

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	
v.	:	CIVIL ACTION NO.
	:	97-CV-2257
	:	
JOHN GARDNER BLACK,	:	
DEVON CAPITAL MANAGEMENT, INC., and	:	
FINANCIAL MANAGEMENT SCIENCES, INC.,	:	
	:	
Defendants.	:	

**MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION
IN RESPONSE TO DEFENDANT’S PRO SE MOTION FOR RELIEF
UNDER FEDERAL RULE OF CIVIL PROCEDURE 60(b)**

Plaintiff Securities and Exchange Commission ("Commission") submits this memorandum in response to John Gardner Black’s pro se motion for relief under Federal Rule of Civil Procedure 60(b) filed on behalf of himself and his companies, Devon Capital Management, Inc. ("Devon") and Financial Management Sciences, Inc. ("FMS") (collectively, "defendants"). The Commission respectfully requests that this court deny defendants’ motion in full. In sum, the remedy provided under Rule 60(b) is extraordinary and should only be invoked under exceptional circumstances.

Defendants have advanced no "extraordinary circumstances" that would satisfy their burden pursuant to Rule 60(b) because they can not. Defendants were represented and advised by counsel throughout the litigation of this matter, resulting in their voluntary consent to the

entry of the judgments that they now seek to have set aside.¹ At no time throughout the proceedings did they either challenge the jurisdiction of this court, allege misconduct by the Commission, or otherwise raise the matters of which they now complain. Defendants had every opportunity afforded to any litigant to defend against this action. Instead, with benefit of counsel, defendants signed consents in which they explicitly: 1) admitted the subject matter of the court over this proceeding; and 2) stated that "no offer, tender, promise or threat of any kind whatsoever has been made by the Commission, or any member, officer, agent or representative thereof in consideration of the foregoing consent." They do not now allege any new fact, information or specific matter which was not known to the parties and to the court throughout the litigation of this matter and prior to this court's entry of the judgments against them.

Defendant Black, writing from jail where he is currently serving a criminal sentence for the very conduct alleged in the Commission's civil action, has failed to meet his burden under Rule 60(b). Defendants' motion should be denied.

I. PRELIMINARY STATEMENT

Defendants' motion makes arguments and asserts facts not supported by the record, thereby putting the Commission at a considerable disadvantage.² The Commission was prepared,

¹ Defendants were represented herein by Richard A. Levan, currently with the Philadelphia firm of Drinker Biddle & Reath and formerly with the firm of Klehr, Harrison, Harvey, Branzburg & Ellers. Mr. Levan is an experienced attorney in both securities and criminal matters, having previously been employed from approximately 1991 to 1996 as a trial counsel in the Philadelphia office of the Commission, and before that as an Assistant United States Attorney for the Department of Justice. Furthermore, counsel for defendant Black signed and approved Black's March 21, 1998 consent to the Court's entry of an Order of Disgorgement and Penalties. See Exhibit A, attached.

² Defendants make reference throughout their memorandum to facts without reference to any evidentiary record in this case. To the extent Black now seeks to "testify," it is significant that this court (Smith, J.) previously has found Black's credibility lacking: "First defendant Black's credibility is questionable. His testimony professing ignorance as to the amount of money his father realized from the sale of Gardner's Candy did not ring true.... [His] credibility is further undermined by the fact that he

upon the filing of its complaint, to develop an evidentiary record further supporting its claims. The development of such an evidentiary record was thwarted, however, by Black's assertion of his rights under the Fifth Amendment of the Constitution to the Commission's requests for testimony and, ultimately, by the consents of all defendants to permanent injunctions and other relief. These consents led to settlement with the Commission and the entry by this court of its Orders dated December 16, 1997 and April 29, 1998, granting to the Commission the relief requested in its complaint.³

II. FACTUAL AND PROCEDURAL HISTORY⁴

A. Background

This matter involves a fraudulent scheme by Black and two entities that he controlled: Devon, a Pennsylvania-based registered investment adviser, and FMS, an affiliate of Devon.⁵ The scheme resulted in the loss of millions of dollars of municipal bond proceeds invested by school districts, primarily located in western and central Pennsylvania.

believed, but wasn't sure, that his federal income taxes had not been filed since 1993." See Memorandum and Order dated October 30, 1997 (Docket No.88) at 9-10, attached as Exhibit A.

³ In their consents that led to settlement of this matter with the Commission and, ultimately, to the referenced Orders by this court, defendants admitted to the complaint's allegations of jurisdiction, agreed not to make any public statement denying any allegation in the complaint, and stated that they gave their consents without "offer, tender, promise, or threat of any kind" by the Commission. See Exhibit B, attached. (Docket Nos. 151, 152, 153 and 275).

⁴ These facts derive from documents filed by the Commission with this court in support of its motions for a temporary restraining order, preliminary injunction, asset freeze and other relief, including the declaration of William Meck and exhibits thereto. (Docket Nos. 4 and 8). References herein to the Meck Declaration will be cited as "Declaration at [pp.]." References herein to the exhibits to the Declaration will be cited as "Decl. Exh. [A]." The Commission will provide courtesy copies of these documents to the court upon request.

