

PARALLEL OR PARALYZED?
SKLENA, RULE 804(b)(1), AND THE COSTLY IMPLICATIONS FOR
INTERAGENCY LAW ENFORCEMENT EFFORTS

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Many observers have called upon civil and criminal law enforcement agencies such as the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Department of Justice to conduct increased parallel proceedings to investigate alleged violations of the federal securities laws. While courts have generally blessed a wide-ranging investigatory and prosecutorial license, a recent Seventh Circuit case, United States v. Sklena, injected renewed uncertainty into the scope of these joint ventures. After the CFTC filed a civil complaint against two traders, the Commission's civil enforcement action was temporarily stayed pending criminal proceedings initiated by the DOJ. Before the criminal trial began, however, one of the traders died. The remaining defendant, David Sklena, sought to introduce the trader's testimony at trial under Federal Rule of Evidence 804(b)(1) under the theory that the CFTC and the DOJ were the "same party" and shared a "similar motive" under the rule. Although the district court dismissed Sklena's argument, the Seventh Circuit rejected the lower court's Rule 804(b)(1) analysis and reversed Sklena's conviction.

This Note explores the Sklena decision by tracing the district court's and Seventh Circuit's application of 804(b)(1), and examining the salient arguments in favor of and against the Sklena approach. It then considers the consequences for law enforcement agencies that will necessarily flow from the Sklena decision. This Note concludes that focusing on the transfer of human capital represents a superior way of aligning criminal and civil law enforcement agencies without disturbing existing legal and evidentiary standards. Though Sklena's rationale may similarly stem from a desire to foster close federal collaboration, this Note contends that incentivizing the interagency infusion of human capital can achieve this same outcome without the steep costs of judicial uncertainty and material federal resources.

I. INTRODUCTION

On April 2, 2004, floor traders David Sklena and Edward Sarvey arrived at work in the five-year Treasury note futures pit at the Chicago Board of Trade ("CBOT").¹ Sklena and Sarvey had no idea that April 2—which, in Sklena's opinion, became "the busiest day in the history of the [CBOT]"—would generate a rapid flurry of transactions that would form the basis of a criminal prosecution against them.²

On that day, the price of the five-year note futures fluctuated wildly—so wildly, in fact, that the aforementioned transactions transpired over a period of only seven minutes.³ The Seventh Circuit recounted the precise details in its decision:

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¹ United States v. Sklena, 692 F.3d 725, 727 (7th Cir. 2012).

² *Id.*

³ *Id.*

Everything happened between 7:31 and 7:38 in the morning; even seconds counted, and so we included them in this account. At 7:31:35, the market price for Five-Year Note futures fell to 111.050, apparently in response to unemployment statistics that had just been released. This was a price that triggered a series of sell stop orders, which obligated Sarvey to sell 2,474 of his customers' contracts at the best available price. Over the course of the next few minutes, the price began to rise again. This was when, according to the government, Sklena and Sarvey conspired to sell Sarvey's customers' contracts non-competitively.⁴

At approximately 7:37 AM, the other traders noticed that Sklena and Sarvey were engaged in a private conversation as chaos reigned within the pit.⁵ Shortly thereafter, Sarvey sold 2,274 contracts to Sklena at a price of 111.065 each, and Sklena immediately resold 485 of those contracts back to Sarvey at 111.070.⁶ Both of these prices were well below the customary market price, positioning the two traders for a massive payday.⁷ Scarcely seven minutes later, Sklena sold his remaining 1,789 contracts and "netted . . . over \$1.6 million, while Sarvey earned at least \$350,000 from the sale of his 485 contracts."⁸

Nearly four years later, in January 2008, the U.S. Commodity Futures Trading Commission ("CFTC") filed a civil complaint against Sarvey and Sklena, alleging that the two traders "engaged in a series of non-competitive trades that defrauded customers out of over \$2 million."⁹ On March 31, 2009, Sklena was indicted by a grand jury on six counts of wire fraud, one count of commodity fraud, and two counts of noncompetitive futures contract trading.¹⁰ Sarvey was charged with the same offenses, along with two additional counts of noncompetitive futures trading.¹¹

