidence, including transcripts of various depositions.<sup>77</sup> The court noted that the depositions were taken in Florida, where Ackerly resided, and that he had chosen to not attend.<sup>78</sup> Ackerly made no statement disputing the facts of the substantive allegations. Another defendant, Richard Adams, portrayed himself as a pawn in the Graystone operation. Saying that he was only an "operations manager,"<sup>79</sup> had no interest in the business,<sup>80</sup> made only a salary during the period in question, and could bring "friends in the business for 25 years" to give "expert testimony," he averred that he had no part in the culpable activities.<sup>81</sup>

On April 21, 1993, Judge Wolin ruled.<sup>82</sup> He first addressed the SEC's request to preclude the defendants' proffered evidence. He characterized the defendants' affidavits as containing "denials of wrongdoing, attacks on the former Graystone employees whose deposition testimony supports this

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<sup>74</sup> Transcript of Proceedings, *supra* note 70, at 5.

<sup>75</sup> Transcript of Proceedings, *supra* note 70, at 5-6.

<sup>76</sup> Vincent Ackerly was not present at the hearing. He also did not participate in the appeal to the Third Circuit, although he did file a Notice of Appeal dated June 22, 1993. An appeal in this case was dismissed as untimely filed by the Third Circuit, with Thomas Ackerly captioned as appellant, on October 12, 1993. Order dated October 12, 1993, *Graystone II*, 25 F.3d 187 (C.A. No. 93-5393). One can only conclude that the name captioned should be Vincent Ackerly rather than Thomas Ackerly.

<sup>77</sup> Transcript of Proceedings, *supra* note 70, at 7-8.

<sup>78</sup> Transcript of Proceedings, *supra* note 70 at 8.

<sup>79</sup> Transcript of Proceedings, *supra* note 70 at 12.

<sup>80</sup> Transcript of Proceedings, *supra* note 70 at 12.

<sup>81</sup> Transcript of Proceedings, *supra* note 70 at 12.

<sup>82</sup> *Graystone I*, 820 F. Supp. 863.

motion [for summary judgment] and defenses based on lack of scienter," and as raising "claims about their respective roles, remuneration and decisionmaking authority at Graystone."<sup>83</sup> Because of the lack of Third Circuit case law on point,<sup>84</sup> the court reviewed factually similar cases from the Southern District of New York. The court decided that the representations about which the defendants had refused to respond during discovery should be excluded.<sup>85</sup> The court stated its reasoning:

Fairness dictates this rule. If a party seeks shelter under his right against self-incrimination, he cannot later emerge and attempt to formulate a defense with evidence previously withheld from discovery. Further, any resultant prejudice must be borne by the party asserting the privilege and not by the one subjected to its use.

As the instant case demonstrates, any other rule would flout the courts and their discovery process. Allowing the New Jersey defendants [the Ackerlys and Adams] to come forward at this stage, after plaintiff has deposed many witnesses and submitted its arguments and proofs, would load the scales unjustly. Thus, the court will not permit the defendants to advance exculpatory claims. . . .<sup>86</sup>

The court then painstakingly examined the sufficiency of the evidence against the defendants<sup>87</sup> and the remedies proposed—injunction and disgorgement<sup>88</sup>—and granted summary judgment and the requested relief to the SEC.<sup>89</sup> The defen-

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<sup>83</sup> *Id.* at 869, 869 n.8.

<sup>84</sup> The court noted, however, that "at least one district court in this circuit has sanctioned its use. *Id.* at 869 n.7 (citing *Goodman v. DeAzoulay*, 539 F. Supp. 10, 16 (E.D. Pa. 1981) (granting plaintiff's motion for sanctions and precluding defendant from introducing evidence relating to matters as to which he invoked Fifth Amendment)). The Third Circuit did not address this case in its argument. The defendant in *Goodman* invoked the Fifth Amendment during a discovery deposition about a bank withdrawal, in the context of a real estate deal gone sour. *Goodman*, 539 F. Supp. at 16. The order dated November 16, 1981, by which the court precluded the defendant from later introducing evidence relating to this point, is unpublished. *Id.*

<sup>85</sup> *Graystone I*, 820 F. Supp. at 869. The court quoted *SEC v. Grossman*, 121 F.R.D. 207, 210 (S.D.N.Y. 1987), for the proposition that "if a party fails to allow pre-trial discovery of evidence on his claim of privilege, a preclusion order should be entered to bar his subsequent use of the evidence." *Id.*; see also *SEC v. Benson*, 657 F. Supp. 1122, 1129 (S.D.N.Y. 1987); *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545, 549-50 (S.D.N.Y. 1985). For discussion of the rationale of these cases, see *infra* notes 182-92 and accompanying text.

<sup>86</sup> *Graystone I*, 820 F. Supp. at 869 (citations and footnote omitted).

<sup>87</sup> *Id.* at 870-74.

<sup>88</sup> *Id.* at 874-76.

<sup>89</sup> *Id.* at 876.

dants appealed the grant of summary judgment and the preclusion order to the Court of Appeals for the Third Circuit. They requested reversal of summary judgment, maintaining that the district court granted it on a deficient record limited by an inappropriate preclusion order.<sup>90</sup>

### B. *The Third Circuit Opinion*

Writing for the Third Circuit, Judge Weis first noted that "[u]se of the privilege in a civil case may . . . carry some disadvantages for the party who seeks its protection."<sup>91</sup> The court then observed that an adverse party also faces potentially substantial problems in that it may be deprived of a "source of information that might conceivably be determinative in a search for the truth."<sup>92</sup> Given the fact that parties may invoke the privilege and then waive it, perhaps after the discovery period concludes, Judge Weis addressed two distinct resulting situations: the consequences of valid invocation and the "effects when [the privilege] is abused, causing unfair prejudice to the opposing litigant," such as in cases of late waiver.<sup>93</sup>

Judge Weis split the balance of the opinion into discussion of three issues: whether a preclusion order is a constitutionally impermissible automatic sanction for a valid invocation of the privilege;<sup>94</sup> the test for the availability and scope of remedial measures in favor of the plaintiffs if the defendants continue to validly invoke the privilege or attempt to waive it;<sup>95</sup> and the appropriate scope of the SEC's remedy, in light of the aforementioned test, and given the level of prejudice imposed by the defendants' invocation and waiver.<sup>96</sup>

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<sup>90</sup> *Graystone II*, 25 F.3d 187, 194 (3d Cir. 1994).

<sup>91</sup> *Id.* at 190 (following *Baxter v. Palmigiano*, 425 U.S. 308 (1976)); see *supra* notes 25-30 and accompanying text.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at 190-91.

<sup>95</sup> *Id.* at 191-92.

<sup>96</sup> *Graystone II*, 25 F.3d at 191-92.

## 1. The Preclusion Order as an Inappropriate Sanction

Judge Weis maintained that in the case of a proper invocation of the privilege, a preclusion order would be an "inappropriate sanction,"<sup>97</sup> noting that "[t]he Supreme Court has cautioned that the Constitution 'limits the imposition of any sanction which makes assertion of the Fifth Amendment privilege 'costly.'"<sup>98</sup> The court went on to describe a number of cases where the invoker of the fifth amendment privilege had faced situations in which either the privilege had to be waived or penalties would have followed automatically.<sup>99</sup> Judge Weis further reasoned that the Federal Rules of Civil Procedure<sup>100</sup> provide that "claims of privilege may be made to withhold material otherwise subject to discovery," and therefore give no basis for "inflicting sanctions when there is a valid invocation of the [privilege]."<sup>101</sup> In conclusion, Judge Weis stated that it was clear from this reasoning "that dismissal of an action or entry of judgment as a sanction for valid invocation of the privilege during discovery is improper."<sup>102</sup> Moreover, since "a complete bar to presenting evidence, from any source, . . . would in *all practical effect* amount to the entry of an adverse judgment, [it] would be an inappropriate sanction."<sup>103</sup>

## 2. Remedial Measures for Invocation or Late Waiver of the Self-Incrimination Privilege

The court next noted that the invocation of the privilege in a civil trial "does not take place in a vacuum; the rights of other litigants are entitled to consideration as well."<sup>104</sup> Judge Weis specified one situation in which concerns for adversaries arise: when a party rests on the privilege throughout discovery,

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<sup>97</sup> *Id.* at 190-91.

<sup>98</sup> *Id.* at 190 (citing *Spevack v. Klein*, 385 U.S. 511, 515 (1967), for the proposition discussed *supra* note 31-42 and accompanying text.).

<sup>99</sup> *Id.*; see *supra* notes 31-38 and accompanying text.

<sup>100</sup> See FED. R. CIV. P. 26(b)(5).

<sup>101</sup> *Graystone II*, 25 F.3d 187, 190-91 (3d Cir. 1994).

<sup>102</sup> *Id.* at 191 (emphasis added).

<sup>103</sup> *Id.* (emphasis added).

<sup>104</sup> *Id.*

but decides to offer testimony just prior to trial.<sup>105</sup> The court recognized that in such a case an adverse party would be at a disadvantage, as the "opportunity to combat the newly available testimony might not exist, a new investigation could be required, and orderly trial preparation could be disrupted."<sup>106</sup> The court cited cases in which courts had issued preclusive orders in response to this type of prejudice, emphasizing that those courts had found that the late waiver would allow the invoker "to impale . . . accusers with surprise testimony at trial."<sup>107</sup>

Judge Weis then enunciated a balancing test for the propriety of a remedy in these situations as follows:

A trial court must carefully balance the interests of the party claiming protection against self-incrimination and the adversary's right to equitable treatment. Because the privilege is constitutionally based, the detriment to the party asserting it should be no more than is necessary to prevent unfair and unnecessary prejudice to the other side.<sup>108</sup>

The court cited two district court cases from other circuits where "the necessary accommodation took place."<sup>109</sup> First, in *FTC v. Kitco of Nevada, Inc.*,<sup>110</sup> the defendant had invoked the privilege in response to some discovery requests, but the court nevertheless allowed him to testify. The Third Circuit noted that the *Kitco* court found it significant that the defendant had provided some discovery and, therefore, the FTC had not been unfairly surprised or prejudiced. Moreover, the FTC "had been able to thoroughly prepare its case and was not solely dependent on the plaintiff for pertinent testimony."<sup>111</sup> Judge Weis also cited *Young Sik Woo v. Glantz*,<sup>112</sup> in which the plaintiff moved for summary judgment<sup>113</sup> against a defendant who invoked the privilege in response to discovery re-

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<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 191.