⁵ Declaration at 4-6 and Decl. Exh. E.

Devon, acting through Black, offered cash management services to local government units ("LGUs"), primarily school districts that raise money through bond offerings.⁶ Each LGU entered into an investment advisory agreement ("LGU Advisory Agreement") with Devon in which the LGU gave Devon full discretion to invest in the LGU's bond offering proceeds.⁷ According to the express terms of the LGU Advisory Agreement, Devon would purchase only those investments authorized by Pennsylvania law, would not take custody of the LGU's funds and would provide to the clients monthly statements reflecting the market value of the assets on a month end basis.⁸ In consideration for Devon's services, the clients each agreed to pay Devon a monthly fee based on an annual rate of .12-.25% of the average month end balance of the assets under management.⁹

In materials sent to prospective clients, Devon touted its years of experience providing investment advice to local governments, especially school districts, and promised to provide clients with a "high level of investment performance."¹⁰ The materials further disclosed Devon's intention of investing the LGU's funds in Collateralized Investment Agreements, which were to be provided by an unidentified affiliate and backed by U.S. Treasury and Agency securities, and that the collateral for the CIA would be marked to market and maintained at the collateral ratio

⁶ See, e.g., Declaration at 7 and Decl. Exhs. A, C and E.

⁷ Declaration at 9 and Decl. Exh. A.

⁸ Declaration at 9 and Decl. Exh. A. The LGU Advisory Agreement further states that Devon may "direct" the LGU to enter into certain transactions with FMS, which it states is primarily owned by Devon shareholders. In fact, Devon and FMS were both wholly owned by Black. Declaration at 10 and Decl. Exh. A.

⁹ Declaration at 9.

¹⁰ Decl. Exh. B.

required by Pennsylvania law.¹¹

B. Collateralized Investment Agreements

Of the \$345 million under management by Devon, Black invested approximately \$233 million of these funds, on behalf of 75 LGUs, in Collateralized Investment Agreements ("CIA's").¹² Each CIA was an agreement between Devon on behalf of a specific LGU, and FMS.¹³ According to the terms of the CIA, FMS guaranteed to the LGU a rate of return specified in the LGU Advisory Agreement and the LGU's principal would be secured or collateralized by securities with a fair market value equal to 100% of the investment.¹⁴

Each CIA was for a fixed time period and during its term Devon would distribute back to each LGU a portion of its principal in accordance with an attached draw schedule.¹⁵ Each LGU was entitled to a return of their full principal upon written request at any time prior to the expiration of the CIA.¹⁶ The CIA provided that Devon would transfer funds from the LGU's "Custodial Account" maintained at a bank local to FMS, which then would deposit the funds into an account maintained in FMS's name ("Main Account").¹⁷ Devon was to purchase authorized

¹¹ Decl. Exh. B. Under the applicable Pennsylvania law, the funds invested by local government units such as school districts, had to be collateralized to the full amount of the funds invested. In its Form ADV, Devon states that its clients will purchase "investment contracts" from its unnamed affiliate. See, e.g., Decl. Exhs. E and F.

¹² Declaration at 12.

¹³ Declaration at 12 and Decl. Exh. C.

¹⁴ Declaration at 12-13 and Decl. Exh. C.

¹⁵ Declaration at 14 and Decl. Exh. C.

¹⁶ Declaration at 14 and Decl. Exh. C.

¹⁷ Declaration at 15 and Decl. Exh. C.

investments with these funds, whereupon FMS would place the investment securities into another FMS account, the "Collateral Account," where the securities were to be held for the benefit of the clients.¹⁸

In fact, Devon, FMS and Black failed to inform Devon's advisory clients of the risk of investing with Devon, Devon's financial condition, and how funds were being used. Since at least 1995, Devon realized at least \$50 million in trading losses.¹⁹ This was not disclosed to advisory clients or prospective advisory clients. Rather, Devon hid this loss by overvaluing by almost \$70 million a specific security known as a collateralized mortgage obligation ("CMO") that it maintained in the Collateral Account.²⁰ By doing so, Devon, through Black, diluted advisory client funds by at least 45% immediately upon investment and prepared and sent monthly statements to advisory clients that significantly inflated the value of the investments made by Devon and held by FMS for the benefit of the clients.²¹

C. Relevant Procedural History

On September 26, 1997, the Commission filed this action against Black, Devon, and FMS. The Commission's complaint alleged violations of Section 17(a) of the Securities Act (15 U.S.C. 77q(a)), Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)) and Rule 10b-5 thereunder (17 C.F.R. 240.10b-5), by Black, Devon and FMS. The complaint further alleged violations of

¹⁸ Declaration at 16 and Decl. Exh. C. In some instances, however, securities that were purchased with pooled assets from the Main Account were, in fact, transferred to accounts designated and controlled by the individual LGU and were not included in the Collateral Account. Declaration at 17.

¹⁹ Declaration at 18.

