

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

July 24, 2009

In the Matter of	:	PETITIONER'S REPLY TO THE
	:	DIVISION OF ENFORCEMENT'S
JOHN GARDNER BLACK	:	JUNE 29, 2009 FILING IN RESPONSE
And	:	TO PETITION TO SET ASIDE ADMINISTRATIVE
DEVON CAPITAL MANAGEMENT	:	PROCEEDING ORDER
	:	

On June 29, 2009 the Division of Enforcement ("Division") filed its response ("Response") to Petitioner John Gardner Black's petition ("Petition") before this Commission to vacate the Commission's order revoking Devon Capital Management's ("Devon") investment advisor's registration and imposing a lifetime industry bar against Petitioner.

The basis for the Petition was the Financial Accounting Standards Board's April 2, 2009 issuance of its interpretation of FASB's Rule 157, governing the method of determining fair value for inactively traded securities. That method, now required by the Commission, is the identical method Black and Devon were utilizing in determining the fair value of Financial Management Sciences' ("FMS") investments and the attendant valuation of the Collateralized Investment Agreement ("CIA"), the security admitted by the Division and judicially determined to be the only security owned by the CIA customers of Black and Devon.

The April 2, 2009 interpretation also brings the valuation method now required by this Commission into compliance with the Internal Revenue Service's Arbitrage Regulations, 26 CFR § 1.148-5, the regulations investors of municipal bonds proceeds must follow. Black and Devon adhered faithfully to those regulations, as required by their customers and even passed a field audit conducted by the IRS in 1996 for 1994 which resulted in a no change letter.

The life time industry bar imposed by the Commission against Black has prevented and is preventing him from earning a living in the only industry in which he worked for over thirty years. That bar was imposed because Black and Devon did not value the CIA as being equal to the forced liquidation value of FMS' assets, but instead valued the assets of FMS on a present value basis, taking into consideration company specific information in determining the value. Effective March 15, 2009, the basis for that bar is now required industry practice, a fact not disputed in the Division's response.

The Division's Response

The Division's ten page Response does not refute nor argue against the Petition or the grounds for its submission. Instead, the Response claims the Commission's Order should remain in effect because Petitioner had breached a contract with his customers by not providing assets equal to the market value of the CIA. That is, the forced liquidation of the assets owned by FMS was insufficient to allow for redemption of the CIAs at market value.

In alleging a security violation in its original complaint, it appears that the Division felt that Black and Devon had a fiduciary duty to inform the owners of the CIA that a security they did not own and that had not traded in the public markets for almost two years, was not valued on a forced liquidation value basis but rather pursuant to a model which incorporated the future interest rate curve and company

specific information, such as the inclusion of approximately \$150 million of thirty day investments. Black gave the model to the representative of the Division in August of 1997 and was on Devon's computer system seized on September 26, 1997.

The Division paints a picture for the Commission that it is politically untenable for the Commission to grant Petitioner's request. Instead of addressing the basis for the Petition, the Division delineates Petitioner's efforts to prove his innocence of the last twelve years, and then characterizes the Petition as a collateral attack.

The Division states "...we see no value in re-opening these proceedings simply to entertain conclusory assertions regarding Black and Devon's valuation of the CIA and the CMO more than a decade ago, assertions that are unsupported by any evidence whatsoever..." It is immaterial what the value of the CIA or the CMO was in 1997. The question before this Commission is: were Devon and Black in compliance in 1997 with the regulations and practices of the Commission as they exist today? And if they were in compliance, why should the industry bar continue?

Black is not making any conclusory assertion, only stating facts. The Division did not employ the valuation method required since March 15, 2009 when it instituted its action in 1997. The Division ignored Petitioner's valuation of the CMO based upon a mark to model analysis that was in the Division's possession a month before it filed its complaint. Instead, the Division filed a complaint using a value determined via a sole bid, on a single investment, under forced liquidation, without divulging company specific information

Reply to the Division

Black did not want this Petition to be a collateral attack on the Commission's prior action. This Petition is a request to discontinue the lifetime industry bar because the basis for that bar, the misconduct of marking all investments to a model, incorporating the forward curve and company specific information, is now permitted by the Commission's own regulations.

