



**JUSTICE DELAYED IS JUSTICE DENIED –
MAKE A "FEDERAL" CASE OUT OF IT**

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Introduction

The Proof of Loss has been filed. The claim has been thoroughly investigated and analyzed. All the policy requirements and conditions have been satisfied. The claim, like the lion's share of all claims, is honored by payment.

But, what to do about recovery? In most jurisdictions, the resources of law enforcement are stretched to such a degree that recovery through the criminal justice system is problematic. Additionally, the fidelity insurer may prefer to rely on self-help remedies such as litigation rather than negotiations that are outside its control. In such situations, the principal may represent a viable source of recovery, at least to the extent that he or she is not judgment proof. The question then becomes what forum should be chosen and in whose name should the action be prosecuted.

One alternative to carefully consider is to file an action in federal court on diversity grounds in the name of the insurer. This is particularly true when one is in a jurisdiction in which devices such as a loan receipt or conditional assignment are not effective to allow the insured to be considered the real party in interest for purposes of standing rules. In such situations, significant strategic advantages can be gained by filing a case in federal court rather than state court. In short, make a federal case out of it.

This article focuses on two of the major benefits to choosing a federal forum. First, federal courts are often less disposed to grant a principal's request for a stay of a civil litigation pending resolution of the criminal proceedings relating to the loss. Second, federal courts, unlike some state jurisdictions, allow an inference to be drawn adversely to the principal from his invocation of his Fifth Amendment privileges in a civil case.

Considerations Regarding A Stay Of The Action

State court jurisprudence in some jurisdictions provides expansive protection to defendants who invoke their right of self-incrimination under the Fifth Amendment. For example, in *Pacers, Inc. v. Superior Court*,¹ drug enforcement agents filed suit against a number of bar employees for assault and battery after a fight erupted between the agents and bar employees during the course of an undercover operation. A federal grand jury refused to pursue indictments, but the U.S. Attorney's Office stated that it would maintain an "open file" on the matter.

During the course of discovery in the civil litigation, the issue of the Fifth Amendment privilege arose. The bar employees refused to answer questions at their depositions unless they were given use and derivative use immunity from criminal prosecution. This request was rejected. The agents sought an order prohibiting the bar employees from testifying at trial as a consequence of failing to answer the deposition questions. The bar employees opposed the motion, instead proposing that they be allowed to postpone their depositions until the statute of limitations ran on the criminal charges. The trial court granted the agents' motion barring the bar employees from testifying.²

The court of appeals took the unusual step of granting the bar employees' request for a writ of mandate. It then reversed the trial court's ruling, holding that the trial court had abused its discretion.³ In doing so, the court of appeals focused almost exclusively on the potential prejudice to the bar employees' defense of the unfiled criminal matter, and it dismissed the agents' desire to have a speedy and complete resolution as "inconvenient[t]"⁴

¹ 162 Cal. App. 3d 686 (1984).

² *Id.* at 686.

³ *Id.*

⁴ 4162 Cal. App. 3d at 690.

One finds quite a different environment in the federal courts. Initially, the question of whether or not to issue a stay is typically seen as a procedural question. As such, the federal courts are free to develop their own rule.⁵

It is clear that the United States Constitution does not generally require a stay of civil proceedings pending the outcome of criminal proceedings.⁶ The decision of whether to stay civil proceedings in the face of an ongoing or potential criminal action should be made "in light of the particular circumstances and compelling interest involved in the case"⁷ Thus, factors to be considered in whether to grant or deny a request to stay are:

(1) the interest of the plaintiffs in proceeding expeditiously with the civil proceeding or any particular aspect of it, and the potential prejudice to the plaintiffs of a delay; (2) the burden which any particular aspect of the proceedings may impose on the defendant; (3) the convenience of the court in management of its cases, and the efficient use of judicial resources; (4) the interests of persons not parties to the civil litigation; and (5) the interest of the public in the pending civil and criminal litigation.⁸

One of the primary factors to be considered in granting or denying a requested stay of civil proceedings pending the outcome of criminal proceedings is the interests of the plaintiff in proceeding expeditiously with litigation.⁹ A victim of an embezzlement frequently can show a compelling interest in proceeding expeditiously with the case. It is

often possible to show dissipation of assets and a risk of loss of evidence due to the passage of time and to the fading of memories. What's more, principals in the course of attempting to hide their wrongdoings will frequently have engaged in a pattern and practice of transactions designed to disguise or launder their activities, giving rise to an inference that they might continue to do so if the civil remedy is delayed.

For instance, in *Federal Savings & Loan Insurance Corp. v. Molinaro*, decided five years after the *Pacer* decision, the Ninth Circuit denied a requested stay by the defendant who was being sued for diverting loan proceeds for his personal benefit. ¹⁰ The court reasoned that the plaintiff had a strong interest in moving forward with the case in an expeditious manner because there was a risk that the defendant would be able to dispose of assets, thereby limiting the plaintiff's potential for recovery. ¹¹ Based on the reasoning in *Molinaro*, a fidelity insurer seeking recovery from a defalcating principal will frequently be able to marshal significant evidence to support an argument that it would be prejudiced by a stay or delay in the litigation.