²⁰ Declaration at 19-26 and Decl. Exhs. I-N.

²¹ Declaration at 28.

Sections 206(1), 206(2) and 206(4) of the Advisers Act (15 U.S.C. 80b-6(1), 80b-6(2) and 80b-6(4)) and Rule 206(4)-2 thereunder (17 C.F.R. 275.206(4)-2) by Devon and Black. The Commission sought, *inter alia*, the entry of permanent injunctions against Black, Devon and FMS barring future violations of the securities laws, disgorgement of any unlawfully obtained proceeds with prejudgment interest, imposition of a civil penalty, and the appointment of an equitable receiver. The Commission also moved for entry of a temporary restraining order (TRO), an asset freeze, and the appointment of an equitable receiver.

On September 26, 1997, this court (Standish, J.) granted the Commission's motions for the entry of a TRO, including an asset freeze, and for the appointment of an equitable receiver. On that same date, Judge Standish appointed Richard Thornburgh as the equitable receiver. A preliminary injunction hearing was scheduled for October 6, 1997.

On October 2, 1997, upon defendants' verbal request, this court (Smith, J.) extended the preliminary injunction hearing until October 27. Subsequently, on October 3, 1997, defendants filed a written motion requesting that the court continue the preliminary injunction hearing date until October 27, 1997 and extend the freeze of assets until that date. Judge Smith issued an Order (dated October 6, 1997) granting defendants' request to reschedule the preliminary injunction hearing and extending the TRO/freeze of assets "with the consent of Defendants until the conclusion of the hearing on Plaintiff's Motion for Preliminary Injunction."

On October 27, 1997, Judge Smith, with the consent of defendants, entered an Order again continuing the preliminary injunction hearing, consolidating the hearing on the preliminary injunction with the trial on the Commission's request for permanent injunctive relief, and installing a case management order that established a trial date in February 1998. Upon

defendants' consent, this Order also extended the freeze of assets until the date of trial.

On October 30, 1997, Judge Smith recused himself. The case was reassigned to the Honorable Donetta W. Ambrose.

On December 16, 1997, having received written consents from each of the three defendants in which they admitted the jurisdiction of this court over them and over the subject matter of this action, the court (Ambrose, J.) entered an Order of permanent injunction (reserving the issues of disgorgement and civil penalties) against all named defendants. In accordance with defendants' consents, the court's Order also continued the freeze of assets pending resolution of issues relating to disgorgement and civil penalties.

On April 29, 1998, upon written consent from defendant Black, the court (Ambrose, J.) entered an Order of Disgorgement and Civil Penalties as to Black, ordering him to disgorge the sum of \$3,632,031 together with prejudgment interest in the amount of \$326,883; and ordering him to pay a civil penalty in the amount of \$500,000 to the United States Treasury.

By Order dated September 23, 1998, this court directed Black to pay the sum of \$1,500 per month, beginning November 1, 1998, until his disgorgement and civil penalty obligations are satisfied.²²

III. LEGAL ARGUMENT

A. Federal Rule of Civil Procedure 60 (b)

Federal Rule of Civil Procedure 60(b) invests federal courts with the power in certain restricted circumstances to "vacate judgments whenever such action is appropriate to accomplish

²² According to records obtained from James R. Walsh, the Trustee in bankruptcy for the Black-owned entities (Devon and FMS), to date, Black has made payments totaling \$32,143.06.

justice." Klapprott v. United States, 335 U.S. 601, 614-15, 69 S. Ct. 384, 390, 93 L. Ed. 266 (1949). Specifically, it allows relief from judgment based on: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence; (3) fraud, misrepresentation, or other misconduct of an adverse party; (4) a judgment being void; (5) a judgment being satisfied; or (6) any other reason justifying relief. The Rule further requires that any motion for relief "be made within a reasonable time, and for reasons (1), (2) and (3) not more than one year after the judgment, order, or proceeding was entered or taken."

The remedy provided under Rule 60(b) is extraordinary and should only be invoked upon a showing of exceptional circumstances. Ackermann v. United States, 340 U.S. 193, 202, 71 S. Ct. 209, 95 L. Ed. 2d 207 (1950). See also, Charowsky v. Kurtz, Warden, 2001 U.S. Dist. LEXIS 1914, *21 (E.D. Pa. 2/23/2001). The United States Court of Appeals for the Third Circuit has held that the purpose of this rule is "to strike a proper balance between the conflicting principles that litigation must be brought to an end and that justice must be done." Boughner v. Secretary of Health, Education & Welfare, 572 F.2d 976, 977 (3rd Cir. 1978). See also, Douris v. County of Bucks, et. al, 2000 U.S. Dist. LEXIS 13406, *2-3 (E.D. Pa. 2000). In most cases, an attorney's negligence will not relieve his client from an adverse judgment." Douris, 2000 U.S. Dist. LEXIS at *2-3, citing James v. International Business Machines, Inc., 1991 U.S. Dist. LEXIS 8625 (E.D. Pa. 1991). Similarly, ignorance of the law and carelessness in its application are not sufficient grounds under Rule 60(b) for a court to reconsider its order. Douris, 200 U.S. Dist. LEXIS at *3, citing Lee v. Toyota Motor Sales, U.S.A., Inc., 1997 U.S. Dist. LEXIS 6889, at *9 (E.D. Pa. 1997). Moreover, the failure to present evidence or a legal argument that was available at the time of the judgment is not an exceptional circumstance justifying relief. Douris, 2000 U.S. Dist. LEXIS