<sup>107</sup> *Graystone II*, 25 F.3d at 191 (quoting *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553, 577 (1st Cir. 1989)); see also *In re Edmond*, 934 F.2d 1304, 1308-09 (4th Cir. 1991); *United States v. Parcels of Land*, 903 F.2d 36, 43 (1st Cir. 1990).

<sup>108</sup> *Graystone II*, 25 F.3d at 192.

<sup>109</sup> *Id.*

<sup>110</sup> 612 F. Supp. 1282 (D. Minn. 1985).

<sup>111</sup> *Graystone II*, 25 F.3d at 192.

<sup>112</sup> 99 F.R.D. 651 (D.R.I. 1983).

<sup>113</sup> There was no preclusion order at issue.

quests, but did not offer an affidavit in opposition.<sup>114</sup> According to Judge Weis, the *Glantz* court observed that the defendant had made no showing as to the contested facts or to the unavailability of third party evidence; he may have been able to "rebut his opponent's case without his own testimony."<sup>115</sup> Accordingly, the *Glantz* court, "in the exercise of caution," declined to enter judgment, and gave the defendant the opportunity to conduct further discovery so as to oppose future motions.<sup>116</sup>

The court then summarily rejected two factually similar cases from the Southern District of New York. In these cases, the court issued orders totally precluding defendants from offering any factual support for defenses and denials as to which they had invoked the privilege during discovery.<sup>117</sup> As in *Graystone*, these were civil enforcement actions by the SEC in which defendants had refused to give any substantial discovery and then attempted to combat summary judgment motions with affidavits and other evidence.<sup>118</sup> Judge Weis rejected the reasoning of *SEC v. Cymaticolor Corp.* as "not . . . satisfactory because the court there did not perform the careful evaluation used in *Kitco*."<sup>119</sup> As to the other case, *SEC v. Benson*,<sup>120</sup> the court noted that it "is not clear from the opinion" whether a total preclusion order was made.<sup>121</sup> Judge Weis opined, however, that "the [*Benson*] defendant's obstructionary conduct throughout the litigation might have had a bearing on the court's ultimate choice of remedies."<sup>122</sup> Beyond these cursory references, Judge Weis did not analyze the reasoning of the cases on which Judge Wolin relied heavily in his district court opinion.<sup>123</sup>

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<sup>114</sup> *Glantz*, 99 F.R.D. at 651.

<sup>115</sup> *Graystone II*, 25 F.3d at 192.

<sup>116</sup> *Id.*

<sup>117</sup> See *SEC v. Benson*, 657 F. Supp. 1122 (S.D.N.Y. 1987); *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545 (S.D.N.Y. 1985).

<sup>118</sup> See *Benson*, 657 F. Supp. at 1128-29; *Cymaticolor*, 106 F.R.D. at 549.

<sup>119</sup> *Graystone II*, 25 F.3d at 192.

<sup>120</sup> 657 F. Supp. 1122.

<sup>121</sup> *Graystone II*, 25 F.3d at 192.

<sup>122</sup> *Id.*

<sup>123</sup> See *supra* note 85 and accompanying text.

### 3. Determining the Proper Remedy for the SEC in *Graystone*

Judge Weis then considered the proper remedy by applying the balancing test set forth above.<sup>124</sup> First, the Third Circuit suggested that the trial court should have determined if defendants had waived their fifth amendment privilege.<sup>125</sup> Judge Weis pointed to the following as *possibly* indicative of a waiver: the affidavits filed in response to the SEC motions for preclusion and summary judgment which "addressed some of the same matters that they had refused to discuss at their depositions;" statements made at the hearing by defendants; and a sworn statement made by Adams, prior to the SEC action, to the National Association of Securities Dealers ("NASD"), a quasi-governmental, self-regulatory organization.<sup>126</sup> The court also cited NASD testimony and a number of documents that Adams had turned over to the SEC<sup>127</sup> as factors that "might . . . have had some relevance in determining the appropriate scope of preclusion, assuming that to be a proper remedy in the circumstances."<sup>128</sup>

Second, the court found that the record did not support the SEC's claim that it suffered prejudice by the defendants' introduction of evidence after discovery and close to the trial.<sup>129</sup> Judge Weis asserted that the SEC had set the timetable by filing the motion for preclusion, which "was apparently the first indication given to defendants that they might be unable

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<sup>124</sup> See *supra* note 108 and accompanying text.

<sup>125</sup> *Graystone II*, 25 F.3d at 193.

<sup>126</sup> *Id.* See *infra* notes 205-10 and accompanying text for an argument against allowing waiver in these circumstances.

The sworn statement cannot operate as a waiver because any waiver "is limited to the particular proceeding in which the witness volunteers the testimony. . . . His voluntary testimony before a coroner's inquest, or a grand jury, or other preliminary and separate proceeding . . . is therefore not a waiver for the main trial." *United States v. Johnson*, 488 F.2d 1206, 1210 (1st Cir. 1973) (citation omitted); accord *United States v. Parcels of Land*, 903 F.2d 36, 43 (1st Cir. 1990); *United States v. Miranti*, 253 F.2d 135, 139 (2d Cir. 1958); *In re Neff*, 206 F.2d 149, 152 (3d Cir. 1953).

<sup>127</sup> The documents were turned over during the course of the investigation, prior to the commencement of this action.

<sup>128</sup> *Graystone II*, 25 F.3d at 193.

<sup>129</sup> *Id.*

to present any kind of defense or that a trial on the merits might not be held.”<sup>130</sup> The court stated that the SEC should have addressed the appropriateness of a preclusion order before the summary judgment motion was made.<sup>131</sup>

Finally, the court noted its skepticism of the SEC’s claim that the “new and unexpected evidence” would cause prejudice.<sup>132</sup> It pointed out that two of the other defendants had entered into consent judgments and had agreed to testify at any evidentiary proceeding, and that the SEC had deposed several other people whose testimony it had used to support the motions before the district court.<sup>133</sup> Judge Weis focused on the information the SEC already possessed; he noted the substantial evidence gathered and significant resources expended, finding this to be “a far cry from a case where invocation of the privilege prevented the opposing party from obtaining the evidence it needed to prevail in the litigation.”<sup>134</sup> The court then summed up its view of prejudice and the preclusion order:

Nothing presently in the record persuades us that the SEC would have been unable to present a strong case even if Adams and Ackerly had been permitted to testify if they chose. The severe remedy of barring defendants from presenting any evidence from third parties was even less necessary. The preclusion sanction did not “level the playing field,” but tilted it strongly in favor of the SEC.<sup>135</sup>

In closing, the Third Circuit gave some sense of the concerns underlying its opinion. Judge Weis cautioned that when the government is a party in a civil case, and also controls possible criminal prosecution, “special consideration should be given to the plight of the party asserting the Fifth Amendment.”<sup>136</sup> He also noted the “burden that *pro se* representation imposes upon extremely busy district judges,” and posited that the “the failure of Adams and Ackerly to present proper legal arguments . . . did not alert [Judge Wolin] to the

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<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Graystone II*, 25 F.3d at 193.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at 193-94.



factors that should be considered in directing an appropriate remedy."<sup>137</sup>

The court cautioned that "[w]e should not be understood as holding that, in the circumstances of this case, no remedial measures should be imposed" and noted that "the imposition of an appropriate remedy is within the discretion of the trial court." The Third Circuit reversed the summary judgment granted by the district court as based on a deficient record, and remanded for consideration of an appropriate remedy in light of the aforementioned factors.<sup>138</sup>

### III. THE PROBLEMS WITH *GRAYSTONE*—OF PRACTICAL EFFECTS AND BALANCING TESTS

#### A. *Summary*

In *Graystone*, the Third Circuit gave its imprimatur to comprehensive invocations of the self-incrimination privilege in civil actions. Initially, it emphasized the practical effect of total preclusion orders in determining the constitutional permissibility of such orders. In contrast, the Supreme Court deliberately has limited its definition of inappropriate sanctions to those that follow *automatically* upon invocation of the privilege, without more.<sup>139</sup> Even given entry of a preclusion order in its favor, a plaintiff must prove a *prima facie* case prior to entry of judgment, and the defendant may still attack the sufficiency of that case. Total preclusion orders simply are not automatic sanctions.

The Third Circuit's condemnation of total preclusion orders as unconstitutional was portentous of its defendant-friendly balancing test. The court balanced the burden placed on the right to invoke the self-incrimination privilege against the prejudice to the opposing party.<sup>140</sup> This test gives those

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<sup>137</sup> *Id.* at 194. Presumably, Judge Wolin did not act without a theory, but found proper and persuasive legal arguments either in the SEC's motions and supporting documents or *sua sponte*. For further discussion of the court's motivation, see *infra* notes 221-33 and accompanying text.

<sup>138</sup> *Id.* at 194.

<sup>139</sup> See *supra* notes 31-42 and accompanying text for a discussion of the Supreme Court authority for this proposition.

<sup>140</sup> *Graystone II*, 25 F.3d at 192.

invoking the privilege license to prejudice the opposing party in every civil case, albeit to varying degrees. Furthermore, the Third Circuit's test is based on factually dissimilar and doctrinally unclear authority. The court compounded the prejudicial effect of this test by defining prejudice very narrowly. Instead of focusing on the benefits the SEC was deprived of, the court's analysis focused on the information that the SEC was able to obtain despite the defendants' assertion of privilege.<sup>141</sup>

The court's test, combined with its restrictive definition of prejudice, produces a powerful privilege. This strong privilege is appropriate only in a criminal case, where any countervailing considerations pale in light of a defendant's immediate criminal jeopardy. A civil case presents no such immediacy, and in a civil case numerous other important considerations arise.