However, the Response filed by the Division is so filled with inaccuracies and innuendo that some of the issues raised in the Response must be addressed here.

The Joint Stipulation of Facts

On January 24, 2000, the United States Government and John Gardner Black executed a Joint Stipulation of Facts and Judge Donetta Ambrose of the United States District Court for the Western District of Pennsylvania, as required by law, judicially determined the facts to be correct. That document is attached to this filing as Exhibit 1. The following are the agreed upon facts:

1. Black did not plead guilty to committing fraud by an investment advisor by offering, purchasing or selling or by misrepresenting the value of the CIA. The US Attorney's Office has already stipulated that the market value of the CIA was not litigated and not agreed upon between Black and itself.
2. The CIA program consisted of 49 institutional customers, not "approximately 100."
3. FMS' portfolio yield was 14% on its \$171 million of assets, over \$23 million per year in profits.
4. The CIA was a contract.
5. Black did not cause the loss of customer funds. The reduction in the value of the FMS portfolio occurred because the Federal Reserve "ordered a series of rate increases" which caused all fixed income instruments to decline in value.

6. FMS, a company owned by Black, had \$7 million in its own assets generated through profits outside of the CIA program.

The Division states that Black "...benefitted financially from the scheme, using at least \$2 million to pay for personal and business expenses." Even the Division, in 1997 admitted that the personal expenses totaled less than \$25. The remaining business expenses were paid during the four year period in question out of profits from the business. The government stipulated that FMS was earning over \$23 million per year in profits. During this time it incurred approximately \$500,000 per year in business expense, mostly employee payroll.

In a footnote on page 3, the Division states that client funds were used to acquire the stock of a former owner. The stock was acquired out of the profits of FMS, not out of client funds. Petitioner knows of no regulation and the Division has not presented any authority that precludes a profitable corporation from acquiring its own stock.

The Division states that Devon obtained \$185,000 in undisclosed advisory fees. First, it is standard industry practice to offer to issuers of Tax and Revenue Anticipation Notes a net earnings yield on their investment. This is the practice followed by participants in the industry. Second, the fees in question were paid by FMS, which, as related above, was generating almost \$23 million of profits annually. Even if those fees were not paid, it would not have increased the earnings of the customers because the return on their investments was at a contracted rate.

The Division also states that on "...April 29, 1998, the court entered an order, by consent, requiring Black to disgorge \$3,632,031, plus prejudgment interest of \$326,883 and to pay a civil penalty

of \$500,000.” This order was entered because, as the Division alleged, Black had possibly breached a term of a financial contract with his customers.

However, on May 9, 2001, the district court determined that the customers owned an enterprise whose value was to be determined by a reasonable expectation of profits, not a financial contract as alleged in the complaint. Petitioner knows of no subject matter jurisdiction which allows either the Division or the district court to impose an order of disgorgement for funds paid out of profits.

Because the Division brought an enforcement action by alleging a breach of contract and a valuation of part of the portfolio of FMS on a forced liquidation value basis instead of the now approved model basis, Petitioner was left with no ability to pay disgorgement. That is why he must appear here *Pro Se*. The only asset he owned of real value was FMS, which the government has stipulated had \$7 million of cash on September 26, 1997 and was generating \$23 million per year in profits. That cash was earned out of profits and could have been used to pay the disgorgement.

Even so, Petitioner paid, according to his records, over \$30,000 toward the disgorgement, not the \$1,500 claimed by the Division. Payments were made to the trustee, Mr. Izzo, pursuant to orders issued by Judge Donetta Ambrose.

The Commission’s Checklist

- *The nature of the misconduct at issue in the underlying matter (more serious and extensive allegations militate against relief).*

The government has stipulated that it was not the conduct of Petitioner that caused the 49 institutional investors to get back less than the market value of their investment. There was no

misrepresentation of the value of the security owned by those investors. As to the assets of FMS being less than the market value of the CIAs outstanding, had the Division used the mark to model in their possession on September 26, 1997, a valuation method currently required by this Commission's regulations, the value of the assets would have exceeded the market value of the CIAs outstanding.

- *The time that has passed since the issuance of the administrative bar.*

Time since the imposition of the industry bar is not at issue. It is the effective date of the new Commission regulations of March 15, 2009.