13406, *3, citing James. v. International Business Machines, Inc., 1991 U.S. Dist. LEXIS 8625 (E.D. Pa. 1991). As demonstrated herein, the facts of this case do not warrant such an extraordinary remedy and defendants' arguments in favor of having the consent judgments set aside fall well short of "exceptional circumstances."

**B. Defendants' Motions To Vacate Should Be Denied Because
No Statutory Ground For Relief Exists Under Rule 60(b)**

**1. No Statutory Ground For Vacatur Exists Under Rule 60(b)(1),
(2) or (3) Because More Than One Year Has Elapsed
Since The Entry of the Judgments Against Defendants**

While defendants' motion does not specify under which clauses of Rule 60(b) they proceed, defendants argue that the judgments against them should be vacated because of misconduct by the Commission (Motion at 2-3). Were there any basis for such an allegation, such a claim arguably could fall within the ambit of Rule 60(b)(3). First, the Commission denies that there was any fraud, misrepresentation or other misconduct of any kind by the Commission or any of its staff either in the conduct of the pre-filing investigation or litigation of this matter.²³ Furthermore, defendants' claim is untimely under Rule 60(b)(3) because more than one year has

²³ To the extent defendants claim that the Commission's misconduct was its failure to disclose to defendants and the court the purported jurisdictional defects discussed in defendants' motion, this claim is moot because, as set forth below, this court had jurisdiction over the matter. The no-action letters cited by defendants simply are inapposite. Dominion Resources Inc., 1985 SEC No-Act LEXIS 2627 (8/24/85), involved an entity that proposed to provide expertise to corporate and government issuers about the structuring of securities transactions but that would not, among other things, have any authority to represent any of the parties in the negotiations or to bind them to any terms of any agreement. The Knight Group, 1991 SEC No-Act. LEXIS 1303 (11/13/91) involved a financial advisory firm which assists states and municipalities in structuring, timing and providing the terms of a new issue of bonds, but does not advise, for compensation, others as to the value of securities or the advisability of investing in, purchasing, or selling securities. In this case, Devon both has control of his clients funds and full ability to bind its clients in contracts such as the CIA, and it receives compensation for its advisory services. Moreover, as set forth above, Devon invested client funds in, among other things, the CIA, which is not an exempted security under the Investment Advisers Act. Finally, to the extent that Devon claims its advisory work solely incidental to its profession, this contention differs substantially from the evidence of record and is not credible.

elapsed since the entry of the last judgment against each of the defendants.²⁴ The most recent judgment entered against defendants Devon and FMS was entered on December 16, 1997 (Docket No. 154); the last judgment entered against defendant Black was entered on April 29, 1998 (Docket No. 278) – all were entered more than three years ago.²⁵

**2. No Statutory Ground For Vacatur Exists Under Rule 60(b)(6)
Because Defendants Have Presented No Exceptional Circumstances**

Although not specified, defendants' motion arguably makes a claim under the catch-all provisions of Rule 60(b)(6), which provides that a court may vacate a prior judgment for "any [] reason justifying relief from the operation of the judgment." That provision of Rule 60(b) has been narrowly construed and relief should be granted only if extraordinary circumstances are present. See Griffin v. Swim-Tech Corp., 722 F.2d 677, 680 (11th Cir.1984) (stating that relief under Rule 60(b)(6) "is an extraordinary remedy which may be invoked only upon a showing of exceptional circumstances"); Batts v. Tow-Motor Forklift Co., 66 F.3d 743, 747 (5th Cir. 1995), cert. denied, 517 U.S. 1221 (1996). No such "extraordinary circumstances" exist in this case. Furthermore, Rule 60(b)(6) cannot be invoked where it simply is invoked to make up for deficiencies in movants' ability to satisfy one of the other grounds enumerated in Rule 60(b). See Bailey v. Ryan Stevedoring, Co., 894 F.2d 157, 160 (5th Cir.), cert. denied, 498 U.S. 829 (1990). Defendants have advanced no "extraordinary circumstances" that would satisfy their burden pursuant to Rule

²⁴ The Rule states, in pertinent part: " The motion shall be made within a reasonable time, and for reasons (1), (2) and (3) not more than one year after the judgment, order, or proceeding was entered or taken." Fed. R. Civ. Pro. 60(b).

²⁵ Neither the Orders of Permanent Injunction nor the Order resolving the issues of disgorgement, prejudgment interest and civil penalties as to defendant Black have been modified since their dates of entry. However, the freeze of assets, which remains in place as to certain of defendant Black's assets, has -- over the course of time -- been periodically modified at the request of Black or his wife, to release certain assets. The last such modification occurred on August 3, 2000 at the request of Judith Black.