The court's concern for the defendants was motivated partially by its wariness of the government as plaintiff, and by the fact that the defendants were unrepresented.<sup>142</sup> The court failed to dig beneath the terms "government" and "pro se" to unearth any truly disadvantageous effect on the *Graystone* defendants. Further inquiry reveals that these defendants were most likely pro se by choice and, even though unrepresented, capable of mounting a defense. Their likely motivation was tactical manipulation. Impressive indications of the defendants' financial resources, the assistance of counsel, and the knowledge necessary for an effective defense all existed in this case.<sup>143</sup> Moreover, the increased jeopardy of facing a government plaintiff in a civil suit of this type may be somewhat overstated, as the various arms of the government pursue important interests other than criminal prosecution.<sup>144</sup> While concern for pro se defendants faced with governmental resources may be appropriate at times, or even generally, that concern was inappropriate in this case.

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<sup>141</sup> *Id.*

<sup>142</sup> See *infra* notes 226-45 and accompanying text.

<sup>143</sup> See *infra* notes 223-36 and accompanying text.

<sup>144</sup> See *infra* notes 239-42 and accompanying text.

## B. Preclusion Is Not an Automatic Sanction

The plaintiff must carry at least one potentially daunting burden prior to the entry of judgment after a total preclusion order: establishment of a *prima facie* case.<sup>145</sup> In a complex, multi-party litigation such as *Graystone*, the SEC must establish a *prima facie* case such that a reasonable jury could find in its favor on each element of the causes of action and counts alleged.<sup>146</sup> Because defendants do not automatically lose, to-

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<sup>145</sup> See, e.g., *Graystone I*, 820 F. Supp. 863 (D.N.J. 1993); SEC v. Cymaticolor, 106 F.R.D. 545 (S.D.N.Y. 1985).

<sup>146</sup> See *Graystone I* for a good example of the complexity of this task. Originally, there were seven defendants: Graystone Nash, Inc., Dennis Williams, Shawn Crane, Robert Rock, Thomas Ackerly, Vincent Ackerly, and Richard Adams. The first four cases were disposed of prior to the proceedings in the district court, Graystone and Williams by default judgment and Crane and Rock by consent judgments. 820 F. Supp. 863, 866. Besides the testimony of Crane and Rock, the SEC needed to draw on the deposition testimony of eight other individuals to establish its *prima facie* case: Joseph McGowan, Chairman and co-owner of Outwater & Wells (Graystone's clearing house), David Spring, Outwater's President, Stephen Ware, originally a Graystone broker and later operations manager, David Torrey, a broker in Boca Raton and later founder of a branch in Jacksonville, Florida, Jose Gallego and Sean Boyle, senior officials in the Boca Raton office and later managers of the Chicago branch, John Mather, compliance officer, and Michael Kupferman, a broker. *Id.* The national character of the alleged securities violations, the 18-month course of the activities and the large number of players required extensive proof.

There were four causes of action. The second, third and fourth alleged, respectively, that the defendants offered and sold unregistered securities in contravention of § 5(a) and (c) of the Securities Act of 1933, that they violated the prospectus requirements of § 5(b) of the Act, and that they made improper purchases during distributions contrary to § 10(b) of the Securities Exchange Act and Rule 10(b)(6) promulgated thereunder. *Id.* at 868.

The first cause of action best shows the task of the SEC in establishing a *prima facie* case. The defendants were charged with violations of § 17(a) of the Securities Act of and §§ 10(b) and 15(c) of the Securities Exchange Act, and Rules 10(b)(5) and 15c1-2 promulgated thereunder, for allegedly fraudulent activity. *Id.* To establish liability under these provisions, the SEC had to prove that each of the defendants 1) engaged in fraudulent conduct 2) in connection with the purchase or sale of securities 3) through the means of transportation or communication in interstate commerce or the mails 4) with the requisite scienter. *Id.* at 870-71; see also *Aaron v. SEC*, 446 U.S. 680, 695 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976). As misrepresentations and omissions on the part of the defendants were alleged, the SEC also had to prove materiality. *Graystone I*, 820 F. Supp. at 871; see also *Basic, Inc. v. Levinson*, 485 U.S. 224, 232 (1988).

To establish fraudulent conduct, the SEC pieced together the operations of Graystone from the testimony of the aforementioned deponents. According to the

tal preclusion is not an automatic sanction. In other words, the defendants' situation is not either-or, as in "either waive the Fifth or lose the case, or a job, or be disbarred."<sup>147</sup> Thus, the Constitution does not proscribe total preclusion. Total preclusion of all factual support for denials and defenses as to which a party has invoked the privilege therefore may be an appropriate court-ordered remedy for either actual or potential prejudice accruing to an opposing party from the invocation.

In short, the Third Circuit erred in holding that "practically automatic" equals "automatic."<sup>148</sup> The Third Circuit found that the "practical effect" of preclusion orders removes them from the realm of permissible remedies into that of "sanction[s] which make assertion of the Fifth Amendment privilege 'costly.'"<sup>149</sup> This "practical effect" method of defining when a measure is "costly" directly conflicts with Supreme

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trial court, the SEC established that the defendants "sought to gain control over the market in their house stocks by strongarming brokers and individual investors." *Graystone I*, 820 F. Supp. at 871. More specifically, the SEC showed that, for 18 months, the defendants controlled the resale prices of all offerings of the house stocks, sold quantities of common stock at predetermined prices, and systematically restricted investor's right to sell their shares by refusing to execute sell tickets. *Id.* The day-to-day mechanism for these activities is set forth in detail. *See id.* at 866-68. All of this investigation and proof belies the notion that proving this type of case is a simple matter.

<sup>147</sup> *See supra* notes 31-42 and accompanying text; *see also* *Rainier Nat'l Bank v. Hartstein*, No. 91-36164, 1993 WL 175265, at \*4-\*5 (9th Cir. May 25, 1993) (describing use of preclusion as that of a "less burdensome vehicle" than entry of summary judgment or directed verdict to prevent unfairness to the opposing party, and characterizing preclusion as "the price of, not the penalty for," defendant's invocation of the privilege).

<sup>148</sup> *See Fendler, supra* note 17, at 1161. Professor Fendler emphasizes that all of the Court's holdings find the automatic nature of the deprivation to be the paramount factor in assessing a measure. *Id.* at 1169. ("In determining whether an adverse consequence amounts to an unconstitutional penalty, whether the adverse consequence automatically follows the exercise of the privilege is more important than [its] severity."). He also goes on, however, to discount the importance of the intervening necessity that the plaintiff establish a *prima facie* case, improperly concluding that "practically automatic" is legally sufficient. *Id.* at 1179.

<sup>149</sup> *Graystone II*, 25 F.3d at 190 (quoting *Spevack v. Klein*, 385 U.S. 511, 515 (1967)). The use of the word "sanction" as opposed to remedy is problematic throughout this line of cases. The Supreme Court cases focus on non-judicial situations where the word is used more synonymously with "penalty," and on the effect of the invocation of privilege on invokers i.e., invoke and lose a job. Conversely, remedy consideration focuses on the effect of invocation upon the opposing party, and its purpose is to compensate for that effect. Accordingly, what is forbidden as a sanction in one case may be permitted as a remedy in another. *See infra* note 162.

Court authority. The Court has proscribed only those consequences that are truly automatic upon invocation.<sup>150</sup> Indeed, despite citing the *Spevack* line of cases—where failure to waive the privilege would have resulted or did result in automatic statutory or administrative termination of employment or office—as exemplary of the Court's reasoning, the Third Circuit simply concluded that "practically automatic" is sufficient. As noted earlier, however, the Supreme Court in *Baxter* clearly rejected that reasoning,<sup>151</sup> permitting total preclusion to be a proper remedy in certain circumstances.

Reasoning from this Supreme Court precedent, the Southern District of New York has endorsed the principle that where a plaintiff must bear its burden of proof, preclusion of support for a defense is *not* an automatic deprivation of a constitutional right. In *SEC v. Cymaticolor*,<sup>152</sup> the defendant contended that a total preclusion order made the assertion of the privilege costly.<sup>153</sup> The court acknowledged that, under *Spevack*, it could not make the invocation "costly,"<sup>154</sup> but concluded that the "risk of losing [the] case on the merits without the use of the evidence is not the type of cost that is prohibited."<sup>155</sup> Again, increased risk of losing on the merits does not equal automatic deprivation.

Courts sometimes have focused on the related proposition that entry of an adverse judgment, if entered on the basis of invocation of the privilege, without more, may be an unconstitutional automatic penalty.<sup>156</sup> *Baxter* stands for this proposition. Describing *Baxter*, the Supreme Court later remarked that:

Respondent's silence in *Baxter* was only one of a number of factors to be considered by the finder of fact in assessing a penalty, and was given no more probative value than the facts of the case warranted; here, refusal to waive the Fifth Amendment leads automatically *and without more* to imposition of sanctions.<sup>157</sup>

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<sup>150</sup> See *supra* notes 31-42 and accompanying text for a discussion of the Supreme Court's holdings and rationales.

<sup>151</sup> See *supra* notes 25-42 and accompanying text.

<sup>152</sup> 106 F.R.D. 545 (S.D.N.Y. 1985).

<sup>153</sup> *Id.* at 550.

<sup>154</sup> See *supra* note 32.

<sup>155</sup> *Cymaticolor*, 106 F.R.D. at 550 (emphasis added).

<sup>156</sup> *Lefkowitz v. Cunningham*, 431 U.S. 801, 808 n.5 (1977); see *supra* text accompanying note 39.

<sup>157</sup> *Cunningham*, 431 U.S. at 808 n.5 (emphasis added). In *Cunningham*, the

In *National Acceptance Co. of America v. Bathalter*,<sup>153</sup> the Seventh Circuit specified what constituted "more." In *Bathalter*, the district court had entered judgment on the pleadings against a defendant who had invoked the fifth amendment privilege as his only response to the complaint.<sup>153</sup> The issue raised on appeal was whether dismissal was an appropriate response.<sup>160</sup> The Seventh Circuit relied on *Baxter* as "[t]he Supreme Court decision coming closest to" the case,<sup>161</sup> and decided that "defendant's claim of privilege should not have been deemed an admission, and that plaintiff should have been put to its proof, either by way of evidentiary support for a motion for summary judgment or at trial."<sup>162</sup> Thus, the court found that the evidentiary burden of summary judgment was sufficient to satisfy *Baxter*.