Another consideration for a court deliberating on whether to stay a civil proceeding is the efficient use of judicial resources.¹² Given the strong public policy for expeditious resolution of civil cases, it is proper for a court to consider the adverse impact that a stay would have on its docket, particularly where such a ruling would require the court to wait virtually indefinitely for the outcome of a criminal case, which may not have yet even been filed. ¹³ Limitations on staffing and a large workload relating to the prosecution of violent crimes and terrorist-related activities lead to a delay in the prosecution of white collar crimes. Thus, it is not uncommon for a fidelity claim to be resolved and for the action seeking recovery to be ripe for resolution well before the completion of any criminal case.

Finally, the court is to consider the burden, if any, imposed on the defendant by its

⁵ See generally, *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

⁶ *Keating v. Office of Thrift Supervision*, 45 F.3d 322,324 (9th Cir. 1995); *Sec. & Exch. Comm'n v. Dresser Indus.*, 628 F.2d 1368, 1375 (D.C. Cir. 1980); *Fed. Sav. & Loan Ins. Corp. v. Molinaro*, 889 F.2d 899, 902 (9th Cir. 1989).

⁷ *Molinaro*, 889 F.2d at 902.

⁸ *Id.* at 903.

⁹ *Id.*

¹⁰ *Id.* at 900.

¹¹ *Id.* at 903.

¹² *Id.*

¹³ *IBM v. Brown*, 857 F. Supp. 1384, 1392 (C.D. Cal. 1994).

denial of the stay request. As the Ninth Circuit stated in *Molinaro*, where no criminal indictment has been handed down, the case for a stay in a civil proceeding is even weaker.¹⁴ The court will examine the ability of the defendant to resist civil litigation with evidence which does not intend to incriminate him.¹⁵ Moreover, the court will require the defendant to proffer any truthful testimony he can offer in the civil case that would be helpful to his defense of the civil case, but which would otherwise be protected by his Fifth Amendment privilege.¹⁶

The Ninth Circuit has recognized that "a defendant has no absolute right not to be forced to choose between testifying in a civil case and asserting his Fifth Amendment privilege."¹⁷ Indeed, the Ninth Circuit has recognized that "not only is it permissible to conduct a civil proceeding at the same time as a related criminal proceeding, even if it necessitates invocation of the Fifth Amendment privilege, but it is even permissible for the trier of fact to draw an adverse inference from the invocation of the defendant's invocation of the Fifth Amendment in a civil proceeding"¹⁸ This philosophy stands in marked contrast to that in some state courts and thus resort to federal courts may be a significant benefit to a fidelity insurer pursuing recovery civilly from the perpetrator.

Evidentiary Inferences Arising From Invocation Of The Fifth Amendment Privilege

What if the alleged principal raises his privilege under the Fifth Amendment to decline to testify on matters which may incriminate him? Does the invocation of the privilege have an evidentiary impact?

There are a wide variety of answers to this question. Authority from some states appear to prohibit any significant impact of such invocation.¹⁹ Other jurisdictions tend to use a

balancing test in which the need for the testimony is balanced against the impact on the litigation and the availability of alternative means of testing the particular question at hand.²⁰ Still other jurisdictions equate the invocation of the privilege against self incrimination with an admission that the underlying conduct that was the subject of the question occurred.²¹

By way of contrast, federal authorities typically allow the drawing of an inference that a party who invokes the Fifth Amendment privilege indeed perpetrated the acts that are the subject of the inquiry.²² Thus, the general likelihood that a federal court will allow such an inference to be drawn, as opposed to the likely opposite result in some state court jurisdictions, is yet another reason to file a recovery action in federal court.

Conclusion

There clearly are benefits to "making a federal case out of it" when it comes to pursuing a principal. The additional deference that the federal courts give to a victim's right to justice, together with the evidentiary impact allowed in federal courts in a civil case regarding the invocation of the Fifth Amendment privilege, are strong strategic factors which weigh in favor of choosing the federal forum.

14 *Molinaro*, 889 F.2d at 903 (citing *Dresser Indus.*, 628 F.2d at 1376).

15 *Molinaro*, 889 F.2d at 903.

16 *See Brown*, 857 F. Supp. at 1390.

17 *Keating*, 45 F.3d at 326.

18 *Id.*

19 *See, e.g.*, CAL. EVID. CODE § 913 (West 2007); *Lentz v. Metro. Prop. & Cas. Ins. Co.*, 768 N.E.2d

538 (Mass. 2(02) (prohibiting any such inference if the question or subject matter is not related to the case at trial); *Gabriel v. Columbia Nat'l Bank of Chi.*, 592 N.E.2d 556 (Ill. 1992).

20 *See, e.g.*, *Stolowski v. 234th E. 178th St. LLC*, 819 N.Y.S.2d 213 (N.Y. Sup. Ct. 2006); *Kernen v. Intercont'l Bank*, 573 So. 2d 976 (Fla. Dist. Ct. App. 1991); *Steinerv. Minn. Life Ins. Co.*, 85 P.3d 135 (Colo. 2004).

21 *See, e.g.*, *Griffith v. Griffith*, 506 S.E.2d 526 (S.C. 1998); *Sanders v. State of Ga.*, 577 S.E.2d 94 (Ga. 2(03) (civil forfeiture action); *see generally*, *WilRoye Inv. Co. II v. Wash. Mut. Bank*, 142 S.W.3d 393 (Tex. 2004) (permissible inference).

22 *See, e.g.*, *Baxter v. Palmitiano*, 425 U.S. 308, 318 (1976); *Keating*, 45 F.3d at 326.