60(b)(6) and therefore, their request for vacatur must fail under this clause of the Rule.

**3. No Statutory Ground for Vacatur Exists Under Rule 60(b)(4)
Because This Court Has Subject Matter Jurisdiction Over This Action**

Defendants have also argued that the judgments against them are void due to the court's lack of jurisdiction. Under Rule 60(b)(4), a court may, where appropriate, vacate a judgment that is void. A judgment is void if it is entered without subject matter jurisdiction. Carter v. Fenner, 136 F.3d 1000, 1005 (5th Cir.), cert. denied, 525 U.S. 1041 (1998). However, defendants' motion under Rule 60(b)(4) is without merit because this court has subject matter jurisdiction over this action and, therefore, had jurisdiction to enter permanent injunctions against defendants and to order them to pay disgorgement and civil penalties.

The United States Supreme Court, in Bell v. Hood, 327 U.S. 678 (1946), enunciated the rule that when a complaint alleges a claim under the Constitution or federal laws, and the basis of federal jurisdiction is also an element in the plaintiff's federal cause of action, then the complaint should not be dismissed for lack of subject matter jurisdiction unless the claim "clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous." Bell, 327 U.S. at 682; Growth Horizons, Inc. v. Delaware County, Pennsylvania, 983 F.2d 1277, 1280-81 (3d Cir. 1993); Kehr Packages, Inc. v. Fidelcor, Inc., 926 F.2d 1406, 1408-09; Kulick v. Pocono Downs Racing Ass'n, Inc., 816 F.2d 895, 897-98 (1987). That is, when jurisdiction and merits issues overlap, properly asserted allegations -- as opposed to adjudicated facts -- vest courts with jurisdiction.

In Growth Horizons, Inc. v. Delaware County, Pennsylvania, 983 F.2d 1277 (3d Cir. 1993), the court reversed the district court's dismissal of the complaint under Rule 12(b)(1), relying upon the Bell rule. Defendants had moved for dismissal pursuant to Rules 12(b)(1) and 12(b)(6). At the

hearing on these motions, the district court heard all of the evidence from both parties concerning the merits of the action and concluded that subject matter jurisdiction was lacking because the defendant's conduct did not run afoul of the statutes prohibitions. In overturning the action of the district court, the Third Circuit found that the district court had failed to apply the rule that "legal insufficiency of a federal claim generally does not eliminate the subject matter jurisdiction of a federal court." *Id.* at 1281, citing several cases including Kulick, at 897-8 (reversing district court's jurisdictional dismissal and holding "once the plaintiff has met this threshold pleading requirement,...the truth of the facts alleged in the complaint is a question on the merits, as is the legal question whether the facts alleged establish a violation"); Poindexter v. United States, 777 F.2d 231 (5th Cir. 1985)(examining whether "the jurisdictional question can be sufficiently extricated from the merits of the complaint"); and Green v. Ferrell, 664 F.2d 1292 (5th Cir. 1982)(reversing a district court jurisdictional dismissal where "rather than seeking to determine some discrete jurisdictional requisite, [the factual inquiry conducted by the district court] blanketed the merits of plaintiff's claims").²⁶

²⁶ In at least two instances, the Court of Appeals for the Fifth Circuit has addressed the issue of dismissal for lack of subject matter jurisdiction in the context of actions brought under the federal securities laws. In Williamson v. Tucker, 645 F.2d 404 (5th Cir.), cert. denied, 454 U.S. 897 (1981), the court held that the Bell rule applies to an action brought under the federal securities laws because the jurisdictional issue of whether the investments involved were securities overlaps with the merits of the case. Williamson, 645 F.2d at 406. In ruling on the defendants' Rule 12(b)(1) motion -- in which they had argued that the joint venture agreements at issue were not securities -- the court applied the Bell rule because "[i]n this case, it is clear that the jurisdictional issue reaches the merits of the plaintiffs' case; if the joint venture interests and notes are not securities, there is not only no federal jurisdiction to hear the case but also no federal cause of action on the stated facts." *Id.* at 416. Earlier in its opinion, the court also noted that "the applicability of the 1933 Act and the 1934 Act to the transactions at issue is the basis of both federal jurisdiction and the merits of the plaintiffs' cause of action." *Id.* at 412. Because the court found that the plaintiffs' claims in Williamson were neither "immaterial" nor "frivolous," it reversed the district court's dismissal for lack of subject matter jurisdiction. *Id.* at 416-17.

