IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION	§	
Plaintiff,	§	
	§	**Civil Case No. 07-02211**
v.	§	
	§	
DARREL T. USELTON and JACK E. USELTON,	§	
Defendants.	§	

DEFENDANTS' RESPONSE OPPOSING THE STATE OF TEXAS'S MOTION FOR A LIMITED STAY OF PROCEEDINGS

Darrel T. Uselton and Jack E. Uselton file this Response Opposing the State of Texas's Motion for a Limited Stay of Proceedings (the "Motion").

Summary of Relief Requested

1. The Useltons request an order from the Court denying the State's Motion to Stay. In the Motion, the State makes no showing of exceptional circumstances or substantial and irreparable prejudice and instead only vaguely alludes to circumstances that are either premature or entirely speculative. Moreover, to the extent "exceptional circumstances" do exist, the State's presence as an Intervenor allows the Court to fashion a remedy that would protect the State's interest while allowing the Useltons to prepare its defense in this case. Accordingly, the State has not satisfied its burden and the Motion must be denied.

Facts

2. On July 3, 2007, the State issued indictments against the Useltons charging each with one count of money laundering and one count of participating in an organized criminal

enterprise for the purpose of money laundering (the "Indictments").[1] The Indictments do not contain counts for fraud or violations of state or federal securities law.

3. On July 9, 2007, the United States Securities & Exchange Commission filed its Original Complaint against the Useltons in these proceedings.[2] In the Complaint, the SEC alleges that the Useltons violated SEC Rule 10b-5 and Section 10b of the Securities Exchange Act of 1934 by manipulating the markets of ten "penny stocks".

4. On October 1, 2007, the State filed the Motion seeking a blanket stay of these proceedings until after the criminal trial on the Indictments. The State's grounds for the stay is that civil discovery in this case would hamper the ongoing criminal case and allow the Useltons to circumvent the rules of criminal procedure pertaining to discovery.[3] As of the fling of the Motion, the Useltons have sought no discovery in these proceedings nor asserted any privilege.

Arguments and Authorities

5. The Court should deny the Motion because the State has failed to demonstrate any justification for such a broad remedy as an indefinite blanket stay. In *SEC v. First Financial Group of Texas, Inc.*, the Fifth Circuit stated that "[t]here is no general federal constitutional, statutory, or common law rule barring the simultaneous prosecution of separate civil and criminal actions by different federal agencies against the same defendant involving the same transactions."[4] In a civil case, there is a strong presumption in favor of discovery, and the government must overcome that presumption in its request for a stay.[5] Moreover, the mere relationship between criminal and civil proceedings, and the resulting prospect that discovery in the civil case could prejudice the criminal proceedings, does not establish the requisite good

[1] See State's Motion, Exhibit A.
[2] See SEC's Original Complaint [Docket No. 1].
[3] See State's Motion, p. 1.
[4] 659 F.2d 660, 667 (5th Cir. 1981).
[5] *U.S. v. Gieger Transfer Services, Inc.*, 174 F.R.D. 382, 385 (S.D. Miss. 1997)(internal citations omitted).

cause for a stay.[6] The State has failed to rebut the presumption of discovery, failed to demonstrate the existence of exceptional circumstances and has failed to show any irreparable prejudice to its criminal case. Accordingly, the Court should deny the Motion.

A. **The State Has Failed To Demonstrate The Existence of Exceptional Circumstances That Would Justify A Blanket Stay Of These Proceedings.**

6. The Court should deny the Motion because the State has failed to meet its burden of showing exceptional circumstances that would create substantial and irreparable prejudice. Though a district court may stay a civil proceeding during the pendency of a parallel criminal proceeding, "[s]uch a stay contemplates 'special circumstances' and the need to avoid 'substantial and irreparable prejudice."'[7] Moreover, in deciding whether to grant a request to stay the civil side of parallel civil/criminal proceedings: "[j]udicial discretion and procedural flexibility should be [used] to harmonize the conflicting rules and to prevent the rules and policies applicable to one suit from doing violence to those pertaining to the other. In some situations it may be appropriate to stay the civil proceeding. In others it may be preferable for the civil suit to proceed-unstayed."[8]

