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

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

JOHN GARDNER BLACK, DEVON
CAPITAL MANAGEMENT, INC., and
FINANCIAL MANAGEMENT
SCIENCES, INC.,

Defendants.

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: Civil Action No. 97-265J
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MEMORANDUM AND ORDER

SMITH, District Judge

Before the court is defendants' Emergency Motion for a Modification of the Temporary Restraining Order, docket no. 38, issued by this court on September 26, 1997. The motion seeks permission to access certain personal assets of John Black and his wife, and to sell certain of the Blacks' real property to obtain sufficient funds to permit a release of \$525,000 to the law firm of Ropes & Gray, \$100,000 to retain local counsel, and \$127,305 for living and fixed expenses for the next six months. Docket no. 38 at 1-2. The motion also seeks to lift the freeze as applied to a bank account of SKA, Inc., a business under the control of defendant Black. The Securities and Exchange Commission (Commission) and the Trustee both oppose the requested release of funds.

On October 27, 1997, a hearing was conducted on defendants' motion. Defense counsel presented argument in support of their motion, claiming that the Blacks could not supply the documentation needed to support their claim for living expenses because their personal records had been seized along with the records of Devon and FMS on September 26, 1997. Until the filing of supplemental memoranda subsequent to the hearing, defendants had not supplied this

court with any affidavits or declarations addressing the issue of financial need. In response to my expressed desire for some evidentiary showing of defendants' need for the assets sought, defendant Black took the witness stand and testified that he did not have access to funds other than those which had been frozen pursuant to the terms of the TRO. He explained that he had borrowed \$75,000 from his father to pay counsel, and declared that he had no other "realistic expectation" of obtaining the funds necessary to pay his attorney fees and living expenses.

During cross-examination, Black related that his father had sold the family business, Gardner's Candies, for \$3 million to \$5 million in the spring of 1997. He explained that his father did not receive all of the proceeds from this sale because of outstanding loans, and that he felt his father needed his assets to provide for himself.

Black also testified that he had contacted his brother on Sunday, October 26, 1997, to request \$29,000 that Black had sent him four years earlier to use as a down payment on a new house. His brother indicated that "he would do what he could" to return the \$29,000, although Black said he did not know when his brother could send it. Black also conceded that his father "has offered to pay a couple thousand dollars" for Black's family's living expenses.

Black was unable to state his approximate net worth. When pressed by the Commission's counsel, he estimated his net worth as "over \$500,000 and under \$1 million." He attributed most of his net worth to the real estate he owns in the Virgin Islands and discounted the notion that his holdings in Pennsylvania had any real value. He emphasized, however, that everything he owns is frozen.

Black indicated that his wife does not own any personal or real property in her own name. Regarding his ability to apply for credit, Black explained that he had not pursued that

course because Mellon Bank revoked his credit line after this action was filed. He has not attempted to obtain any additional funds from his credit cards, he said.

Upon cross-examination by the Trustee's counsel, Black indicated that he had not been paid by Devon or FMS for over a year. He believed, although he wasn't sure, that the last time he filed his federal income tax return was in 1993.

At the conclusion of Black's testimony, defense counsel asserted that the defendants had demonstrated that Black has no other assets available to pay either his attorney fees or his family's living expenses. Counsel submitted that due process considerations favor a release of funds in light of the concurrent criminal investigation now pending and the fact that Black needs to be able to defend himself.

Neither the Commission nor the Trustee presented evidence.

The assets Black seeks permission to use, according to the motion, consist of the balance of a personal trust established in 1985 from the proceeds of a sale of a family business, and certain real estate purchased with funds from that trust. The trust balance is approximately \$71,000 at present. The real property which could be sold is situated in Pennsylvania and the Virgin Islands, and defendants' motion places a minimum value on it of \$730,000.

Black's post-hearing submission includes an affidavit by Mrs. Black which attests that the trust accounts were opened in 1985 and 1986. The 1985 account was opened with proceeds from the sale of Gardner's Candies.¹ The 1986 account was opened with the funds from "an

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The record fails to establish precisely how much of Gardner's Candies was sold in 1985. It is apparent that only a portion of the business, or a product line, was sold at that time, in light of the 1997 sale by Black's father for \$3 million to \$5 million.

inheritance gift from David J. Black and his wife.” Docket no. 87 at ¶¶ 2.a, 2.b. Mrs. Black further attested that funds from the trust accounts were used to purchase various Pennsylvania and Virgin Islands properties during 1986, 1987 and 1988.