A year later, in Fragumar Corp., N.V. v. Dunlap, 685 F.2d 127, 128-30 (5th Cir. 1982), the court of Appeals for the Fifth Circuit again reached the same conclusion. There, plaintiffs in a federal securities action claimed that joint venture interests in an undeveloped tract of land were "securities" within the

"[T]he question of subject matter jurisdiction and the merits will normally be considered intertwined where the [same] statute provides both the basis of federal court subject matter jurisdiction and the cause of action." Eubanks v. McCotter, 802 F.2d 790, 793 (5th Cir. 1986) (citing Clark v. Tarrant County, 798 F.2d 736, 742 (5th Cir. 1986)). In federal securities law claims, the same statutes provide both the basis of federal subject matter jurisdiction and the causes of action; that is, the statutes that contain the jurisdictional requirement that a violation involve securities are the same statutes that set the parameters of the cause of action. See Section 17(a) of the Securities Act, 15 U.S.C. 77q(a); Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b); and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5; and Section 206 of the Advisers Act, 15 U.S.C. 80b-6, and Rule 206(4)-2 thereunder, 17 C.F.R. 275.206(4)-2. As a result, the jurisdictional and merits issues here overlap.

Defendants do not argue that this court lacked subject matter jurisdiction because the Commission's claims were "frivolous and insubstantial." The Commission's claims against defendants clearly were neither frivolous or insubstantial -- then or now. Thus, the only issue is whether the Commission properly asserted allegations that would vest the court with jurisdiction.

The Commission's complaint properly pleaded various violations of the federal securities laws by defendants. As stated in the Commission's complaint, this court had jurisdiction over this action and all parties pursuant to Section 22 of the Securities Act, 15 U.S.C. 77v, Sections 21 and 27 of the Exchange Act, 15 U.S.C. 78u(e) and 78aa, and Sections 209(d) and 209(e) of the Advisers

meaning of the Securities Act and the Exchange Act. Fragumar, 685 F.2d at 128. The court, following its holding in Williamson, reversed the district court's dismissal -- at the close of plaintiffs' case at trial -- for lack of subject matter jurisdiction. Id. at 128-30. The appellate court determined that the dismissal for lack of jurisdiction was improper because the basis of federal jurisdiction was also an element in the plaintiffs' federal cause of action and the claim was neither frivolous nor immaterial. Id.

Act, 15 U.S.C. 80b-9(d) and (e).²⁷ Moreover, prior to defendants' consent to judgments in this matter, when this court considered and granted the Commission's motion for a temporary restraining order, this court (Standish, J.) *found* that the Commission had made a prima facie showing of the securities law violations alleged in the complaint.²⁸ As set forth below, insofar as defendants provide no meritorious reason to now question those findings, the Commission respectfully maintains that this court had jurisdiction over this matter and, thus, defendants' motion must fail under Rule 60(b)(4).²⁹

²⁷ These statutes provide that, if the Commission, through its authority to perform investigations, determines that any person has violated, is violating, or is about to violate, provisions of the Securities Act, Exchange Act, and/or the Advisers Act, it may bring an action in, among other places, the proper district court of the United States to enjoin such acts of practices.

²⁸ The standards for issuance of a TRO in a Commission enforcement action are set forth in the applicable statutes and require the Commission to establish (and the court to find): (1) a prima facie case of previous violations of the federal securities laws; and (2) a reasonable likelihood that the wrong will be repeated. SEC v. Management Dynamics, Inc., 515 F.2d 801, 807 (2d Cir. 1975); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972); SEC v. Current Financial Svcs., Inc., 783 F. Supp. 1441, 1442 n.4 (D.D.C. 1992). See also, Section 20(b) of the Securities Act; Section 21(d) of the Exchange Act and Section 209(d) of the Advisers Act.

²⁹ See also In Electronics Boutique Holdings Corp. v. Zuccarini, et. al, 2001 U.S. Dist. LEXIS 765 (E.D. Pa. 2001), in which the court denied a motion to vacate its judgment for a permanent injunction under Rule 60(b)(4) because of claimed lack of personal jurisdiction over the defendant, finding that it, indeed, had personal jurisdiction over the defendant. Significantly, that court also considered whether vacating the judgment would be in the interests of justice. The court determined that justice favored denying the motion because vacating the judgment would prejudice the plaintiff; the defendant was culpable in the entry of the judgment; and the defendant had no meritorious defense. As the court acknowledged, these factors generally are considered in instances in which judgment is entered without consideration of the merits (whereas, in the case before it, the court had evaluated the merits of the case). Notwithstanding, the court found their consideration appropriate in determining whether justice required it to grant the motion.

In the present case, justice favors denying defendants' motion. Specifically, as set forth above, this motion puts the Commission at a significant disadvantage because it was prevented from fully developing an evidentiary record by Black's assertion of his rights under the Fifth Amendment of the Constitution to the Commission's requests for testimony and, ultimately, by the consents of all defendants to preliminary injunctions and other relief. Moreover, the Commission has expended significant time and resources in bringing and ultimately settling this action. In addition, the contested judgments were entered with defendants' consent and while defendants were fully represented. Finally, as set forth herein, none of defendants' claims under 60(b) are meritorious. Accordingly, the equities weigh heavily in favor of denying defendants' motion.

B. Defendants' Motion To Vacate Should Be Denied Because Their Attacks On The Merits Are Completely Without Basis In Fact Or Law

1. The Existence Of A Security: The CIA Is A Security

Defendants claim that CIA was not a security and, accordingly, that the Commission did not allege facts that made out a violation under the securities laws. Defendants are wrong on both counts.