7. In examining whether special circumstances exist, courts in this district have considered the following factors: 1) the extent to which the issues in the criminal case overlap with those presented in the civil case; 2) the status of the case, including whether the criminal defendant has been indicted; 3) the private interests of the plaintiff in proceeding expeditiously weighed against the prejudice to plaintiff caused by the delay; 4) the private interests of and

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[6] *Id.* (citing *U.S. v. 6600 North Mesa, El Paso, Texas*, 903 F.2d 312, 320 (5th Cir. 1990).
[7] *United States v. Little Al*, 712 F.2d 133, 136 (5th Cir.1983) (quoting *SEC v. First Fin. Group of Tex., Inc.*, 659 F.2d 660, 668 (5 Cir. Oct.1981)).
[8] *SEC v. Mutuals.com, Inc.*, 2004 WL 1629929 at *2 (N.D.Tex. July 20, 2004) (Fitzwater, J.) (citing *United States v. Gieger Transfer Serv., Inc.*, 174 F.R.D. 382, 385 (S.D.Miss.1997) (in turn quoting *Campbell v. Eastland*, 307 F.2d 478, 487 (5th Cir.1962) (citation and internal quotation marks omitted)).

burden on the defendants; 5) the interests of the courts; and 6) the public interests.[9] These factors, when taken in conjunction with the facts of this case demonstrate that there are insufficient exceptional circumstances to justify a blanket stay. Accordingly, the Court should deny the Motion.

i. **The Overlap between the State's Criminal Case and the SEC's Civil Case Is Insufficient to Justify a Stay.**

8. The Court should deny the Motion because the facts relevant to the State's criminal case and the SEC's civil case have insufficient overlap. In the Motion, the State argues that the facts and circumstances of the two cases or virtually identical.[10] This however is far from accurate. The Court is not presented with the typical case of parallel civil and criminal proceedings where the SEC and the U.S. Attorney's Office are attempting to prosecute defendants for the exact same conduct. Instead, the facts of the State's criminal case overlap only a small part of the SEC's civil case, and the ultimate wrongful conduct that the State and the SEC seek to punish are entirely different.

9. The State's criminal case on the Indictments does not relate to the overwhelming majority of the SEC's civil case. The Indictments allege that the Useltons committed money laundering of illicit proceeds from the sale of stock of Oretech, Inc. ("Oretech").[11] On the other hand, the SEC accuses the Useltons of orchestrating at least ten different fraudulent manipulations of the markets for ten different stocks, only one of which is Oretech.[12] Accordingly, the majority of facts, circumstances, documents, and witnesses that will be relevant to the SEC's civil case do not relate at all to the State's money laundering case. As such, the two

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[9] *Holden Roofing, Inc. v. All States Roofing, Inc.*, 2007 WL 1173634 1, 1 (S.D. Tex. 2007); *State Farm Lloyds v. Wood*, 2006 WL 3691115 1, 1 (S.D. Tex. 2006).
[10] See State's Motion, p. 2.
[11] See State's Motion, Exhibit A.
[12] See Securities & Exchange Commission's Original Complaint [Docket No. 1].

proceedings at issue are much more different than they are alike. As such, these parallel proceedings do not present an "exceptional circumstance" justifying a stay.

10. A stay is also not warranted in this case because the ultimate wrongful conduct the State and the SEC seek to punish is completely different. The State seeks to punish the Useltons criminally for committing money laundering. Specifically, the State alleges that the Useltons "did knowingly acquire, maintain an interest in, conceal, possess, transfer, and transport the proceeds of criminal activity".[13] The SEC seeks to civilly enforce federal securities law and punish the Useltons for alleged fraudulent sales of stock.[14] The Original Complaint is devoid of any facts relating to money laundering or any other transfer of illicit funds. Accordingly, the ultimate wrongful acts the State seeks to punish are completely irrelevant to these civil proceedings. Moreover, the very natures of the statutes the State and the SEC seek to enforce are fundamentally different, and therefore seek to enforce different public policies. As noted in *In re Par Pharm*, a stay is inappropriate when the parallel criminal and civil proceedings seek to enforce or vindicate different public polices.[15] As such, there is insufficient overlap between the criminal and civil cases to warrant a blanket stay, and the Court should deny the Motion.

