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

SECURITIES AND EXCHANGE COMMISSION Plaintiff v. JOHN G. BLACK, DEVON CAPITAL MANAGEMENT SERVICES, INC., and, FINANCIAL MANAGEMENT SCIENCES, INC. Defendants	Civil Action No. 97-265J

PLAINTIFF'S MEMORANDUM OF LAW
IN SUPPORT OF ITS EX PARTE MOTION FOR TEMPORARY RESTRAINING ORDER, PRELIMINARY INJUNCTION, ASSET FREEZE AND OTHER RELIEF

Plaintiff Securities and Exchange Commission ("Commission") submits this memorandum of law in support of its ex parte motion for an order: (i) temporarily restraining Defendant Devon Capital Management ("Devon") from further violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77q(a), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated thereunder; Section 206 of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C.80b-6, and Rule 206(4)-2(a) promulgated thereunder, 17 C.F.R. 275.206(4)-2(a); (ii) temporarily restraining Defendant John Gardner Black ("Black") from further 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, 17 C.F.R. 240.10b-5, promulgated thereunder; and from aiding and abetting violations of Section 206 of the Advisers Act,

15 U.S.C. 80b-6, and Rule 206(4)-2(a), promulgated thereunder, 17 C.F.R. 275.206(4)-2(a); (iii) temporarily restraining Defendant Financial Management Sciences ("FMS") from further 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, 17 C.F.R. 240.10b-5, promulgated thereunder; (iv) preliminarily enjoining Defendants from further violations of the same provisions; (v) freezing all assets of Defendants Devon, Black and FMS; (vi) granting expedited discovery; (vii) appointing a trustee for Devon and FMS to, among other things, conduct an accounting of Devon and FMS; (viii) prohibiting document alteration or destruction; and (ix) authorizing alternate means of service.

INTRODUCTION

This emergency matter seeks to stop an ongoing fraud involving Devon, an investment adviser registered with the Commission and located in Tyrone, Pennsylvania, its owner, Black, and a related entity, FMS. Devon offers cash management services to local government units ("LGUs"), primarily school districts that raise money through municipal bond offerings. To engage Devon, LGUs sign investment advisory agreements with Devon, the terms of which, among other things, provide fixed returns and provide that Devon will not maintain custody of any advisory client owned monies or securities. Devon has the LGUs invest in an instrument identified as a Collateralized Investment Agreement("CIA") which is provided by an unidentified affiliate, actually FMS, and backed by U.S. Treasury and Agency securities.

The CIA is an agreement between Devon, on behalf of a specific LGU and FMS, pursuant to which FMS guarantees a rate of return specified in the LGU Advisory Agreement. According to the terms of the CIA, the LGU's principal will be secured or collateralized by securities with a fair market value equal to 100% of the investment.

The CIA provides that Devon will transfer funds from the LGU's "Custodial Account" maintained at a local bank to FMS, which then deposits the funds into an account maintained in FMS's name ("Main Account"). Devon is supposed to purchase authorized investments with these funds, whereupon FMS places the investment securities into another FMS account, the "Collateral Account," where the securities are held for the benefit of the clients. In some instances, securities that are purchased with pooled assets from the Main Account are transferred to accounts designated and controlled by the individual LGU, and not in the Collateral Account.

Notwithstanding representations made to advisory clients, Devon, FMS and Black, fail to inform advisory clients of the risk of investing with Devon, Devon's financial condition, and how funds are being used. Since at least 1995, Devon realized at least $50 million in trading losses. This is not disclosed to advisory clients or prospective advisory clients. In fact, Devon hides this loss by overvaluing by $71 million a specific security known as a collateralized mortgage obligation ("CMO") it maintained in the Collateral Account. Thus, advisory client funds are diluted by at

least 45% immediately upon investment. Black prepares, or directs the preparation of, false monthly statements Devon sends to advisory clients in which the value of the investment made by Devon and held by FMS on their behalf is significantly overstated.

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The facts supporting this motion are set forth in the Declaration of William Meck filed herewith; the supporting legal authority is set forth in detail below.