Section 2(1) of the Securities Act and Section 3(a)(10) of the Exchange Act define the term "security" to mean, among other things, any "investment contract." As stated by defendants, investment contracts are defined as (1) an investment of money, (2) in a common enterprise, (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); SEC v. Infinity Group, et. al, 212 F.3d 180, 187 (3^d Cir.), cert. denied sub nom Springer v. SEC, 2001 U.S. LEXIS 2012 (U.S. 2001). This standard embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. Howey, 328 U.S. at 299. See also, Infinity Group, 212 F.3d at 191. A common enterprise exists when there is horizontal commonality, or a pooling of investors' contributions and distribution of profits and losses on a pro-rata basis among investors. Infinity Group, 212 F.3d at 187-88, quoting Steinhardt v. Citicorp, 126 F.3d 144, 151 (3^d Cir. 1997). Cf. Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2^d Cir. 1994) ("...horizontal commonality: the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits.").

As defendants concede, investments of money were made under the CIA.³⁰ Devon's clients gave proceeds of bond offerings to Devon with the expectation and intention that Devon invest these funds in securities, such as the CIA.

Moreover, the investments in CIAs were investments in a common enterprise, or parts of pooled groups of funds where the fortunes of each client were tied to the success of the overall venture. Specifically, client funds were pooled in two accounts, the Main Account and the Collateral Account. First, they were pooled in the Main Account in order for FMS to invest in securities on behalf of all advisory clients. Then, the securities purchased with the pooled funds were deposited in the Collateral Account where they accrued interest. FMS pledged to each investor all amounts in the Collateral Account as security for FMS's performance under the contract.³¹ In addition, upon default by FMS, each client could declare any amounts accrued and unpaid to be due and payable immediately.³² In other words, in the event that FMS defaulted or otherwise failed to achieve the return specified in each CIA, each client was equally entitled to take from the Collateral Account all amounts due and owing to it under the CIA. This, of course, would require a distribution of the Collateral Account in proportion to each client's share or, in essence, a pro rata distribution of the (pooled) Collateral Account. And, in fact, that is what occurred. Defendants overstated collateral because FMS suffered substantial trading losses. Ultimately, after this fraud was discovered, each client received a pro rata distribution of assets from the pooled

³⁰ Defendants' Memorandum at 6.

³¹ Decl. Exh. C.

³² Decl. Exh. C.

accounts.³³

Finally, the CIAs provided a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. The focus under this prong is whether "the purchaser [is] attracted the investment by the prospect of a profit on the investment rather than a desire to use or consume the item purchased." Infinity Group, 212 F.3d at 187, quoting Steinhardt, 126 F.3d at 152 . Also relevant is whether the investor "meaningfully participated in the management of the partnership in which it has invested such that it has more than minimal control over the investment's performance." Steinhardt, 126 F.3d at 152. In the present case, the clients did not intend to consume anything in return for the money they gave to Devon. Rather, they gave money to Devon specifically for "professional management of the Client's funds on deposit."³⁴ In furtherance of this responsibility, Devon, on behalf of the client, invested money in CIAs "with FMS ... under which Client will receive a net fixed rate of return on its investment on the deposit."³⁵

³³ See, e.g., Order dated July 1, 1998 at Docket No.327. Defendants argue that the terms of the various CIAs, which purportedly contained different interest rates and expenditure schedules, defeat any claim of horizontal commonality. (Defendants' Memorandum at 6). This is both untrue and disingenuous. First, at least under some circumstances, investors necessarily would receive pro rata distributions from pooled accounts. In fact, it is only in the event that FMS's investments earn amounts equal to or more than all amounts due under the various CIAs that client distribution would not be pro rata. Moreover, defendants' actions virtually guaranteed that this event did not occur: by hiding trading losses and not otherwise supplementing the collateral account, they placed each investor in the position of making a claim for its pro-rata share of the Collateral Account. Cf. Wasnowic v. Chicago Board of Trustees, 352 F.Supp. 1066,1070 (M.D. Pa.), aff'd without op., 491 F.2d 752 (3d Cir.), cert. denied, 416 U.S. 994 (1974) (original contract, and not fraudulent actions, determine the existence of an investment contract). Significantly, the CIA also is a common enterprise under the "vertical commonality" test, or a test which focuses on whether the fortunes of the investor are tied to that of the manager. Infinity Group, 212 F.3d at 188, n.8 (noting that the Third Circuit has not yet decided whether to adopt this analysis). Specifically, FMS only makes a profit on its investments of Devon's clients' funds if its investments produce earnings that exceed that due under the CIAs.

³⁴ Declaration and Decl. Exh. A, at introduction.

³⁵ Declaration and Decl. Exh. C.