ii. <u>The Status of the State's criminal trial does not justify a stay of these proceedings.</u>

11. In the Motion, the State argues that a stay is warranted because the defendants have already been indicted. To justify this position the State relies upon *SEC v. Mutuals.com, Inc.*, 2004 WL 1629929 (N.D.Tex. 2004) for the proposition that "a stay of a civil case is most appropriate were a party to a civil case has already been indicted for the same conduct."[16] The State's reliance on *Mutuals.com* is misplaced because the Useltons have not been indicted for the

[13] See State's Motion Exhibit A.
[14] See SEC's Original Complaint.
[15] 133 F.R.D. 12, 14 (S.D.N.Y. 1990).
[16] See State's Motion, p. 5.

conduct of which they are accused in this case. The Useltons concede that an alleged violation of the Texas Securities Act is mentioned in the Indictments, however the Indictments are clear that the ultimate wrongful conduct the State seeks to punish is not the Useltons' alleged acts of securities fraud but for money laundering and participating in an organized criminal enterprise to launder money. The State has not indicted the Useltons for *any* violation of *any* securities law. As securities fraud and money laundering are ultimately distinct acts, the Useltons have not been indicted for the wrongful conduct alleged by the SEC in these civil proceedings. This factor therefore does constitute a "special circumstance" and the Court should deny the Motion.

12. Even if the Court were to hold that the counts in the Indictments encompass a securities law violation that would still be insufficient to justify a blanket stay of this case. The Indictments refer to one security: Oretech. This is but one of ten stocks that are relevant to the claims of the SEC. Accordingly, taking the Indictments in the light most favorable to the State, the Useltons have still not been indicted for the overwhelming majority of the wrongful conduct alleged by the SEC. At most, the facts of the Indictments might justify severing the SEC's claims relating to Oretech into another matter. It does not, however, justify a stay of this entire case, and the Court should therefore deny the Motion.

iii. <u>The Public's interests are not served by a lengthy stay of these proceedings.</u>

13. The public's interests are not served by a lengthy stay of these proceedings. In the Motion, the State correctly noted that as a matter of law "[i]n the context of a civil enforcement suit, the plaintiff's interest and the public interest are intertwined."[17] And certainly, the public has a recognized interest in the enforcement of federal securities regulation. This

[17] See State's Motion, p. 5.

interest could only be harmed by a lengthy delay in these proceedings.[18] In the Original Complaint, the SEC alleges facts that occurred as early as May 2005. The State proposes a stay in these proceedings until at least October 2008, and potentially much longer.[19] As such, the State is proposing a three-year gap between the date of the occurrences relevant to this case and the advent of discovery. Such a delay risks the loss of documentary evidence or simply the loss of recollection in the minds of potential witnesses. This could materially affect all parties' ability to develop their claims and defenses, and ultimately affect the ability of the court to reach a just resolution. The public interest is not served by this delay. This public's interest is therefore not an exceptional circumstance warranting a blanket stay.

14. Likewise, the State has failed to demonstrate the public's interest would be served by the blanket stay it requests. The State argues in the Motion that a stay would serve the public's interest in maintaining the criminal process by preventing the Defendants from obtaining discovery in the civil case that they would not be entitled to in the criminal case.[20] The State asserts that the Useltons would use civil discovery to obtain information from law enforcement personnel such as the identity of the State's confidential sources.[21] This argument ignores the fact that discovery against the SEC would not reach the State as they represent separate interests (unlike the SEC and the U.S. Attorney), have separate cases and separate investigators. It also ignores that the State could protect this information from discovery by asserting it law-enforcement or work-product privileges. Likewise, the State's claim that this case should be stayed to prevent the Useltons from using this case as a "dodge" on the

[18] In the Motion, the State asserts that the SEC has agreed to a stay of these proceedings. That statement is inaccurate. The SEC made it clear in the telephonic scheduling conference for this matter that it simply took no position regarding the State's request for a stay. It cannot, therefore be said that the SEC, who represents the public interest, either approves the stay or believes it is in the public's best interest.
[19] See State's Motion, p. 7.
[20] See State's Motion, p. 6.
[21] See State's Motion, p. 6.

limitations of criminal discovery is unfounded. The case here is easily distinguishable from the principal cases relied upon the State. The Useltons did not institute this civil action to end-run the State's criminal prosecution; they are simply defending themselves in a civil proceeding brought against them by the SEC.[22] Accordingly, even taking the State's assertions as true, they fail to present prejudice that is so substantial as to require a blanket stay of this case.