My disposition of this motion is informed by CFTC v. American Metals Exchange Corp., 991 F.2d 71 (3d Cir. 1993), the only Third Circuit authority on point. In American Metals, the court affirmed the district court’s decision denying the defendant’s “request to pay his attorneys’ fees out of his frozen assets.” Id. at 79. The district court had also denied the request to pay the defendant’s mortgage and his son’s tuition from the frozen assets. The freeze order allowed the defendant \$1,355 per month for “sufficiently documented expenses for utilities, taxes, insurance and clothing.” Id.

The defendant’s assets in American Metals had been frozen pursuant to a preliminary injunction granted after the district court found that the plaintiff had shown a likelihood of proving that the defendants had violated securities laws. The Third Circuit reasoned:

While we recognize that Maxwell’s lawyers should be reimbursed for their efforts on his behalf, we do not find the district court’s failure to disturb the freeze order to be an abuse of discretion. First, plaintiffs have shown that Maxwell has had access to funds, not covered by the freeze, which he has used to pay some legal fees. Second, Maxwell has been slow to produce his financial records to the court. Lastly, Maxwell’s current attorneys entered their appearance after Maxwell’s assets were already frozen and thus should have recognized that there might be some delay in obtaining reimbursement for services rendered.

Id. at 79-80. Significantly, this conclusion was preceded by a recognition that the freeze order should remain in effect “until the district court determines whether it can make an informed determination of the amount of unlawful proceeds retained by Maxwell, and, if it can, what that amount may approximate.” Id. The quantification of the extent of the defendant’s ill-gotten

gains was recognized as a factor which would impact any disgorgement order that the district court could properly issue.

American Metals places the burden upon the defendant to show the need for access to the frozen assets and the unavailability of other funds.

I will address defendants' motion as though it were two motions: one seeking a release of funds for living expenses and another seeking a release of funds for attorneys' fees. I do so because the interests affected by these two discrete claims are profoundly different. The request as it pertains to SKA, Inc. will be addressed first, however, as it affects my disposition of the request for living expenses.

Release of SKA, Inc. from Freeze Order

Defendant Black seeks the release of SKA, Inc. from the terms of the order freezing any assets under his control. SKA owns two rental properties in Tyrone, Pennsylvania which are leased to several small businesses. As a result of the freeze order, defendant Black contends that SKA has been prevented "from receiving monthly rent checks" and has been unable to pay its monthly bills for maintenance, utilities, insurance and real estate taxes. Docket no. 38 at 12. Defendant Black further submits that SKA receives \$2,367 in monthly rental payments from its tenants, resulting in a "modest income stream after expenses." Id. The SEC does not oppose the release of SKA's bank account "solely for the purposes described . . . This would allow a potential income stream, which again Black should be ordered to use[] as an offset against any living expenses he is allowed." Docket no 52 at 10.

I will grant the request to modify the freeze order as it pertains to SKA's bank account. SKA should proceed to collect the monthly rent due and to pay its bills. In the event any income

remains after payment of these bills, defendant Black may apply such funds to his living expenses.

Living Expenses

The defendant's motion requested funds in order to provide for the following expenses: real estate expenses; automobile and travel expenses; education; insurance; health care; utilities; communications; payroll; credit card bills; and other expenses. At oral argument the Commission did not oppose the following expenses, provided that defendant made a showing that the funds were unrelated to the fraud alleged in the complaint: \$14,850 for the mortgage payments on the family residence; \$4,362 for payments on two vehicles; \$3,000 for travel expenses; \$4,650 for other expenses such as groceries, clothing, household supplies and similar items; and \$7,000 for utilities and communications. I will modify the TRO to permit defendant Black to access the necessary funds for the above items necessary over the next several months to live and assist with the defense of this case.

In granting this very limited relief, I credit Black's testimony, as corroborated by his wife, Judith, that certain trust funds were derived from family and family business sources, and were therefore unrelated to any alleged fraud. I was less than satisfied, however, with the balance of Black's testimony, a point I shall address *infra*. Although funds presently in the family trust shall be reachable for purposes of the instant motion, the Black's real estate is another matter.

Defendants' motion seeks, in addition to the \$14,850 for his mortgage, another \$20,474 for real estate expenses such as real estate taxes, including a \$2,000 association fee for the Virgin Islands property. Since nonpayment of these taxes will not result in the immediate loss of

these assets, I decline to order a release of funds for this expense at this time. Should it appear that any of Black's real estate is in jeopardy of being subjected to a tax sale, any party or the Trustee may seek further relief.