ARGUMENT

I. A TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION IS NECESSARY AND APPROPRIATE TO PROTECT INVESTORS AND THE PUBLIC INTEREST

A. A Special Standard Applies to Commission Requests for Preliminary Injunctions and Temporary Restraining Orders

Under Section 20(b) of the Securities Act, Section 21(d) of the Exchange Act and Section 209(d) of the Advisers Act[1], the Commission is entitled to a temporary restraining order or preliminary injunction when it establishes: (1) a *prima facie* case

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[1] Section 21(d)(1) of the Exchange Act provides in pertinent part:

> Whenever it shall appear to the Commission that any person is engaged or is about to engage in any acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, . . . it may in its discretion bring an action in the proper district court of the United States . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.

15 U.S.C. 78u(d)(1). Sections 20(b) of the Securities Act and 209(d) of the Advisers Act contain substantially the same language. 15 U.S.C. 77t(b) and 15 U.S.C. 80b-9(d).

of previous violations; and (2) a reasonable likelihood that the wrong will be repeated. Unifund Sal Kemp v. Peterson, 940 F.2d 110, 113 (4th Cir. 1991); SEC v. Management Dynamics, Inc., 515 F.2d 801, 807 (2d Cir. 1975); SEC v. International Loan Network, Inc., 770 F. Supp. 678, 688 (D.D.C. 1991), aff'd, 968 F.2d 1304 (D.C. Cir. 1992); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972). A request by the Commission for a temporary restraining order or preliminary injunction is governed solely by these statutory standards, and therefore the Commission faces a lower burden than a private litigant when seeking such relief. Most importantly, "there is no requirement that the Commission demonstrate irreparable injury or lack of any adequate remedy at law." SEC v. Scott, 565 F. Supp. 1513, 1536 (S.D.N.Y. 1983), aff'd sub. nom., SEC v. Cayman Islands Reinsurance Corp., 734 F.2d 118 (2d Cir. 1984). See also, Kemp v. Peterson, 940 F.2d at 113; SEC v. Management Dynamics, Inc., 515 F.2d at 808. As the Supreme Court has held with regard to an analogous regulatory statute:

> [T]he standards of the public interest, not the requirements of private litigation, measure the propriety and need for injunctive relief in these cases.

Hecht Co. v. Bowles, 321 U.S. 321, 331 (1944) (price control regulations).

When viewed under this standard, the compelling facts and circumstances of this case clearly establish that the Commission is entitled to both a temporary restraining order and preliminary injunction against the Devon, Black and FMS, together with the

other emergency relief sought. This relief is necessary to ensure the status quo, prevent the defendants from continuing their violative conduct, prevent the acquisition of additional investor funds, protect any remaining investor funds and protect documents and other evidence from destruction or alteration.

B. Defendants Have Violated and Are Violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder prohibit the employment of fraudulent devices in connection with the offer, purchase or sale of securities.[2] A defendant violates these provisions when he, (i) by the use of the mails or other jurisdictional means; (ii) makes false and misleading statements or omissions of material fact, or otherwise employs any device, scheme or artifice to defraud, or engages in any transaction, practice or course of business which operates as a fraud or deceit; (iii) "in connection with" the offer, purchase or sale of securities; and (iv) acted with the requisite intent or scienter. Aaron v. SEC, 446 U.S. 680, 697 (1980); SEC v. Kimmes, 799 F. Supp. 852, 858 (N.D. Ill. 1992), aff'd, 997 F.2d 287 (7th Cir. 1993); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1969), cert. denied, 394 U.S. 976.[3]

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[2] The Supreme Court has recognized that the anti-fraud provisions of the Securities Act and the Exchange Act prohibit essentially the same conduct. See U.S. v. Naftalin, 441 U.S. 768, 778 (1979).

[3] Scienter is defined as a "mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976). There is no

As set forth below, the Commission has clearly met its burden here.

1. Defendants used, and are using, the mails and an instrumentality of interstate commerce

Devon, Black and FMS have used the mails and telephonic communication, means of interstate commerce, to assist their fraudulent scheme, thereby satisfying this element. Use of the mails included the solicitation of advisory clients, together with the monthly mailing of account statements, as well as other forms of communication.

2. Defendants have made, and are continuing to make false and misleading statements and omissions of material fact and are engaging in a fraudulent scheme

The anti-fraud provisions prohibit misrepresentations and omissions of material facts based on the presumption that investors are entitled to full and complete disclosure of all material facts. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963). The general standard for assessing materiality was enunciated by the Supreme Court in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976), in which the Court held:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important ... What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable

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scienter requirement for violations of Sections 17(a)(2) or 17(a)(3). Aaron v. SEC, 446 U.S. 680, 697 (1980).