Unlike the defendant in *Bathalter*, the SEC was put to its proof in *Graystone* after the preclusion order, prior to the entry of judgment.<sup>163</sup> The SEC successfully established each element of its prima facie case against the defendants on its motion for summary judgment. Thus, the district court's decision in *Graystone* was consistent with *Bathalter*, *Baxter* and the automatic deprivation test. If a deprivation is not automatic, but may occur only after further proof, a proposed remedy is constitutionally permissible. The court may then assess the appropriateness of that remedy in light of the facts of the case.

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defendant was required to either waive the privilege or automatically forfeit political party office.

<sup>158</sup> 705 F.2d 924 (7th Cir. 1983).

<sup>159</sup> See *id.* at 926.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 929-30.

<sup>162</sup> *Id.* at 932. The Third Circuit inaccurately cites *Bathalter* as supportive of the proposition that "dismissal of an action or entry of judgment as a sanction for a valid invocation of the privilege during discovery is improper." *Graystone II*, 25 F.3d at 191. *Bathalter* was dismissed in the district court and therefore cannot fairly be said to stand for such an assertion. Other courts have stated that dismissal, while not available as an automatic sanction, might be appropriate as a remedy to prevent unfairness to the party opposing the invoker. See, e.g., *Wehling v. CBS*, 608 F.2d 1084, 1087 n.6 (5th Cir. 1979) (cautioning that "dismissal is appropriate only where other, less burdensome remedies would be an ineffective means of preventing unfairness to [the opposing party]"). *Id.* at 1088.

<sup>163</sup> See *Graystone I*, 820 F. Supp. 863 (D.N.J. 1993); *supra* note 143.

C. *Take Away the Sword: In Civil Cases, Prejudice Should Be Compensated, Not Balanced*

1. The Proper Test

In civil cases, if constitutional concerns have been satisfied, courts should apply a remedy calculated to completely neutralize any prejudice falling upon the party opposing an invocation of the privilege. In contrast, the Third Circuit balanced the burden on the defendants' right to invoke against the degree of prejudice to the plaintiff to determine the type and scope of remedy. The court concluded that "the detriment to the party asserting [the privilege should be] no more than is necessary to prevent unfair and unnecessary prejudice to the other side."<sup>164</sup> This test, on its face, manifests a willingness to tolerate some degree of prejudice, so long as it is no more than is fair and necessary. Instead, courts should only balance the weight of the prejudicial burden on the opposing party against the counterweight of a proposed remedy. The only goal should be to compensate for the adverse effects of privilege invocation, not to subsidize privilege invocation in a civil case.

Moreover, the court's reliance on *FTC v. Kitco of Nevada, Inc.*<sup>165</sup> and *Young Sik Woo v. Glantz*,<sup>166</sup> as illustrative of the "careful evaluation" of its proposed balancing test, is faulty.<sup>167</sup> A closer look at these cases reveals important factual differences and, more importantly, that the *Kitco* court actually applies a strictly compensatory standard. In fact, a compensatory standard, also applied by courts in the Southern District of New York, has more authoritative support and is more desirable for broad policy reasons than the *Graystone* standard.<sup>168</sup>

The cases on which the Third Circuit relies fail to support its lenient balancing standard. To buttress this test, the court relied on *FTC v. Kitco of Nevada, Inc.*, where the defendant

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<sup>164</sup> *Graystone II*, 25 F.3d at 192.

<sup>165</sup> 612 F. Supp. 1282 (D. Minn. 1985).

<sup>166</sup> 99 F.R.D. 651 (D.R.I. 1983).

<sup>167</sup> *Graystone II*, 25 F.3d at 192. See *supra* notes 109-16 and accompanying text for the court's interpretation of these cases.

<sup>168</sup> See *infra* notes 182-201 and accompanying text.

had invoked the privilege at a deposition "only in regard to certain areas of inquiry,"<sup>169</sup> unlike the total avoidance in *Graystone*. In response to this partial invocation in discovery, the *Kitco* court found a *complete* bar on testimony and presentation of evidence to be inappropriate.<sup>170</sup> The court went on to gauge the prejudice to the plaintiff and to assess what remedy, if any, should be imposed. The court found that the FTC had not been "unfairly surprised or prejudiced," and thus declined to adopt even "a more limited ban."<sup>171</sup> The *Kitco* court did not mention balancing. Indeed, the notion that the court intended to remedy any prejudice that it found is further supported by its reliance on *Lyons v. Johnson*.<sup>172</sup> *Lyons* provided that the invoker's

obtaining of this shield . . . could not provide a sword to her for achieving assertion of her claims against the defendants without having to conform to the processes necessary to orderly and equal forensic functioning. . . . If *any* prejudice is to come from such a situation, it must, as a matter of basic fairness[,] . . . be to the party asserting the claim and not to the one who has been subjected to its assertion. It is the former who has made the election to create an imbalance in the pans of the scales.<sup>173</sup>

The *Kitco* court found that there was no prejudice, but cited *Lyons*, suggesting that if it had found prejudice, the party invoking the privilege would have shouldered it. This disposition conflicts with the test formulated by the Third Circuit, a test that suggests prejudice to the opposing party can be fair and necessary.<sup>174</sup> The Third Circuit test, combined with its

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<sup>169</sup> 612 F. Supp. at 1290.

<sup>170</sup> *Id.* at 1291.

<sup>171</sup> *Id.* The *Kitco* court's assessment of the degree of prejudice, however, was made with the same narrow, results-based focus that the court in *Graystone II* advocated and with which this Comment takes issue: "The FTC thoroughly prepared its case and seemed able to anticipate through other witnesses what [the defendant's] testimony might be. It was not solely dependent upon the testimony of [the defendant] for pertinent information." *Id.* See *infra* notes 212-15 and accompanying text for a more considered view of the prejudice that plaintiffs in this situation suffer.

<sup>172</sup> 415 F.2d 540 (9th Cir. 1969).

<sup>173</sup> *Id.* at 542 (emphasis added). In *Lyons*, the plaintiff had invoked the privilege during discovery; the final sentence makes clear, though, that the court found that *any* prejudice should fall upon the invoker because that party has "made the election to create an imbalance in the pans of the scales," not because that party had brought the action. *Id.*

<sup>174</sup> See *supra* notes 164-65 and accompanying text.



definition of prejudice, will allow the privilege to be used as a sword in many situations. This use of the privilege will unduly disadvantage opposing parties and prevent a fair contest between civil litigants.

Neither does the other case on which the Third Circuit rested its decision, *Young Sik Woo v. Glantz*,<sup>176</sup> support the balancing formulation. Moreover, *Glantz* does not carefully evaluate prejudice to the plaintiff. In *Glantz*, the matter before the court was a motion for summary judgment; there was no preclusion order at issue.<sup>176</sup> The defendant had invoked the privilege during discovery<sup>177</sup> and had not filed an affidavit in response to the plaintiff's motion.<sup>178</sup> Further, the defendant had made no attempt to introduce evidence that would show a genuine issue of material fact requiring trial.<sup>179</sup> The court, after a lengthy discussion of the absolute propriety of summary judgment in such a situation, exercised "an abundance of caution" and deferred entry of judgment<sup>180</sup> to allow the defendant an opportunity to "engage in such discovery as he deem[ed] propitious to secure facts essential to justify his opposition."<sup>181</sup> The dissimilarities in the fact pattern and procedural context of *Glantz* and *Graystone* are such as to preclude any application of the lessons of the former to the latter. Exercising forbearance in the interests of justice without evaluating prejudice that may accrue to the plaintiff is hardly supportive of the Third Circuit's balancing rule, in which evaluation of prejudice is essential.

Rather than focusing on dissimilar or inapposite precedent, the Third Circuit should have adopted the test that the Southern District of New York formulated and applied in *SEC*

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<sup>176</sup> 99 F.R.D. 651 (D.R.I. 1983).

<sup>176</sup> *Id.*

<sup>177</sup> There was no elaboration on the scope of *Glantz's* invocation of the privilege during discovery.

<sup>178</sup> *Glantz*, 99 F.R.D. at 651. The defendant responded to the motion with only a Memorandum in Opposition. *Id.* at 651 n.1. The court stated that in this document the defendant "insinuates that the averments upon which the pending motion is bottomed may be less than Holy Writ, [but that] he nowhere articulates any particularized challenge." *Id.* at 652.

<sup>179</sup> *Id.* at 653-54.

<sup>180</sup> The court decided to "deny the pending motion without prejudice to the right of the movants to renew it at any time on or after" one month and 19 days after the date of decision. *Id.* at 654.

<sup>181</sup> *Id.*

*v. Benson*<sup>182</sup> and *SEC v. Cymaticolor Corp.*<sup>183</sup> In *Benson*, the defendant, president of a publicly held company, was accused of diverting over \$500,000 from the company in a fraudulent scheme.<sup>184</sup> Similar to the defendants in *Graystone*, Benson refused to participate in discovery for an extended period, to the point of obstruction.<sup>185</sup> He then invoked the privilege, refusing to respond to queries about any of the denials and defenses asserted in his answer.<sup>186</sup> In entering an order of preclusion, the court found that "[a]lthough [Benson] cannot be required to incriminate himself, he may not use the shield to the disadvantage of civil adversaries."<sup>187</sup> In *Benson*, as in *Graystone*, the court carefully limited its total preclusion order to defenses and denials about which there was no discovery.<sup>188</sup> There, as in *Graystone*, the defendant totally avoided discovery. The court consequently precluded him from offering any factual support for any of his defenses and denials.<sup>189</sup>

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<sup>182</sup> 657 F. Supp. 1122 (S.D.N.Y. 1987).

<sup>183</sup> 106 F.R.D. 545 (S.D.N.Y. 1985).

<sup>184</sup> *Benson*, 657 F. Supp. at 1124-25.