The original request for automobile and travel expenses was \$19,003. This includes the \$4,652 for car payments and \$3,000 for travel expenses consented to by the SEC. The balance of the request will be denied. I have already noted that during the pendency of this action there will be a certain scaling back in the lifestyle of defendant Black and his family. Trips to Washington to meet with counsel may be made by car, and daily round trips from Central Pennsylvania are common. Should overnight accommodations be needed, economy hotels are available in the Maryland and Virginia suburbs. Defendants may, of course, seek additional travel expenses should experience demonstrate that the \$3,000 allowance is inadequate.

Defendant Black also requests \$30,740 for tuition payments for college for his two daughters and preparatory school for his son. I cannot justify releasing \$12,500 for the son's preparatory school when there is a free alternative available, namely a public school. No free alternative exists for Black's daughters, however, and it would be unfair to innocent children to deprive them of the remainder of their college courses for the year. For that reason, I will grant the request for \$16,500 to pay the tuition of Black's daughters, Sarah and Katherine.

A request for \$13,696 for insurance seeks to cover the cost of health insurance, homeowners' insurance, insurance on the Blacks' farm properties and real estate in Tyrone, and two small life insurance policies on the life of defendant Black. The request will be denied as it seeks to cover the cost of life insurance policies for defendant Black inasmuch as this is not an essential expense. The request for the remaining insurance payments will be denied without

prejudice because, first, the documentation provided fails to establish when such a payment is due, and second, the premiums for insurance appear excessive for just six months' coverage. Moreover, the request for funds to insure the Tyrone properties appears to be duplicative in light of the relief granted for SKA.

The request for \$2,420 for health care would cover outstanding medical bills and additional health expenses incurred due to the need for frequent medical attention necessitated by Black's high blood pressure and Mrs. Black's Addison's disease. The request as it pertains to past due bills from medical providers will be denied since there appears to be no legitimate reason to distinguish them from any other creditor.

Utilities and communications need not be addressed because the Commission does not oppose the request for \$7,000.

The motion also seeks the release of \$7,307 to cover sums owed to an injured farm hand, federal withholding and unemployment taxes. In the absence of documentation to support these expenses, such funds will not be released. While I am sensitive to the specter of an injured farm hand who is without access to funds, it is unclear on this record why he is not eligible for either workers compensation or unemployment compensation.

The defendant also seeks to obtain the release of \$32,230 to pay four separate credit cards. These creditors are not unlike the medical providers and will not be treated any differently than other creditors.

A tally of the approved items equals \$50,632.00 (\$14,850 - mortgage; \$4,632 - car payments; \$3,000 - travel; \$12,600 - tuition for Sarah Black; \$3,900 - tuition for Katherine Black; \$7,000 for utilities and communications; and \$4,650 - other expenses). These expenses

may be paid in part, however, by the \$25,500 which the Blacks will receive over the next six months in rental income from various non-SKA properties.² For that reason, I will release at this time \$25,132.00, the difference between the \$50,632.00 in approved expenses and the \$25,500 in rental income.

Attorneys' Fees

Defendants recognize the applicability of American Metals, 991 F.2d at 79. They contend, however, that the case is distinguishable. First, they cite the fact that this court's freeze order was issued as part of an ex parte TRO without the benefit of the evidentiary hearings and preliminary injunction which preceded the freeze order in American Metals. By itself, the procedural posture of this case carries little significance in my determination of whether to release some of defendant Black's assets because the "freeze is designed to preserve the status quo by preventing the dissipation and diversion of assets . . . until the district court determines whether it can make an informed determination of the amount of unlawful proceeds retained." Certainly, we have not yet reached that point. Id.

Second, defendants submit that the district court in American Metals found that the defendant had access to unfrozen funds to pay \$7,400 per month for his mortgage. Defendants argue that Black's testimony, as supported by Mrs. Black's affidavit, demonstrate that they have no access to other funds. I cannot make such a finding for a number of reasons.

First, defendant Black's credibility is questionable. His testimony professing ignorance

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The defendants' motion explains that the "Blacks can offset the expenses described above with the income they receive" from rental properties separate and distinct from those of SKA. Docket no. 38 at 11. This rental income is estimated to total \$25,500 over the next six months.

as to the amount of money his father realized from the sale of Gardner's Candy did not ring true. When pressed on cross-examination, Black estimated the amount was \$3 million to \$5 million. I find this pretension to agnosticism unconvincing.