> <u>investor as having significantly altered the "total mix" of information made available.</u> (Emphasis added).

<u>See also</u> <u>Basic, Inc. v. Levinson</u>, 485 U.S. 224 (1988).

Devon and FMS, at the direction of Black, are making material misrepresentations and omission to prospective advisory clients and advisory clients about, among other things, the value of the CMO, the risk of the investment, the financial condition of the investment adviser, and how advisory client funds are being used. Devon, at the direction of Black, is concealing trading losses of at least $50 million. Specifically, the risk of investing in Devon is being misrepresented. Clearly, the advisory clients would have considered a $50 million loss material. Devon does not inform advisory clients that at the time they make their investment, it is automatically diluted by this pre-existing debt. Black is concealing these trading losses by overvaluing a collateralized mortgage obligation by approximately $71 million above market value, and reflecting this overvaluation in advisory client account statements. Devon refers to the investments as "collateralized," which is to imply that they are guaranteed by a second set of securities. In fact, the government securities being represented as collateral for the investment are purchased with client funds. There are no additional securities or other assets to protect the client's investment against loss.

Not only does Devon provide false account statements to clients, in at least two instances, Devon provided inaccurate information to school board auditors by providing verification that

investments were fully valued.

In the interest of perpetuating Devon, Black has orchestrated an elaborate scheme to keep Devon afloat and avoid detection. Black's scheme includes transferring custody of Devon advisory client funds to FMS to avoid detection, and preparing and directing the preparation of false account statements which are sent by Devon to the LGUs. Devon fails to disclose to clients the uses it has made of the monies. Devon, notwithstanding the $70 million shortfall, uses advisory client monies to pay expenses, including the settlement of a lawsuit with a former Devon partner. From January 1996 through August 15, 1997, FMS withdrew approximately $1.2 million in expenses. These monies should have been devoted to satisfying the trading losses. Finally, also not disclosed is the fact that Devon receives double investment adviser fees; first from the LGUs and then from FMS. None of this is disclosed to the LGUs.

3. Defendants' Scheme is in Connection With the Offer, Purchase or Sale of Securities

a. The Existence of a Security

The CIA, the investments offered and sold in this case, are securities under the federal securities laws. 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." 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); Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459 (3d Cir. 1982)(quoting Howey). In the Court of Appeals for the Third Circuit, the common enterprise element is satisfied under a "horizontal commonality test" when the investments are part of a pooled group of funds and the fortunes of each client are tied to the success of the overall venture. 682 F.2d at 460.

While all three elements are met in this case, it is important to note at the outset that the agreement the LGUs signed specifically states that it is an investment contract. Clearly, the arrangement satisfies the first element, an investment of money. Devon's clients invest monies with the expectation and intention that Devon will invest these funds in securities, such as the CIA. Advisory client funds are pooled in two accounts, the Main Account and the Collateral Account. First, they are pooled in the Main Account in order to purchase securities on behalf of all advisory clients. Second, the securities purchased with the pooled funds are then deposited in the Collateral Account where they accrue interest. The interest earned on the pooled account is distributed on a pro-rata basis to all advisory clients. Moreover, each advisory client has a security interest in the Collateral Account equal to the amount of their investment. When funds are generated by the collateral in these separately held accounts (either through earnings or proceeds of sales), the "returns" are removed from the separately held accounts, placed back into the Main Account and then, distributed to all of the LGUs

on a pro rata basis, at the rates specified in the LGU Advisory Agreements. Finally, the third element is met by virtue of the fact that advisory clients rely on Devon's expertise. Clearly, the profits the LGUs earn advisory clients are to be derived from the efforts of others, and the advisory clients' participation is to be passive.

b. The "In Connection With" Requirement

The conduct of Devon, FMS and Black is "in connection with" the purchase or sale of securities. The courts have held that this requirement is satisfied where, as is the case here, the purchase or sale of securities was an integral part of any fraudulent scheme. See Superintendent of Ins. of State of NY v. Bankers Life & Casualty Co., 404 U.S. 6, 13 (1971); Perez-Rubio v. Wyckoff, 718 F. Supp. 217, 237 (S.D.N.Y. 1989). In this case, the sale of Devon's CIA is fundamental to the scheme. Black, on behalf of Devon and FMS, accepts funds from the LGUs who give Devon full discretion to invest the LGUs' bond offering proceeds in securities. Such sales provide Devon and Black with new capital which enables Devon to retain existing advisory clients by meeting demands for advisory client withdrawals, to attract new advisory clients, to fund the operation, and to pay personal expenses.