<sup>185</sup> *Id.* at 1128-29 (over a year passed from first discovery requests until issuance of the preclusion order). The *Graystone* defendants invoked the privilege at least two and one-half years before they finally disputed the plaintiff's case. See *supra* note 65 and accompanying text. They also failed to appear at a pre-trial conference, which prompted the magistrate judge to consider sanctions. Order dated May 13, 1992, *Graystone I*, 820 F. Supp. 863.

<sup>186</sup> *Benson*, 657 F. Supp. at 1129.

<sup>187</sup> *SEC v. Benson*, No. 84 Civ. 2262, 1985 WL 1308, at \*2 (S.D.N.Y. Apr. 9, 1985). The court cited the same case as the *Kitco* court, *Lyons v. Johnson*, 415 F.2d 540 (9th Cir. 1969), for this proposition. See *supra* notes 172-73 and accompanying text.

<sup>188</sup> *Benson*, 1985 WL 1308 at \*2 ("Defendant Benson is hereby precluded from offering evidence in support of his denials and affirmative defenses, positions on which he has declined to furnish disclosure claiming privilege under the Fifth Amendment.").

<sup>189</sup> The preclusion order in *Benson* was granted in 1985, two years before entry of summary judgment for the SEC. See *supra* note 182. Therefore, preclusion was allowed as a remedy for a valid invocation of the privilege and not, as in *Graystone I*, in light of a late attempt at waiver. The court in *Benson*, however, found the defendant's request to engage in discovery, presumably to find evidence other than his own testimony to oppose summary judgment, inappropriate as an alternative to immediate entry of summary judgment. 657 F. Supp. at 1129-30. The court noted: "[I]t is only now that the SEC has amassed a powerful case on the motion for summary judgment that Benson proposes to pursue a slightly different strategy," and that, as he "had the opportunity to take discovery for a year[. . .] [t]o permit him to reopen discovery now would abuse the plaintiff's rights." *Id.* This reasoning could be applied just as appropriately to *Graystone* regarding the late waiver attempt implicit in the defendant's last minute responses

In *Cymaticolor*, the Southern District again took from a defendant the sword supplied by privilege. The defendant was a corporate officer accused of manipulating the company's stock. He had invoked the privilege as to selected denials and defenses, and in response the SEC sought a total preclusion order as to those denials and defenses.<sup>190</sup> The court first dispensed with the defendant's argument that a total preclusion order was an automatic deprivation.<sup>191</sup> Once past the constitutional issue, the court noted the prejudicial effects on the SEC.<sup>192</sup> Finally, the *Cymaticolor* court imposed a preclusion order as to the denials and defenses with regard to which the privilege was asserted. In so doing, the court effectively removed the sword from the defendant's possession without running afoul of Supreme Court automatic deprivation strictures.

## 2. Why Focus on Removing the Sword Rather Than on the Integrity of the Shield?

Compensatory orders such as those issued by the courts in *Graystone I*, *Cymaticolor* and *Benson*, and the manner in which they lessen the utility of the privilege in civil cases, certainly provide a defendant with reason to hesitate before adopting the strategy of stonewalling discovery. This result is desirable in light of the other important substantive and procedural interests at stake in these cases.<sup>193</sup> Substantively, SEC civil enforcement actions, as well as other civil enforcement, regulatory and administrative actions and proceedings, are valuable vehicles both for ensuring that offenses against the public are not repeated—by obtaining injunctive, deterrent or retributive relief<sup>194</sup>—and for compensating the public,

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after an extended period of fifth amendment silence.

<sup>190</sup> SEC v. *Cymaticolor Corp.*, 106 F.R.D. 545, 549 (S.D.N.Y. 1985). It is worth clarifying that total preclusion orders should apply only to denials and defenses as to which the defendant has provided no discovery and not to all denials and defenses. This is an important distinction in situations like *Cymaticolor*, where only certain denials and defenses are concealed by the invocation. In a *Graystone* situation, however, this is a non-distinction; the defendant has provided no discovery at all, dictating that the remedy must apply to all asserted denials and defenses.

<sup>191</sup> See *supra* notes 152-55 and accompanying text for the *Cymaticolor* court's rebuttal of the constitutional objection.

<sup>192</sup> *Cymaticolor*, 106 F.R.D. at 549-50.

<sup>193</sup> See *infra* notes 194-201 and accompanying text.

<sup>194</sup> The SEC could have sought a civil penalty "not to exceed three times the

through disgorgement of ill-gotten gains.

The Supreme Court has acknowledged that countervailing interests such as these are a valuable consideration by placing greater limits on the effectiveness of the self-incrimination privilege in government-initiated civil actions than in criminal proceedings. For instance, the proper administration of the "correctional process and important state interests other than conviction for crime" were at issue in *Baxter*.<sup>195</sup> Other examples of important considerations underlying civil actions include anti-trust actions, in which the maintenance of business competition and injunction of anti-competitive behavior are important policy concerns;<sup>196</sup> and civil rights actions, which address violations of constitutional rights in a civil context.<sup>197</sup>

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profit gained or loss avoided as a result of such unlawful purchase or sale" in addition to or instead of the injunction and disgorgement sought in *Graystone I*. Insider Trading Sanctions Act of 1984, Pub. L. 98-376, § 1, 98 Stat. 1264 (1984) (adding § 21A to the Securities Exchange Act of 1934), as amended by Insider Trading Act of 1988, Pub. L. 100-704, § 3(a)(2), 102 Stat. 4677 (1988) limiting liability for aiding and abetting, and establishing liability for persons controlling primary violators subject to a \$1 million cap).

These civil penalties have raised the specter of double jeopardy. The Supreme Court, in *United States v. Halper*, 490 U.S. 435 (1989), held that penalties would constitute punishment if they were grossly disproportionate to the loss suffered by the government, regardless of whether civil or criminal penalties were assessed first. See also *United States v. Marcus Schloss & Co.*, 724 F. Supp. 1123, 1126 (S.D.N.Y. 1989) (interpreting *Halper* and stating that "exaction before imposition of criminal punishment should have the same double jeopardy effect as exaction afterwards"). Loss is defined to include costs of investigating and prosecution. *Halper*, 490 U.S. at 446 n.6; see also *Schloss*, 724 F. Supp. at 1128 (holding that a total penalty of \$273,800 on total profit disgorged of \$136,000 was not "wholly divorced from the level of fraud and the government's expenses, including those of investigation and prosecution" and, therefore, did not constitute a penalty). Courts have further expanded the permissible penalty by recognizing general and rather nebulous societal damage. See 3B HAROLD S. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 9.46 (1994) (citing a number of expansive readings of damage in the course of a general discussion of the history of and outlook for § 21A); David S. Rudstein, *Civil Penalties and Multiple Punishment Under the Double Jeopardy Clause: Some Unanswered Questions*, 46 OKLA. L. REV. 587 (1993) (summarizing the *Halper* doctrine, describing its elements and analyzing recent cases). Under this case law, double jeopardy seems to allow plenty of room for civil penalties.

<sup>195</sup> *Baxter v. Palmigiano*, 425 U.S. 308, 319 (1976).

<sup>196</sup> Anti-trust violations are subject to both civil action and criminal prosecution. Sherman Act §§ 1-3, 15 U.S.C. §§ 1-3 (1988 & Supp. 1991).

<sup>197</sup> Often, civil rights actions arise where criminal actions may later be brought by the state. See, e.g., *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553 (1st Cir. 1989) (civil rights action by motorist against squad of policemen after the officers without identifying themselves, alit from an unmarked car with guns drawn, and

Finally, as in *Graystone*, the interests of past and future investors, who may be affected by conduct that violates regulations, in addition to the common interest of the government and the public in an orderly, fair and liquid securities markets, are all worthy concerns. These important pursuits demand a limited and controlled privilege in the civil context; they are furthered as its insulatory effect is lessened.

Procedural and systemic considerations also point to the desirability of a weakened privilege in a civil context. As a threshold matter, the privilege "has little to do with a fair trial and derogates rather than improves the chance for accurate decisions."<sup>198</sup> Many believe that the privilege actually "undermine[s] . . . the trial system's capacity to ascertain the truth."<sup>199</sup> Such limits, however, enhance the chance of accurate decisions and facilitate the search for the truth. The privilege only takes on an overriding importance in a criminal proceeding; only there, where obtaining a criminal conviction is the state's single predominant interest, is the defendant's need for protection sufficiently immediate and powerful.<sup>200</sup>

The essential effect of the availability of total preclusion orders is to encourage earlier waiver of the privilege by those who are inclined to do so. If the party consciously asserting the privilege has prioritized the fear of criminal prosecution, then the threat of a preclusion order will have no effect on the decision to maintain the invocation. The penalty in the civil phase is not made any greater by preclusion. Conversely, if the party merely is asserting the privilege tactically, then forcing an earlier, less prejudicial waiver is a highly desirable goal in light of this abuse of the privilege. Total preclusion of factual support for all defenses and denials is at one end of the spectrum of remedies; towards the other end, partial preclusion<sup>201</sup> and other less restrictive measures may suffice to remedy more selective use of the privilege. The availability of this range of

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shot and injured the motorist as he attempted to flee the perceived threat).

<sup>198</sup> *Baxter*, 425 U.S. at 319.

<sup>199</sup> *Heidt*, *supra* note 49, at 1082.

<sup>200</sup> *See Baxter*, 425 U.S. at 318-19.

<sup>201</sup> Partial preclusion might proscribe support for certain denials and defenses, or the defendant's testimony only, as opposed to all factual support from any source for all denials and defenses where discovery has been completely stonewalled by assertion of the privilege.

trial management options encourages selectivity both in the utilization of the privilege and the scope of the invocation, while leaving open the option of silence to maximize insulation from criminal prosecution.

Another important factor weighted toward adopting a compensatory standard to circumscribe offensive uses of the privilege is the potential that overly lenient balancing will totally defeat the process of discovery and undermine the principles of equality and openness that support it. Accordingly, the method of defining and measuring prejudice caused by invocation is of paramount importance in shaping a measure to remedy this counterproductive potential. As both case law and policy concerns support a compensatory standard, including the use of appropriately tailored preclusion orders, a broader and fairer method of gauging prejudice than that used by the Third Circuit is warranted.