As discovery began, the CFTC took lengthy depositions from both Sarvey and Sklena regarding the trades on April 2, 2004, but the Commission's civil enforcement action was temporarily stayed pending the criminal proceedings in October 2010.¹² Sarvey, however, died before the criminal trial began.¹³ At trial, Sklena sought to introduce Sarvey's testimony from depositions taken by the CFTC. Among other reasons, Sklena hoped that the testimony would: (1) corroborate his account of the timing of the CBOT trades; (2) question the credibility of the government witnesses who suggested a timeline for the trading activity at issue; and (3) further clarify his private conversation with Sarvey that, according to the government, formed the basis of the traders' conspiracy to engage in noncompetitive trades.¹⁴ Although Sarvey's testimony was undoubtedly hearsay, Sklena argued that the evidence was admissible under Federal Rule of Evidence 804(b)(1)¹⁵, also known as the Prior Testimony Exception to Hearsay Rule, because: (1)

⁴ *Id.*

⁵ *Sklena*, 692 F.3d at 727.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* (internal quotation marks omitted).

¹⁰ *Id.* at 728.

¹¹ *Id.*

¹² *Id.* at 727–28.

¹³ *Id.* at 727.

¹⁴ *Sklena*, 692 F.3d at 733.

¹⁵ Rule 804(b)(1) provides that certain testimony is not excluded by the rule against hearsay if the declarant is unavailable as a witness:

(1) Former Testimony. Testimony that:

(A) was given as a witness at a trial, hearing, or lawful deposition, whether given during the current proceeding or a different one; and

the declarant (Sarvey) was unavailable as a witness; (2) the CFTC and the Department of Justice (“DOJ”) could be considered the same party for purposes of Rule 804(b)(1); and (3) the CFTC, in the civil case, had both the opportunity and a similar motive to that of the DOJ to develop Sarvey’s testimony.¹⁶ The district court rejected Sklena’s argument and found Sarvey’s deposition testimony inadmissible under Rule 804(b)(1).¹⁷ After a bench trial, the district court convicted Sklena on seven counts.¹⁸

Two years later, on January 13, 2012, Sklena’s appeal reached the Seventh Circuit. Sklena argued that he was entitled to a new trial because the district court erred by denying his motion under Rule 804(b)(1) and excluding Sarvey’s deposition testimony.¹⁹ Despite acknowledging the lack of controlling law on the issue, the Seventh Circuit disagreed with the district court, concluding that Sarvey’s deposition was in fact admissible under Rule 804(b)(1).²⁰ Upon finding that the district court’s erroneous exclusion of Sarvey’s testimony was not harmless, the Seventh Circuit reversed.²¹

On remand, Sklena will receive a new trial—now armed with Sarvey’s deposition. Although the DOJ itself never questioned Sarvey before his death, it must now live with the questions posed and the answers received by the CFTC during its deposition. The Seventh Circuit’s ruling on Rule 804(b)(1) in *Sklena*—and law enforcement agencies’ response to that ruling—will therefore have important implications for the investigation and prosecution of those engaged in securities fraud. This Note assesses the major arguments supporting and opposing the decision before offering an alternative, non-judicial means of accomplishing the same goals that the *Sklena* court may have desired. Part II recaps the evolution of civil and criminal law enforcement proceedings as authorized by statutory and case law authority. Part III explores the *Sklena* decision by tracing the district court’s and Seventh Circuit’s application of Rule 804(b)(1), and identifying the key arguments in favor of and against the *Sklena* approach. Part IV examines the consequences for law enforcement agencies resulting from the *Sklena* decision. Finally, Part V advocates that incentivizing the transfer of human capital between criminal and civil law enforcement entities would better facilitate parallel proceedings than judicial means like *Sklena*.

(B) is now offered against a party who had—or, in a civil case, whose predecessor in interest had—an opportunity and similar motive to develop it by direct, cross-, or redirect examination.

FED. R. EVID. 804(b)(1).

¹⁶ *Sklena*, 692 F.3d at 730–31.

¹⁷ *United States v. Sklena*, No. 09 CR 302, 2011 WL 1755769, at *10 (N.D. Ill. May 9, 2011), *rev’d*, 692 F.3d 725 (7th Cir. 2012).

¹⁸ *Sklena*, 692 F.3d at 728.

¹⁹ *Sklena*, 692 F.3d at 730.

²⁰ *Id.* at 732–33.

²¹ *Id.* at 733–34.