- *The compliance record of, and any regulatory interest in, the petitioner since issuance of the administrative bar.*

Black has been in full compliance with the industry bar and is currently in full compliance with all current Commission regulations. He is not acting as an investment advisor to non-institutional or non-accredited individuals and is not soliciting advisory clients.

- *The age and securities experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar.*

Black, is 65 and has over thirty years experience in the field of investing municipal bond proceeds solely for institutional clients. Black has not previously requested relief from the bar.

- *Whether the petitioner has identified verifiable, unanticipated consequences of the bar.*

A continuation of the bar is a statement to the participants in the market that even though they are in compliance with this Commission's regulations and FASB's rules, they may still face prosecution for using a mark to model valuation method for inactively traded securities.

- *Whether there exists any other circumstances that would cause the requested relief from the administrative bar to be inconsistent with the public interest or the protection of investors.*

Relief from the bar is consistent with the position the Commission took when it determined that use of mark to model valuation is consistent with the public interest and provides protection to investors. Mark to model was the valuation method Petitioner was employing and that model has been in the possession of the Division.

The Division uses this section to state that because Black has fought his conviction that "...he has yet to understand that his actions were fraudulent and harmful to investors." The Response goes on to state that Black has failed to pay disgorgement and civil penalties. The reason Black has continued to fight his conviction for the last twelve years is because he did not plead guilty to misrepresenting the market value of the CIA. And the government concurs with this statement. [See: Pages 30 and 31 of January 24, 2000 Transcript, attached as Exhibit 2]

It is the Division which has failed to release the mark to model analysis of FMS' assets, a model they have held since 1997 and which is now an approved method of valuation of inactively traded securities.

Next, it is unclear in the regulations and judicial opinions that the Division has either the subject matter or regulatory jurisdiction to request an order of disgorgement from district courts when the amount

being sought was paid from profits. Again, as the government has stipulated, FMS was earning approximately 14% on its \$171 million in assets, a \$23 million per year net profit.

Lastly, the Response claims that Petitioner's "misconduct resulted in losses of \$71 million to investors." That misconduct allegedly occurred between 1995 and 1997. The government has stipulated it was not misconduct on the part of Black that caused investor losses; rather it was the effect of the Federal Reserve raising interest rates.

The business that Petitioner was conducting was unique because his practice was limited to investing the proceeds of municipal bond issues. Petitioner had developed many programs in his thirty year career to reduce the effect of the arbitrage regulations on his clients; the CIA was just such a program. As required by the arbitrage regulations, all investment of municipal bond proceeds must be done pursuant to some form of model. Those models require all cash flows from all investments be amalgamated and analyzed on a present value basis utilizing a reasonable expectation of profits. Again, this is precisely the type of model that is in the possession of the Division.

Summary

The Division has not cited a single instance where enforcement action was taken against an individual or corporation who had less than fifty institutional clients. Also, the Division has not cited a single instance where the securities in question were financial contracts. Further, Petitioner cannot find any instance where enforcement action has been brought because a firm was employing a mark to model valuation method for its assets. The only logical conclusion for arguing for the continuation of the industry bar against Petitioner for utilizing a model to value a portfolio of investments is the Division is opposed to the unique and specific business Petitioner created, advising municipalities on reducing or managing their arbitrage payment to the federal government.

Therefore, Petitioner requests that this Commission direct the Division of Enforcement to value the assets of FMS and the CIA pursuant to the Commission's own regulations and the model used by Black which is in the possession of the Division. Further, Petitioner requests that this Commission lift its life time industry bar against Black and reinstate the registration of Devon Capital Management.

Petitioner, at age 65, has no interest and is not planning on becoming involved in the investment advisory business again. He has brought this petition because it is the right thing to do.

July 23, 2009

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of this Petitioner's Reply to the Division of Enforcement's June 29, 2009 Filing was sent on July 23, 2009 via United States first class mail, postage prepaid and addressed to:

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John G. Black

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July 23, 2009

Kenneth H. Hall
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Re: File No. 3-9599

Dear Mr. Hall,

Enclosed please find two copies of Petitioner's Reply to the Division of Enforcement's June 29, 2009 Filing which is being filed in the above referenced proceeding.

Sincerely,

John G. Black