### 3. Prejudice to the SEC in *Graystone*: Ask Not of the SEC What It Has, Ask of What It Was Deprived

The Third Circuit approached the question of prejudice by assessing the possibility of waiver, the timing of the preclusion request, the facts the SEC had, and the relative strength of its case if the court allowed the defendants to testify. First, the court assessed the possibility of waiver.<sup>202</sup> In the view of the court, waiver either would have obviated a preclusion remedy or limited its scope. The court then stated that the SEC should have resolved the issue of preclusion prior to moving for summary judgment and that any prejudice relating to this timing was the SEC's fault. The court went on to note that the SEC

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<sup>202</sup> The defendants' affidavits opposing the Commission's summary judgment motion will almost certainly be found to be attempts to waive the fifth amendment privilege previously invoked. The affidavits contained assertions about their "respective roles, remuneration and decisionmaking authority at Graystone," information which they had previously maintained was wholly privileged. *Graystone I*, 820 F. Supp. at 869. They may attempt to maintain that the testimony in the affidavits was only a partial waiver, and that they therefore are still able to invoke as to other denials and defenses, unrelated to the testimony proffered. Because the crux of their denials and defenses is that they, 1) did not play a part in the illicit activities, 2) did not receive any money from them, and 3) did not have anything to do with deciding to undertake them, however, it is difficult to see what issues they would maintain their testimony did not touch.

"possessed substantial evidence" and that it was "apparent that the government had devoted substantial resources to expose the fraudulent security arrangements and proceed against those responsible."<sup>203</sup> Finally, the court noted that "nothing . . . in the record persuades us that the SEC would have been unable to present a strong case even if Adams and Ackerly had been permitted to testify if they chose."<sup>204</sup> Judge Weis also noted that the SEC was able to depose other witnesses and had other former defendants at its disposal to provide testimony, if needed.<sup>205</sup>

Preliminarily, if the court were to find or allow a waiver so late in the proceedings,<sup>206</sup> it would set a precedent that would give subsequent defendants a degree of advantage. To be sure, the degree will vary, depending upon the availability of other sources of information, and the ability of particular defendants to benefit from the judicial gift of hindsight. Yet, some advantage would obtain in nearly every case. Only the availability of a prophylactic measure, such as preclusion in cases of late waiver, will ensure that defendants cannot profit from their exercise of the self-incrimination privilege, and will deter abuse of the privilege and the civil discovery process.

In a section preceding its waiver discussion, the Third

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<sup>203</sup> *Graystone II*, 25 F.3d at 193.

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> The focus throughout this Comment is on compensating for invocation in two situations: where there is a valid invocation of the privilege throughout discovery, without an attempt at waiver, and where there is a late attempt at waiver. The earlier in the action a party attempts to waive the privilege and respond to discovery, the less should be the magnitude of compensatory measures. Earlier in discovery, there is less of a hindsight advantage conferred, and less of the advantages of timely discovery are lost or diminished. Very early in the action, waiver should be uniformly allowed with appropriate compensatory safeguards.

The approach of the Third Circuit to allowing waiver could lead to perverse results. For instance, early in discovery, a defendant may note that a plaintiff does not have significant sources of evidence independent of defendant's testimony. The defendant could consequently decide to waive a short-lived assertion of privilege to be deposed, secure in the knowledge that his self-serving testimony will most likely be uncontradicted. Faced with an attempted waiver of privilege by the defendant, the Third Circuit would simply allow waiver, assuming that discovery subsequently could ameliorate any prejudice to the plaintiff, and never reach its assessment of the evidence test. Under a compensatory approach, the court would be free to assess what the plaintiff lost in the time that it was not able to conduct discovery, and to impose a preclusion measure if the potential to subvert the discovery process was sufficiently strong.

Circuit relied on a case in which a court did not allow such a late waiver: *Gutierrez-Rodriguez v. Cartagena*.<sup>207</sup> The court prefaced its discussion of *Gutierrez-Rodriguez* with this summary of the argument against late waiver:

One of the situations in which [concern for other litigant's rights] comes into play arises when one party invokes the Fifth Amendment during discovery, but on the eve of trial changes his mind and decides to waive the privilege. At that stage, the adverse party—having conducted discovery and prepared the case without the benefit of knowing the content of the privileged matter—*would be placed at a disadvantage*. The opportunity to combat the newly available testimony might no longer exist, a new investigation could be required, and orderly trial preparation could be disrupted. In such circumstances, the belated waiver of the privilege could be unfair.<sup>208</sup>

In *Graystone*, the SEC had “conducted discovery and prepared the case without the benefit of knowing the content of the privileged matter.”<sup>209</sup> Two possible distinctions between the cited circumstances and *Graystone* can be drawn: first, that the potential waiver in *Graystone* was not “on the eve of trial,” or second, that the SEC experienced no real prejudice from the “belated waiver” attempt.

A comparison with *Gutierrez-Rodriguez* does not support the viability of these possible distinctions. Though the attempted waiver in *Gutierrez-Rodriguez* took place four days before the scheduled trial date,<sup>210</sup> the principle in *Graystone* is precisely the same. In both cases, discovery was closed and the parties were moving toward a decision on the merits. The defendants in *Graystone* decided to testify only after they had seen all of the SEC's argument on the merits, which had accompanied its motion for summary judgment. This circumstance is, in fact, as prejudicial as a waiver on the eve of trial, and is more analogous to a waiver at trial after proofs have been presented. The prejudice to plaintiffs in both of these situations of attempted late waiver is severe, and as such courts should police it.<sup>211</sup>

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<sup>207</sup> 882 F.2d 553 (1st Cir. 1989).

<sup>208</sup> *Graystone II*, 25 F.3d at 191 (emphasis added).

<sup>209</sup> *Id.*

<sup>210</sup> *Gutierrez-Rodriguez*, 553 F.2d at 576.

<sup>211</sup> The type and extent of prejudice in these situations is discussed *infra* this section.



The court noted that the timing of the preclusion motion, made concurrently with the motion for summary judgment, did not support a conclusion that the SEC was prejudiced. This view ignores the practical realities of litigation. These defendants were two of the principal figures in the alleged fraudulent scheme. Obviously, given a choice, the SEC would rather obtain discovery from these defendants than piece information together from other, less direct sources. Less investigation saves time and money. Questioning principals in the scheme provides much more meaningful opportunity to narrow issues and gain intelligence on their tactical use of information. The SEC must walk a proverbial tightrope in the Third Circuit. If the SEC moves for preclusion early, during discovery, the court will most likely find that there is not enough prejudice to warrant the remedy, necessitating perhaps a later motion, intensified investigatory efforts, or both. On the other hand, if the SEC moves later, after the close of discovery and its investigation, the court will not allow preclusion because the SEC now may have "enough" evidence, or should have resolved the matter earlier. The court's analysis will often foreclose plaintiffs in the position of the SEC from meaningful redress.

The timing of the motion is less important if the court takes a broader view of the degree of prejudice a party incurs when its adversary stonewalls its discovery requests. The court in *Graystone* effectively penalized the SEC for developing a strong case against the defendant. The court failed to take into account that the case would be even stronger if the defendants were denied the fruits of a tactical recantation of their invocation of the privilege. The court's focus on the availability of other witnesses ignores the broad practical and legal benefits of discovery from the defendants themselves. These benefits go far beyond simply eliciting factual answers to a sequence of questions, with each answer in vacuum-like isolation. The court's approach highlights the overarching problem of gauging the impact of total avoidance: quantifying the "facts" a party has is much simpler than calculating the often more subtle prejudice to that party that may result from the opposition's comprehensive invocation of the self-incrimination privilege.

Discovery is meant to provide far more than facts. An assessment of prejudice should look both forward and back, to determine what other valuable intelligence the invoking party

has concealed or obscured. The invoking defendant deprives the plaintiff of a complete opportunity to "ascertain the position of the adverse party on the controverted issues,"<sup>212</sup> especially as to the opposition's "theory and use of the evidence."<sup>213</sup> This intelligence may be otherwise impossible to obtain. If a defendant in the position of those in *Graystone* had not invoked at all or had waived the privilege earlier, there would have been a "definite impact on the course of . . . discovery."<sup>214</sup> Other avenues of inquiry could have been opened or doubt cast on other testimony, or possible perjury in the defendant's testimony exposed in light of other evidence. The SEC is likely to have devoted great resources and invested large sums of taxpayer money in pursuing evidence that could have been much more easily and cheaply obtained by deposing the defendants. These investments were necessitated only by the defendants' delay in coming forward. The defendants' invocation of privilege took from the SEC the advantages of full and mutual discovery. The Third Circuit failed to factor these consequences into its remedy consideration.

Implicitly recognizing both the significance and the elusiveness of some of these advantages, the court in *Gutierrez-Rodriguez* did not make any detailed assessment of the strength of the opposition's case or of what was deprived by the invocation. Instead, the court acted to eliminate even the potential for prejudice inherent in a late waiver, stating that, "it would be an abuse of the fifth amendment to allow [the defendant] to claim the privilege . . . during discovery and concurrently subject plaintiff to the *possibility* that at the eleventh hour he might waive the privilege and testify at trial."<sup>215</sup> Often, only forward-looking preclusion orders such as that in *Gutierrez-Rodriguez* can remedy this potential for prejudice inherent in invocations of the self-incrimination privilege.<sup>216</sup>

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<sup>212</sup> SEC v. Cymaticolor Corp., 106 F.R.D. 545, 549-50 (S.D.N.Y. 1985).

<sup>213</sup> *Id.* at 549.

<sup>214</sup> *Id.* at 550.

<sup>215</sup> *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553, 576 (1st Cir. 1993) (emphasis added); see also notes 206-10 and accompanying text.

