

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

**SECURITIES AND  
EXCHANGE COMMISSION,  
Plaintiff**

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**CASE NO. H-07-2211**

**DARREL T. USELTON  
AND JACK E. USELTON  
Defendants**

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**STATE OF TEXAS' MOTION FOR A LIMITED STAY OF PROCEEDINGS**

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**TO HONORABLE JUDGE KENNETH HOYT:**

Pursuant to Federal Rule of Civil Procedure 26(c), the State of Texas moves for a protective order staying the above-captioned proceedings for one year from the date of the filing of this motion, or the completion of the criminal trial in the 339<sup>th</sup> District Court, Harris County, Texas, Hon. Caprice Cosper, presiding, against these same defendants for substantially the same conduct with which they are charged in the instant case.<sup>1</sup> The grounds for this motion, as further discussed herein, are that allowing civil discovery in this case would hamper the ongoing Texas criminal cases against Darrel T. Uselton and Jack E. Uselton and would permit them to circumvent the rules of criminal procedure pertaining to discovery.

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<sup>1</sup> The State of Texas has concurrently filed a motion to intervene under Rule 24 of the Federal Rules of Civil Procedure.

## BACKGROUND

On July 9, 2007, the Securities and Exchange Commission (“SEC”) filed civil charges in this Court against Darrel T. Uselton and Jack E. Uselton (collectively “Useltons” or “Defendants”) for alleged securities fraud violations.

Less than one week earlier, on July 3, 2007, a grand jury in Houston, Harris County, Texas, had indicted both Defendants, alleging that they had combined and conspired with others to violate New York state securities laws and Texas state securities laws. Specifically, each defendant is charged with one count of Engaging in Organized Criminal Activity-Money Laundering for violating Section 29 of the Texas State Securities Act, and one count each of Engaging in Organized Criminal Activity-Money Laundering for violating Section 352-c(6) of the General Business Law of the State of New York. *See* Exhibit A. These criminal cases have a future docket setting of September 25, 2007.

The alleged conduct and activity in the state criminal cases are virtually identical to conduct and activity alleged in the SEC’s complaint. As described in the Texas Attorney General's Affidavit for Search Warrant in the criminal cases (“Texas AG Search Warrant”), which was ordered on December 5, 2006, the Useltons are alleged to have orchestrated a market manipulation scheme in which the trading volume and price of penny stock securities, including Oretch, Inc. (“ORTE”), were artificially increased

so that they could be resold at a higher price. The perpetrators of this scheme first obtained free or cheap stock. They then increased the share price and volume by using the Internet to distribute spam email to hundreds of thousands of prospective investors urging them to purchase the stock. . . . After manipulating the price of stock upward, they then sold their stock to unwitting investors on the NASDAQ over the counter market located in New York, New York. This type of scheme is referred to as a “pump and dump.” . . . Additionally, intermediary businesses

were used to send the spam through “hijacked” computers, further concealing the identity of the perpetrators.

*See* Exhibit B (Texas AG Search Warrant at ¶¶ 8-9); Exhibit C (July 9, 2007 Texas Attorney General News Release (“Texas Attorney General, SEC File Market Manipulation and Stock Fraud Charges Against Two Texas Residents”).

The conduct alleged by the SEC in the case before this court is nearly identical to the criminal conduct alleged in the state criminal proceedings. The SEC complaint alleges that the Uselftons obtained shares for little or no cost from penny stock companies, including ORTE, and sold those shares by orchestrating spam email campaigns using an array of computer “botnets” (*i.e.*, hijacked computers) that concealed the Uselftons’ identity, their holdings, and their intent to sell their stock into the artificial market they created through their spamming campaigns. *See generally* SEC Complaint at ¶¶ 1-6. Likewise, the time frame of the alleged activity in both criminal and civil cases are virtually identical.

Accordingly, the SEC’s civil case, as well as the documents and witnesses necessary to prove its case, are nearly identical to those in the Texas criminal cases.

## **ARGUMENT**

In ruling on requests for stays of the civil side of parallel civil/criminal proceedings, it is the law of this Circuit that judicial discretion and procedural flexibility should be utilized 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. *See, e.g., Securities and Exchange Commission v. Mutuals.com, Inc.*, 2004 WL 1629929, at \*2-3 (N.D. Tex. July 20, 2004) (quoting *United States v. Gieger Transfer Serv., Inc.*, 174 F.R.D. 382, 385 (S.D. Miss. 1997) and *Campbell v. Eastland*, 307 F.2d 478, 487

(5th Cir. 1962)). As the *Mutuals.com* court observed, “Certainly, a district court may stay a civil proceeding during the pendency of a parallel criminal proceeding. Such a stay contemplates ‘special circumstances’ and the need to avoid ‘substantial and irreparable prejudice.’” *Mutuals.Com*, 2004 WL 1629929 at \*3 (citations omitted).

Among the factors for a court to consider in deciding whether or not to grant a limited stay are:

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 defendants have been indicted; 3) the private interests of the plaintiffs in proceeding expeditiously, weighed against the prejudice to plaintiffs caused by the delay; 4) the private interests of and burden on the defendants; 5) the interests of the courts; and 6) the public interest.

*Id.* (citing *Heller Healthcare Fin., Inc. v. Boyes*, 2002 WL 1558337, at \*2 (N.D. Tex. July 15, 2002) and *Trustees of the Plumbers & Pipefitters Nat’l Pension Fund v. Transworld Mechanical Inc.*, 886 F.Supp. 1134, 1139 (S.D. N.Y. 1995) (internal citations omitted)).