15. The State's claim that civil discovery in this case would damage the State's criminal case is also entirely speculative and attempts to create a *per se* rule against parallel civil and criminal proceedings. Presently, the Useltons have requested no discovery in this case, nor have they asserted their Fifth Amendment rights. As such, it is only the mere *possibility* of discovery that the State believes justifies an indefinite blanket stay. Such is not the case. The possibility of civil discovery is present in every parallel civil and criminal proceeding. If this fact alone were sufficient to justify a blanket stay of civil proceedings, this would amount to the *per se* prohibition on parallel proceedings that the Fifth Circuit expressly rejected in *First Financial Group of Texas*. Second, the State has completely failed to demonstrate how the Useltons' potential use of civil discovery against the SEC would create any concrete prejudice let alone the "substantial and irreparable prejudice" required to obtain a stay. The State makes no showing that its investigation is still on-going, or how discovery against the SEC would adversely impact the same. As noted in *Geiger* (a case cited by the State in the Motion), the mere relationship between criminal and civil proceedings, and the resulting prospect that discovery in the civil case could prejudice the criminal proceedings, does not establish the

[22] See *Campbell v. Eastland*, 307 F.2d 478 (5th Cir. 1972)(Government sought stay of discovery from individual plaintiffs who filed civil tax refund case while criminal prosecution was still pending); *see also Application of Eisenberg*, 654 F.2d 1107, 1113 (5th Cir. 1981)(Denial of pretrial deposition by plaintiff in light of grand jury proceedings regarding the same witness).

requisite good cause for a stay.[23] As the State has demonstrated no more than the mere prospect of prejudice, the Useltons' potential use of civil discovery in this case does not constitute a "special circumstance" warranting a stay.

iv. <u>A lengthy stay would greatly prejudice the Useltons.</u>

16. The Court should deny the Motion because the stay requested therein would cause undue prejudice to the Useltons. The stay proposed by the State would extend this matter for an indefinite time period, which would be not less than a year. During this stay, evidence could be lost, and witnesses' recollections will likely fade. Moreover, the State's criminal case cannot be expected to preserve evidence relevant to the Useltons' defense of the SEC's claims because at least nine of the securities relevant to these proceedings have no bearing on the allegations contained in the Indictments. Accordingly, the stay proposed in the Motion will prevent the Useltons from preserving evidence, thereby prejudicing the Useltons' ability to prepare their defense.

17. The Useltons may also suffer great pecuniary loss by virtue of the requested stay. Presently, the SEC is seeking disgorgement of approximately $4,600,000.00 from the Useltons. The SEC is also seeking prejudgment interest on this amount, which accrues at eight percent per year.[24] Accordingly, if the stay were granted as the State requests, these proceedings would be stayed until at least October 2008. Accordingly, the Useltons may be liable for an additional $400,000.00 by this delay. This prejudice is both severe and unnecessary, and the Court should deny the Motion accordingly.

18. Jack Uselton will also suffer prejudice unique to him if the Motion were to be granted. Jack Uselton is 69 years and currently suffers from diabetes, high-blood pressure, and

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[23] *Id.* (citing *U.S. v. 6600 North Mesa, El Paso, Texas*, 903 F.2d 312, 320 (5th Cir. 1990)).
[24] See SEC's Original Complaint, p. 30.

has developed a heart condition. Indeed his health is so poor that he had to be hospitalized when he surrendered himself to the Harris County Sherriff for processing. If the Motion is granted, the amount of time that he spends defending himself will be extended for at least another year. Jack Uselton's health requires that he be allowed to defend himself and resolve all matters globally. Otherwise, he faces this very real possibility that he will spend the rest of his life in litigation. This personal prejudice also weighs against a stay.