Clearly, in this case, clients were attracted to the CIA by the prospect of investment for a profit. Moreover, aside from their ability to withdraw funds prematurely, the clients had no control over the investments made with their funds. Under the LGU, the client provided to Devon "investment discretion for those funds that the Client may place under Devon's management."³⁶ Devon, in turn, exercised that discretion by investing the money in FMS, which Devon purportedly ascertained to "possess the resources and capability to provide a fixed investment yield." The clear intent of both agreements is that Devon and FMS had substantial, if not full, control over investments made with the funds under their management.³⁷

Finally, defendants completely mislead the court by citing as support for their position SEC v. Bennett, 889 F.Supp. 804 (1995). The procedural history of this matter does not parallel that in Bennett. Furthermore, the Bennett decision actually supports a finding that this court had subject matter jurisdiction over this matter. In Bennett, the Commission petitioned the court for entry of a preliminary injunction by consent on the same day that it filed its complaint. Because the matter was consented to from the outset, the Commission did not file supporting affidavits and exhibits. The court expressed concern about entering the requested relief without more (either an adversarial contest or supporting evidence) from which it could determine subject matter jurisdiction. The SEC filed a brief and factual affidavits supported by extensive exhibits. The court concluded, "After reviewing the SEC's affidavits and exhibits, I conclude that the SEC's characterization of

³⁶ Declaration and Decl. Exh. A, at 1.

³⁷ Defendants argue that this third element means that the customers had no input into the management of the enterprise. In fact, in Steinhardt, the Third Circuit recounts its rejection of this interpretation of the law. See, e.g., Steinhardt, 126 F.2d at 152-154. Even assuming, arguendo, the facts as stated by Defendants (which, at least in part, are not supported by the evidence of record) the clear intent of both the LGU and the CIA is that Devon and FMS have substantial, if not full, control over investments made with the funds under their management.

the interests at issue here as ‘securities’ surpasses the ‘wholly insubstantial’ standard set forth [earlier in this opinion]." Id. at 808.³⁸

In the instant case, prior to the entry of the consent judgments which defendants now contest, this court entered a TRO *without defendants' consent*. In doing so, the Commission submitted and the court considered an extensive brief, two factual declarations and extensive supporting exhibits. Thus, this court had ample evidence to assess and find subject matter jurisdiction and, in fact, did so prior to entry of the consent judgments.

2. Devon Was An Investment Advisor

Defendants further claim that the Commission could not make claims under the Advisers Act because Devon was not an investment advisor as defined under that Act.³⁹ Defendants' contest of this point is surprising. Specifically, for years Devon, through Black, registered with the Commission as an investment adviser, acknowledging that it received fees for providing investment advisory services for clients.⁴⁰ In any event, Devon fits easily within the definition of "investment adviser" contained in the Advisers Act.

Section 202(a)(11) of the Advisers Act, 15 U.S.C. § 80b-2(a)(11), provides, in relevant part, that an "investment adviser" is:

Any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and

³⁸ Earlier in the opinion, the court recited the law for determining subject matter jurisdiction, citing to Kulik v. Pocono Downs Racing Ass'n, Inc. See discussion above concerning Rule 60(b)(4).

³⁹ The Commission does not, in its Complaint, claim Black to be an investment adviser and, accordingly, does not address Defendants' arguments to this end.

⁴⁰ See Declaration at 4 and Decl. Exh. E.

as part of a regular business, issues or promulgates analyses or reports concerning securities, but does not include ... any person whose advice... relate [sic] to no securities other than ...exempted securities for the purposes of the Act...

This definition includes not only those who make recommendations to their clients, but also those who wield management powers over their clients' money. SEC v. Saltzman, 127 F.Supp. 2d 660, 669 (E.D. Pa. 2001).

In this case, Devon entered into investment advisory agreements with multiple clients whereby each client gave Devon investment discretion for funds placed by the client under Devon's management.⁴¹ Pursuant to these agreements, Devon directed the investment of client funds and received a monthly fee based on an annual rate ranging from .12-.25% of the average month end balance of the assets of management.⁴² In sum, Devon was an investment adviser as that term is defined in Advisers Act.

3. Whether FMS Was An Investment Company Is Completely Irrelevant

Defendants argue that FMS is not an "investment company" under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52. This argument is irrelevant to the Commission's action and, accordingly, to this court's judgments. The Commission's complaint does not allege that FMS was an "investment company". Nor does it allege violations of the Investment Company Act or seek relief thereunder. Stated simply, whether or not FMS is an "investment company," as that term is defined under the Investment Company Act, is completely irrelevant and, thus, cannot

⁴¹ Decl. Exh. A.


⁴² Declaration at 9 and Decl. Exh. A.

for a basis for setting aside the judgment in this case.⁴³

IV. CONCLUSION

For the foregoing reasons, the Commission respectfully requests that this court deny defendants' motion in full.

Respectfully submitted,



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⁴³ Defendants further contend that issuers of tax-exempt bonds are not investors under the securities laws. To the extent defendants are arguing that issuers of tax exempt bonds cannot invoke the services of investment advisers or be victims of fraud under the Securities Act and the Exchange Act, the Commission disagrees and respectfully requests that the court require defendants to provide support for this proposition.