<sup>216</sup> Fact-finders, whether judge or jury, may draw an adverse inference in civil cases, *Baxter v. Palmigiano* 425 U.S. 308, 318 (1986), which may, to an extent, remedy prejudice accruing to plaintiffs from invocation. In matters resolved at the summary judgment stage by courts, like *Graystone I*, perhaps the adverse inference can provide an effective method of redress. Judges are well-equipped to gauge

#### 4. The Third Circuit's Mercy Motivations

##### a. *Deference by the Court*

The *Graystone* court seemed to accord the defendants the kind of careful treatment usually reserved for defendants in criminal cases. Two factors drove the court in *Graystone*: the pro se nature of the defendants in the trial court proceedings, and the government's concurrent control of the decision whether to initiate a parallel criminal action. Regarding the pro se status of the defendants, Judge Weis opined that "[t]he decision to invoke or waive the Fifth Amendment is not always self-evident, and it requires serious consideration of the consequences."<sup>217</sup> He went on to note that "[t]he failure of Adams and Ackerly to present proper legal arguments in response to the motion for preclusion did not alert the district judge . . . to the factors that should be considered in directing an appropriate remedy."<sup>218</sup> Regarding government control, Judge Weis stated that "[c]ourts must bear in mind that when the government is a party in a civil case and also controls the decision as to whether criminal proceedings will be initiated, special consideration must be given to the plight of the party asserting

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prejudice and then choose between one or a combination of remedies.

There are, however, two problems with leaving prejudice to be balanced by the adverse inference. First, not all matters will be resolved at the summary judgment stage. Juries, unlike judges, may be misled due to inflamed passions or may confuse the issues, as a result of a late waiver. Juries could be misled by long-withheld testimony tailored to inflame their passions against and prejudice the opposition. Preclusion insures against this.

Second, the adverse inference is imprecise, especially in comparison to preclusion. The inference is both permissive only and variable in extent, on a case-by-case basis. Preclusion is mandatory and by definition precisely coextensive with the information withheld and the prejudice stemming from it. Juries may tend to minimize the inference drawn when it stems from invocations prior to the testimony offered at trial after late waiver, even though charged with applying it. The effect of allowing trial testimony would be to make the prejudice stale. The prejudice could go unremedied. Judges, because of the nature of the inference, would be forced to apply a remedy that may only awkwardly and amorphously suit the situation at hand. Moreover, due to the suspect nature of testimony following late waivers, addressing reams of incredible testimony also may delay consideration of dispositive motions. The adverse inference, while useful, is not a panacea for prejudice springing from assertions of the self-incrimination privilege.

<sup>217</sup> *Graystone II*, 25 F.3d at 193.

<sup>218</sup> *Id.* at 194.

the Fifth Amendment.<sup>219</sup> With these factors in mind, the court not only set out the points—waiver and prejudice—on which “proper legal arguments” needed to be made on remand, but also fit facts into the legal framework. Judge Weis essentially dictated to the trial court, the closest judicial actor,<sup>220</sup> that any remedy should be minimal. This conclusion is in no way justified by the defendants’ “plight.”

The court essentially ruled out one solution commonly advocated both by courts and commentators faced with discovery avoidance: preclusion of defendants’ testimony alone.<sup>221</sup> One commentator has stated categorically that “[c]ertainly, the preclusion order should extend to the defendant’s own testimony.”<sup>222</sup> This conclusion is appropriate because

[t]his is the precise information that the defendant withheld under claim of privilege. It is only by preventing the defendant from changing his mind after some reasonable period of time that the plaintiff can be protected against unfair “sandbagging.”<sup>223</sup>

Many other courts have agreed with this reasoning, and precluded defendant’s testimony in similar situations.<sup>224</sup> The *Graystone* court’s de facto rejection of this commonly applied measure is indicative of its undue concern for the defendants.

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<sup>219</sup> *Id.* at 193-94.

<sup>220</sup> The First Circuit characterized the trial court in this manner in *Gutierrez-Rodriguez*, 882 F.2d at 577 (deferring to the discretionary judgment of “the judicial actor closest to the situation”).

<sup>221</sup> This differs from total preclusion, which would bar defendant from introducing any evidence, from any source, in support of denials and defences on which the privilege was invoked.

<sup>222</sup> Fendler, *supra* note 17, at 1194.

<sup>223</sup> Fendler, *supra* note 17, at 1194 (quoting *Duffy v. Currier*, 291 F. Supp. 810, 815 (D. Minn. 1968)).

<sup>224</sup> See, e.g., *Rainier Nat’l Bank v. Hartstein*, No. 91-36164, 1993 WL 175265 (9th Cir. May 25, 1993); *In re Edmond*, 934 F.2d 1304 (4th Cir. 1991); *United States v. Parcels of Land*, 903 F.2d 36 (1st Cir. 1990); *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553 (1st Cir. 1989); *United States v. Talco Contractors, Inc.*, 153 F.R.D. 501 (W.D.N.Y. 1994); *SEC v. Interlink Data Network*, No. Civ.A. 93-3073R, 1993 WL 603274 (C.D. Cal. Nov. 15, 1993); *United States v. Sixty Thousand Dollars in U.S. Currency*, 763 F. Supp. 909 (E.D. Mich. 1991); *Duffy*, 291 F. Supp. 810.

b. *A Closer Look at The Graystone Defendants: Sophisticated Businessmen, Pro Se by Choice*

The defendants in *Graystone* have many advantages over typical pro se defendants, and their pro se appearances are most likely tactically motivated. In this case, judicial deference is clearly unwarranted. After stating that the effects of privilege invocation "depend to a large extent on the circumstances of the particular litigation," Judge Weis made no detailed analysis of the defendants' circumstances. Instead, the court merely noted, in a rather cautionary tone, that the defendants were unrepresented.<sup>225</sup> The court's concession that the defendants "had apparently received off-hand advice from lawyers at some point"<sup>226</sup> is an understatement. These defendants are far removed from the indigent, the undereducated and the unsophisticated whom the court might justifiably protect.

The defendants received more than "off-hand advice from lawyers." For example, Ackerly noted that "in the very beginning, we were represented by counsel, both corporately and individually."<sup>227</sup> Similarly, Adams stated that he had invoked the privilege for one year at the direction of Graystone's attorneys, until the attorneys informed him of their withdrawal because a conflict had arisen after the present action was initiated.<sup>228</sup> Contrary to their protestations of non-representation, the defendants' respective answers all were printed in the same format and font. Individual averments properly differentiated between denials, denials of information and belief, and partial admissions—altogether a very uniform and professional job for three separate pro se defendants.<sup>229</sup> Ackerly further stated that the defendants did not attend other depositions on

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<sup>225</sup> *Graystone II*, 25 F.3d at 192-93.

<sup>226</sup> *Id.*

<sup>227</sup> Transcript of Proceedings, *supra* note 70, at 7.

<sup>228</sup> Transcript of Proceedings, *supra* note 70, at 12-13.

<sup>229</sup> See Answers of Defendants Richard Adams, Thomas Ackerly and Vincent Ackerly to Complaint for Injunctive and Other Relief, all dated November 20 or 21, 1991, *Graystone I*, 820 F. Supp. 863 (D.N.J. 1993). Even assuming that this does not indicate extensive assistance of counsel, it surely indicates a level of sophistication and legal competence unworthy of the solicitousness of the court. See *infra* text accompanying note 238 for a further discussion on this point.

advice of counsel.<sup>230</sup> Given this fact, one can draw a fair inference that the defendants also would have sought and received advice on how to proceed in their contemporaneous depositions, and on the invocation of privilege. Lastly, the off-hand advice to which the court referred was from "three former prosecutors" who "branded" the defendants with the idea that "you simply don't give testimony."<sup>231</sup> This revelation not only further indicates that the *Graystone* defendants had received significant legal guidance and assistance, but also adds doubt as to the defendants' lack of financial resources.<sup>232</sup>

Legal help often is costly. Defendants who can afford but choose to forego legal representation, however, are less deserving of judicial protection than those who cannot afford it. Blanket deference is not warranted for those who have a choice and who, in choosing to appear pro se, worsen "the burden pro se representation imposes upon extremely busy district judges."<sup>233</sup> Disadvantaged and white-collar defendants typically are not similarly situated regarding their ability to pay for legal help. White collar defendants may have other considerations in not retaining counsel.

The defendants in *Graystone* were not indigent and did not need the special solicitousness of the court. Other *Graystone* defendants had entered into consent judgments agreeing to disgorge significant amounts of illicit gains.<sup>234</sup> Most notably,

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<sup>230</sup> Transcript of Proceedings, *supra* note 70, at 8.

<sup>231</sup> Transcript of Proceedings, *supra* note 70, at 9.

<sup>232</sup> It is possible that defendants received free legal advice. If they did not, however, legal advice from "three former prosecutors" probably was expensive.

<sup>233</sup> *Graystone II*, 25 F.3d 187, 194 (3d Cir. 1994).

<sup>234</sup> Defendant Shawn M. Crane entered into a Consent Judgment for approximately \$61,000; defendant Robert L. Rock entered into a judgment for disgorgement of approximately \$279,000. *Graystone II*, 25 F.3d at 193. The court noted that "[t]he amount of these judgments stand [sic] in stark contrast to the approximately \$60.5 million assessed against Adams and Ackerly," *id.* at 193 n.2, to further its portrayal of the "plight" of these persecuted defendants, *id.* at 194.

This is misleading for a number of reasons. The \$60.5 million figure requested to be disgorged represents the total amount allegedly bilked from the public, per SEC policy where the course of settlement negotiations have not convinced regulators that such an amount is not "recoverable or enforceable." Transcript of Proceedings, *supra* note 70, at 6. Rock and Crane were relatively minor players compared to Ackerly and Adams, who were among the top decisionmakers at the firm. The judgments entered are the product of negotiations, and thus may not reflect the true amount attributable to the minor defendants. Most importantly, the court neglected to mention that there also was a default judgment entered for

Dennis Williams, an Executive Vice President of Graystone and operator of a number of franchise offices, agreed to disgorge almost \$14 million; the court noted that he had the "apparent ability" to do so.<sup>235</sup> Adams, also an Executive Vice President, and Ackerly, President and Chairman of the Board of Directors, were in an equal or greater position to profit from the allegedly criminal activity. Casting more doubt upon the poverty of the defendants is the fact that Adams, after losing in the district court, retained counsel for his appeal.<sup>236</sup> While it admittedly is unlikely that defendants would have received appointed counsel had they applied, they made no application. One motivation for foregoing the opportunity for appointed counsel might have been the continued concealment of the kind of illicit gains that their alleged cohorts had agreed to disgorge,<sup>237</sup> gains that they would have had to conceal by perjuring themselves in their applications. These defendants simply do not merit the same careful treatment accorded to the poor and disadvantaged.