Generally, the interests of justice weigh in favor of a stay of parallel civil proceedings due to the variety of ways in which the civil case may impede a criminal proceeding. *See Application of Eisenberg*, 654 F.2d 1107, 1113 (5<sup>th</sup> Cir. 1981) (it is “this circuit’s policy that criminal prosecutions take priority over civil actions”). *See also Campbell v. Eastland*, 307 F.2d 478, 487 (5th Cir. 1962) (“Administrative policy gives priority to the public interest in law enforcement. This seems so necessary and wise that a trial judge should give substantial weight to it in balancing the policy against the right of a civil litigant to a reasonably prompt determination of his civil claims or liabilities.”); *State Farm Lloyds v. Wood*, 2006 WL 3691115, at \*3 (S.D. Tex. Dec. 12, 2006) (“The public’s interest in the integrity of the criminal case is entitled to precedence over the civil litigant.”) (citations omitted).

As a threshold matter, the overlap of issues weighs considerably in favor of a stay. As noted above, the subject matter of the civil and criminal cases is essentially the same. All of the defendants in the criminal cases are also charged in the civil case with violating federal securities laws by their participation in the manipulation of multiple penny company stocks. The issues in the criminal cases substantially overlap with those presented in the civil case. As noted above, criminal indictments have been returned against the defendants in the civil case.

Moreover, “a stay of a civil case is most appropriate where a party to the civil case has already been indicted for the same conduct.” *Mutuals.Com*, 2004 WL 1629929 at \*3 (citations omitted). In the criminal cases, the defendants have already been indicted and the cases are proceeding on the trial docket. Thus, this factor weighs strongly in favor of a limited stay. *State Farm Lloyds*, 2006 WL 3691115 at \*2 (“If criminal indictments are returned against a civil defendant, a court should strongly consider staying the civil proceedings until the related criminal proceedings are resolved.”) (citations omitted).

In addition, the private interests of the plaintiff also weighs in favor of a stay. The SEC, which has an interest in the prompt resolution of its claims, has agreed to a limited stay of the civil proceedings. “In the context of a civil enforcement suit, the plaintiff’s interest and the public interest are intertwined.” *Mutuals.Com*, 2004 WL 1629929 at \*3 (citing *SEC v. Mersky*, 1994 WL 22305, at \*3 (E.D. Pa. Jan. 25, 1994)).

Further, a limited stay of this case will not prejudice the rights of any of the parties, because the civil action was only recently filed. In fact, the parties will benefit from a limited stay because the resolution of the criminal cases will likely reduce the scope of discovery and simplify, if not resolve, the issues in the civil case and avoid the necessity of consuming resources in the concurrent defense of both a civil lawsuit and criminal indictments. See *White v. Mapco Gas Products Inc.*, 116 F.R.D. 498, 501-03 (E.D. Ark. 1987); *Bureerong v. Uvawas*, 167 F.R.D. 83, 87 (C.D. Cal. 1996) (noting that

"some common factual questions may be conclusively determined in the criminal action," which would "serve the interests of judicial economy by narrowing the focus of the action to the benefit of the litigants."). As one court in this district recently recognized: "The outcome of the criminal proceedings may guide the parties in settlement discussions and potentially eliminate the need to litigate some or all of the issues in this case." *State Farm Lloyds*, 2006 WL 369115, at \*3. A stay of discovery will also relieve defendants of the burden of defending against civil and criminal cases simultaneously. Once the limited stay is lifted in the civil case, Defendants will have the right to obtain all of the discovery that they would otherwise be entitled to under the Federal Rules of Civil Procedure.

A stay in this case will also minimize the defendants' opportunity and ability to use civil discovery to avoid the restrictions that would otherwise pertain in criminal discovery to a criminal defendant. *See Application of Eisenberg*, 654 F.2d at 1113 (liberal civil discovery is not a "back door" to information beyond reach of criminal discovery rules). A limited stay of the instant case is appropriate to preclude the litigants from using liberal civil discovery proceedings to obtain information not available under more restricted criminal discovery provisions. *See Campbell*, 307 F.2d at 487 ("A litigant should not be allowed to make use of the liberal discovery procedures applicable to a civil suit as a dodge to avoid the restrictions on criminal discovery and thereby obtain documents he would not otherwise be entitled to for use in his criminal suit"). Moreover, law enforcement agents, who have developed confidential sources, should not be hindered in their efforts by the threat of civil deposition subpoenas, and should not have to prematurely disclose confidential information that has been developed in the course of their criminal investigation. Interference with the orderly presentation of witnesses and other evidence would significantly impede the criminal cases.

Finally, a limited stay of the case will not harm the public interest. In fact, because of the overlap between the criminal and civil cases, the pending criminal

prosecution advances the public interest at stake here. The Fifth Circuit has long recognized the public interest in criminal law enforcement. *Mutuals.Com*, 2004 WL 1629929, at \*3 (citing *Campbell*, 307 F.2d at 487). Additionally, “the public has an interest in ensuring the criminal discovery process is not subverted.” *Id.* (citing *Morris v. Am. Fed’n of State, County and Mun. Employees*, 2001 WL 123886, at \*2 (S.D. N.Y. Feb. 9, 2001)).

Counsel for plaintiff, the Securities and Exchange Commission, have advised the State of Texas that they do not oppose the limited stay of the civil proceedings. Counsel for both defendants, Mr. Dan Cogdell, has advised the State of Texas that he is opposed to the limited stay of the civil proceedings.

The State of Texas has a strong interest in maintaining the integrity of the criminal process, which will be subverted unless the court allows a limited stay of proceedings pursuant to Rule 26(c) of the Federal Rules of Civil Procedure.

THEREFORE, the State of Texas requests that this case be stayed for a limited time until September 17, 2008, or the completion of the criminal case.

Respectfully submitted,

/s/

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