v. <u>The Courts Are Not Benefited By a Stay.</u>

19. The Court's interests also weight against a stay of this case. The courts have an interest in efficiently managing their dockets. In the Motion, the State argues that the "resolution of the criminal cases will likely resolve, if not avoid the necessity of consuming resources in the concurrent defense of both a civil lawsuit and criminal indictments."[25] That argument is speculative at best. It presupposes that the State will win its case. To the extent it does not, the SEC would not be bound by the jury's verdict because of the different standards of proof. As the District Court for the North District of Texas noted in *SEC v. Kornman*, the mere fact that "a stay might ultimately serve judicial economy at some undefined future point is not a "special circumstance."[26] Moreover, as the State's case involves only one of the ten stocks at issue in this case, the majority of the facts and issues would still have to be litigated for the first time in this case. Accordingly, regardless of the outcome of the State's case, this lawsuit would have to proceed. As such, the Court's interests are not served by having this case sit dormant on its docket for over a year.

[25] See State's Motion, p. 5.
[26] 2006 WL 148733 1, 3 (N.D. Tex. 2006).

B. A Stay Is Inappropriate Because The State And The SEC Seek To Enforce Different Laws And Different Public Policy.

20. The stay requested by the State is also inappropriate because the SEC and the State seek to enforce different statutes and therefore different public policies in the civil and criminal trials. As noted in *Par Pharm*, when different regulatory authorities seek to enforce different statutes, and therefore different public policies, a stay of the civil proceeding is inappropriate.[27] Such is the case here. It is undisputed that the State seeks to enforce its prohibition on money laundering while the SEC seeks to enforce federal prohibitions on fraud relating to the sale of securities in interstate commerce. The State and the SEC are, therefore attempting to enforce fundamentally different laws and different public polices. A blanket stay of this civil case is, therefore inappropriate. The Motion should, therefore be denied.

C. Any Prejudice to the State's Interest May Be Alleviated By Less Harsh Remedies Than A Blanket Stay.

21. An indefinite blanket stay is unnecessary as the State's presence in this case allows less drastic remedies to protect the State's interest relating to the criminal trial. As noted by the State in its Motion, the ultimate goal in addressing parallel civil and criminal proceedings is to use judicial discretion and procedural flexibility to harmonize the conflicting rules and to prevent the rules and policies applicable to one suit from doing violence to those pertaining to the other.[28] With that purpose in mind, the State's presence as an Intervenor in this litigation sufficiently protects the integrity of the criminal trial. As an Intervenor, the State could seek protective orders against discovery that crosses the line from legitimate development of the civil case into an invasion of the State's work-product or investigative material. Moreover, the Useltons do not object to a representative of the State attending any deposition in this matter,

[27] 133 F.R.D. at 14.
[28] See State's Motion, p. 3.

thereby alleviating any concern that the Useltons may obtain information that the State could not. Accordingly, the State's presence provides an adequate remedy short of a blanket stay that would both protect the integrity of the criminal trial and prevent prejudice to the Useltons' defense of this case.[29] Accordingly, any "exceptional circumstances" or prejudice that would otherwise warrant a stay are alleviated by the State's presence in this case. The Court should, therefore deny the Motion.

Relief Requested

Based on the foregoing, Darrel Uselton and Jack Uselton request that the Court enter an order i) denying the State of Texas's Motion For A Limited Stay of Proceedings, and ii) granting the Useltons all other relief to which they are justly entitled.

DATED: October 19, 2007.

Respectfully submitted,

COGDELL LAW FIRM

By: /s/ M. Kevin Powers

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[29] In *Anthony v. City of Philadelphia*, 2001 WL 118964 (E.D. Pa 2001), the District Court for the Eastern District of Pennsylvania refused to say a plaintiff's civil rights claim because the Intervention by the District Attorney allowed it to protect its interests by seeking a protective order for improper discovery.

CERTIFICATE OF SERVICE

A true and correct copy of the foregoing was served on the party listed below either via electronic means as listed on the Court's ECF noticing system or via first class United States mail, postage prepaid on October 19, 2007.

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