A final distinction remains. The defendants were experienced executives in a major business enterprise. Admittedly, businessmen are not lawyers. Nevertheless, they are not prisoners nor members of any other group worthy of increased solicitousness due to their position. If anything, these defendants were more prepared than the average layperson to comprehend, plan and execute a legal defense. The defendants ran a complicated business.<sup>238</sup> They were its top managers and policymakers, necessarily possessing deep and intimate knowledge of the corporation's inner workings. When combined with the indications of legal assistance and financial resources, the sophistication of the *Graystone* defendants should have bred increased wariness on the part of the Third Circuit, not increased care.

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another, more highly placed defendant, Dennis Williams—for disgorgement of almost \$14 million. Moreover, the court noted that Williams had the apparent ability to disgorge this amount. See *infra* note 234 and accompanying text. All signs point to the existence of at least sufficient financial resources to retain counsel.

<sup>235</sup> Order dated Dec. 11, 1992, *Graystone I*, 820 F. Supp. 863 (No. 91-4327).

<sup>236</sup> *Graystone II*, 25 F.3d at 188.

<sup>237</sup> Alternatively, the defendants may have desired to conceal other assets unrelated to this action.

<sup>238</sup> See *supra* notes 58-59 for a description of the scope of the business.

c. *The "Government" Is Not a Party*

It is an oversimplification to assume that because the government was a party in *Graystone* the defendants' "plight" was worthy of enhanced judicial solicitude. Granted, some danger of baseless civil actions brought solely to compel testimony from potential criminal defendants, or vice versa, exists.<sup>239</sup> Agency self-interest, however, along with the competition for resources among government arms such as the SEC and the U.S. Attorney may significantly decrease this possibility. Moreover, in a properly founded action, the possibility and ease of cooperation between agencies like the SEC and the U.S. Attorney is a desirable by-product of the pursuit of legitimate societal goals in a civil context. In addition, cooperation is not a phenomenon limited to a coordinate arm of the government and the U.S. Attorney. Private litigants bringing securities fraud actions, for example, also are likely to cooperate with the U.S. Attorney when cooperation will aid in attainment of their ends. This potential further disperses the air of novelty from the SEC-as-plaintiff situation.

Congress has charged the SEC with the smooth running and fair operation of securities markets. The SEC's resources,

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<sup>239</sup> There is a longstanding consensus that allowing maintenance of suits brought solely to support others "would be flouting the policy of the law." *United States v. Procter & Gamble Co.*, 356 U.S. 677, 683 (1958). In *Procter & Gamble*, defendants requested discovery and production of grand jury transcripts, partly maintaining that the earlier, unsuccessful criminal indictment was baseless and brought solely to aid the civil action. *Id.* On appeal the Supreme Court rejected the request, stating that "[t]here is no finding that the grand jury proceeding was used as a shortcut to goals otherwise barred or more difficult to reach." *Id.*; see also *United States v. Pennsalt Chem. Corp.*, 260 F. Supp. 171, 180 (E.D. Pa. 1966) (allowing discovery of the circumstances surrounding the investigation leading to a civil suit, including the timing of a grand jury inquiry and of other events leading to the suit, to support plaintiff's claim that a grand jury inquiry was made solely to support the civil action); *United States v. Thayer*, 214 F. Supp. 929, 932 (D. Colo. 1963). The court in *Thayer* granted defendant a new trial where defendant was prosecuted for perjury for answers given during an SEC investigation of his role in a sale of stock. The court stated that defendant "may have been misled by the fact that the main object of the investigation appeared to be inquiry into substantive violations." *Id.* In fact, the court held the object of the investigation was to cause the witness to perjure himself. *Id.* at 931. This holding has been cited with approval by the Supreme Court. See *United States v. Kordel*, 397 U.S. 1, 11-12 (1970).



while formidable, are nonetheless finite. The budget process allocates funding based in part on its availability, of course, but is also dependent on the extent to which Congress perceives the agency to be effective in implementing the congressional mandate. The more successful the SEC is in recovering disgorgement of illicit gains, enjoining fraudulent or unfair practices in securities dealing, and otherwise fulfilling this mandate, the more secure is its funding. Actions brought largely to serve other agencies would tend to waste the SEC's finite resources, as their initiation, typically, would not be a product of an accurate assessment of the possibility of success redounding to the SEC's benefit. These abusive actions, therefore, will be exceptional. Moreover, the adverse publicity that could result from unprincipled exercises of civil power at the bidding of the criminal authorities could further harm the long-term interests of the SEC.<sup>240</sup> These factors indicate that concern for testimonial compulsion in trumped-up cases is exaggerated and not a worthy motivating factor for the Third Circuit to aid the defendants in *Graystone*.

Some might argue that the greater ease and increased possibility of cooperation with criminal prosecutors inherent in any action brought by the SEC points toward greater safeguarding of fifth amendment rights. In a well-founded action such cooperation is merely a favorable by-product of the government's legitimate pursuit of important societal interests.<sup>241</sup> Certainly, the possibility exists that, even in an action brought to serve the legitimate interests of an agency like the SEC, information could be sought at the behest of another agency that has no real bearing on the case at hand. Measures

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<sup>240</sup> This point, that bad publicity is both undesirable and harmful, is almost self-evident, but difficult to prove. There do not appear to be any concrete examples. The coverage of one prominent case, however, shows a willingness by the press to point out the possibility of government weakness rather than the overwhelming evident strength of a case. See Martha M. Hamilton & David A. Vise, *Levine Defense Outlined: Attorneys Say SEC Shows No Evidence*, WASH. POST, May 21, 1986, at G1. The implication in the title is that this is harassment—an SEC fishing expedition. The claims of Levine's attorneys were set out in detail. Conversely, the reams of SEC evidence, and the defense attorney's efforts to gloss over the evidence, are given only a few lines. One can only imagine the savaging the government would receive if a truly questionable investigation or action was uncovered.

<sup>241</sup> See *supra* text at note 194 and text following note 197 for a discussion of the interests served by SEC action.

available to courts, however, such as protective orders or further restrictions on discovery, effectively counteract this type of abuse.

Finally, the considerable possibility of a private litigant's cooperation with the U.S. Attorney removes the situation of defendants like those in *Graystone* from the realm of the novel and constitutionally dangerous. Claims similar to those in *Graystone* could be brought as a class action.<sup>242</sup> With disgorgement amounts in the millions of dollars, such actions most likely would attract competent legal representation.<sup>243</sup> A competent plaintiff's attorney, in marshalling resources for an effort to extract a favorable settlement of such a case, certainly would consider the possibility of cooperation with the U.S. Attorney and would make the plaintiff's awareness of that possibility clear to the defendants. Granted, cooperation would not be as easy or seamless as that between two government agencies; nevertheless, the danger to the defendant is comparable in kind and only incrementally less in degree than that present when the SEC is a party plaintiff. This difference in degree does not support the type of favorable treatment the *Graystone* defendants received from the Third Circuit, either alone or in combination with their ostensibly unrepresented status.

#### CONCLUSION: TOTAL AVOIDANCE SHOULD BRING TOTAL PRECLUSION

The degree of preclusion in a given case should be tailored to counterbalance the extent of the prejudice to opposing parties caused by discovery avoidance. In situations where defendants provide timely discovery on specific issues a lesser preclusion order or other remedy may be appropriate. Selective

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<sup>242</sup> See *supra* note 143 for a discussion of the various causes of action in this case under the Securities Act of 1933 and the Securities Exchange Act of 1934. Actions under §§ 11 and 12 (expressly) of the Securities Act, §§ 10(b) and 15(b) of the Securities Exchange Act, and Rule 10(b)(5) promulgated thereunder (impliedly) may be brought privately. See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 150-54 (1972) (Rule 10b-5).

<sup>243</sup> Effective representation of class interests is a prerequisite to maintenance of a class action under the Federal Rules of Civil Procedure. See FED. R. CIV. P. 23(a).

preclusion of evidence bearing on certain defenses, denials or claims may ameliorate the effects of the shield of privilege on discovery. Even in these cases, though, courts' efforts in a civil context should be to avoid prejudice to any party, and decidedly not to subsidize a tactical distortion of the fair contest through an invocation of the fifth amendment privilege.

Where discovery avoidance is total, however, despite the difficulty of quantifying precisely the harmful effects of the invocation, courts must effectively counteract these harmful effects. Simply put, loss of the opportunities inherent in discovery to improve its case or position prejudices a plaintiff even if the defendant is not permitted to testify. The prejudice is far greater if the testimony is allowed. The only way to ensure that one invoking the privilege gains advantage from its use is to totally preclude any factual support from any source for the denials and defenses as to which that party has asserted the privilege.

Total preclusion is a measured, proportionate remedy that does not operate as an automatic deprivation, and therefore does not fall into the category of "costly" sanctions proscribed by the Supreme Court. It is not a reflexive measure taken as a result of a lack of "careful evaluation."<sup>244</sup> Rather, total preclusion is a solution that both takes into account the manifold substantive and procedural interests present in civil actions such as *Graystone*, and embodies a realistic estimate of the prejudice imposed on civil litigants who use the self-incrimination privilege to stonewall discovery. Courts have an obligation to prevent imbalances from tainting a civil trial. Total preclusion is the permissible remedy that is most sure to counteract the level and type of prejudice inherent in cases of total avoidance. It is a fair and proper price of, not a penalty for, the invocation of the Fifth Amendment in a civil case.

*Christopher V. Blum*

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<sup>244</sup> *Graystone II*, 25 F.3d at 192 (characterizing the remedy in *FTC v. Kitco of Nev., Inc.*, 615 F. Supp. 1282 (D. Minn. 1985), as a product of careful evaluation and opposing it to the total preclusion in *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545 (S.D.N.Y. 1985)).