Black's considerable financial background and investment advisory experience also makes it difficult for this court to believe that he does not know his own net worth, or what the value of his real estate holdings are. His rough estimate of a net worth of \$500,000 to \$1,000,000 is, to say the least, intriguing. At least one of the trust accounts held for Black and his wife was valued at \$800,000 - \$900,000 in 1985 before the couple drew on the account. To accept Black's estimate, one would have to believe that an experienced investment adviser realized zero or negative growth in his net worth over the past twelve years, a period that included the biggest "bull market" in history. Until Black can explain his lack of personal investment success during this time, his testimony is not worthy of credence.

Finally, Black's credibility is further undermined by the fact that he believed, but wasn't sure, that his federal income taxes had not been filed since 1993.

Black's testimony has failed to satisfy me, at least for the present, that he is without access to other funds. He has not asked his father for additional monies. He has not pressed his brother for repayment of a valid loan. Consistent with American Metals, I will deny the request for a release of some of defendant Black's assets to pay attorneys' fees because I am unable to conclude that Black has no access to other funds, and because counsel has already received \$75,000 toward its retainer.

Notwithstanding the authority of American Metals, defendants contend that any refusal to grant their request for funds to pay their attorneys' fees "raises serious due process concerns"

because their "constitutional guarantee of due process of law would be severely compromised if defendants were denied the means with which to pay for their own defense on the basis of an ex parte TRO." Docket no. ___ at 9 (relying on Mathews v. Eldridge, 424 U.S. 319 (1976)).

A serious due process concern is not a due process deprivation. In the absence of a finding that defendant Black is without access to other funds, I need not address whether there is even a constitutional issue. Nevertheless, I note that the Supreme Court in Caplin & Drysdale v. United States, 491 U.S. 617, 626 (1989), held that a criminal defendant has "no Sixth Amendment right to spend" forfeitable assets for "services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice." As the Seventh Circuit held in SEC v. Cherif, 933 F.2d 403, 417 (1991), in considering the ability of a defendant to utilize assets frozen pursuant to an ex parte TRO extended by consent of the defendant until the subsequent entry of a preliminary injunction, "[i]t would be anomalous to hold that a civil litigant has any superior right to counsel than one who stands accused of a crime." See also Monsanto v. United States, 491 U.S. 600, 615-16 (1989).

An appropriate order will follow.

ORDER

AND NOW, this 30th day of October, 1997, consistent with the foregoing Memorandum, it is hereby

ORDERED AND DIRECTED that the defendants' Emergency Motion for a Modification of the Temporary Restraining Order, docket no. 38, is GRANTED IN PART and DENIED IN PART as follows:

1. The temporary restraining order issued September 26, 1997, docket no. 5, which froze

all assets under the control of defendant Black shall not be applied to the bank account of SKA, Inc., a business under the control of defendant Black. Defendant Black shall deposit all rental proceeds due SKA into SKA's bank account and pay all costs incurred by SKA's rental properties, including maintenance, utilities, insurance and real estate taxes from this account. Any balance remaining after the payment of costs incurred by SKA may be applied by defendant Black to his family's living expenses. Defendant Black shall keep records of all income received and expenses paid by SKA, and shall provide an accounting of same to the Trustee, upon request.

2. The temporary restraining order issued September 26, 1997, docket no. 5, which froze all assets under the control of defendant Black is modified to permit the withdrawal of a total of \$25,132.00 from the two trust accounts in the name of John G. Black and Judith K. Black. The \$25,132.00 shall be used only for the purposes set forth in this Memorandum.

3. Defendant Black shall maintain a ledger of all funds received from the trust accounts, rental income, and SKA excess income. A ledger documenting all expenses shall also be maintained. A monthly accounting of the funds received and the expenses incurred shall be provided to the court, the Commission and the Trustee, along with supporting documentation at the conclusion of each month. Any further request for living expenses shall be accompanied by appropriate documentation for the expenses which defendant may seek to pay from the frozen assets.

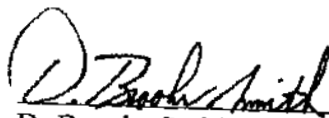
4. Defendants' motion seeking \$100,000 for local counsel is DENIED as unripe.³

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Counsel for defendants conceded at argument that "local counsel" with whom they had spoken are now unwilling to be engaged for the amount previously discussed.

5. Defendants' motion seeking \$525,000 for counsel fees is DENIED.

BY THE COURT,



D. Brooks Smith
United States District Court

cc: Michael Newman, Esq.
Merri Jo Gillette, Esquire
Michael Nussbaum, Esquire
Honorable Richard L. Thornburgh