4. Defendants Acted with Scienter

The Commission also must establish that the proposed defendants acted with scienter. Scienter is defined as a "mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193n.12 (1976). There is no

scienter requirement for violations of Sections 17(a)(2) or 17(a)(3). Aaron v. SEC, 446 U.S. 680, 697 (1980). Scienter includes conduct evidencing an intent to mislead, as well as conduct demonstrating a reckless disregard for misleading statements. Id. at 701-02; Sharp v. Coopers & Lybrand, 649 F.2d 175, 193 (3d Cir. 1981), cert. denied 455 U.S. 938 (1982).

The scienter of the defendants is evidenced by the lengths to which they have gone to conceal the existence of the losses.[4] Among other things, Black prepares or directs the preparation of false monthly account statements reflecting the overvalued investments sent to Devon advisory clients. Bank statements for the Collateral Account clearly contradict these valuations as they continue to value the particular collateral at approximately $14 million. This contradicts Devon's internal records wherein the collateral is valued at $83 million.[5]

Further, it appears that the very reason Black established FMS is an attempt to circumvent the custody rules, which require annual independent audits, the results of which are filed with the Commission. Had such audits been done, the trading losses and

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[4] The "state of mind" of Devon and FMS is established by, among other things, the fraudulent actions of Black because "a corporation can only act through the persons associated with it . . ." SEC v. Manus, [1981-1982] Transfer Binder] Fed. Sec. L. Rep. (CCH) Paragraph 98, 307 (S.D.N.Y. 1981).

[5] In February 1996, in what appears to be an attempt to prevent the custodial bank from becoming aware of the deficit in the Collateral Account, Black took over the function of valuing the securities maintained in the account.

overvaluation of the portfolio would have been disclosed, and Black's operations would have collapsed. Black clearly knew, or was reckless in not knowing, that he was concealing trading losses from Devon advisory clients.

C. Defendant Devon has Violated, and Continues to Violate, the Anti-fraud Provisions of the Advisers Act

1. Sections 206(1),(2) and (4) of the Advisers Act

In regard to claims of fraud under the Advisers Act, Sections 206(1), 206(2) and 206 (4) of the Advisers Act makes it unlawful:

> (1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; ...and (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

To prove a violation of Section 206, the Commission must show that the defendant is an investment adviser, that the defendant used the mails or interstate commerce to engage in fraudulent actions or behavior, and that the defendant acted with scienter with regard to Section 206(1) only. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 200 (1963); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); SEC v. Wall Street Pub. Inst. Inc., 591 F.Supp. 1070, 1083 (D.C. 1984). The scienter and materiality requirements under Section 206 have been defined by the general standards utilized under the antifraud provisions of the Securities Act and Exchange Act. Steadman, 603 F.2d at 1130; SEC v. National Executive Planners, Ltd., 503 F. Supp. 1066, 1074 (M.D.N.C. 1980).

For the same reasons as discussed above in regard to the violations of the antifraud provisions of the Securities Act and

the Exchange Act, Devon, aided and abetted by Black, violated Sections 206(1), (2) and (4) of the Advisers Act.

2. Section 206 and Rule 206(4)-2(a) Under the Advisers Act

Pursuant to Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder, failure to comply with the strict guidelines for investment advisers who accept custody of client funds or securities constitutes a fraudulent, deceptive or manipulative act, practice or course of business. 17 C.F.R. 275.206(4)-2. Specifically, the Rule states that any investment adviser who has custody of client funds must, among other things, have funds verified by an independent public accountant at least once a year. In addition, Rule 206(4)-2 specifically states that investment advisers who do not comply with these guidelines are deemed to have engaged in fraudulent conduct in violation of Section 206(4) of the Advisers Act.

Devon, under standards enunciated by the Commission, is deemed to have custody of client funds for purposes of Rule 206(4)-2(a). Regardless of statements in the LGU Advisory Agreement that Devon does not take custody of client funds, Devon is subject to the custody provisions with respect to the CIA funds. Pursuant to Crocker Investment Management Corp., No-Action Letter, Ref. No. 77-1219CC (March 15, 1978), Devon is subject to the custody rules by virtue of the fact that FMS is an affiliated company which has possession of clients' funds and securities. In Crocker, the Commission's Division of Investment Management stated that an advisor may have custody through an affiliated entity if: (1) the

clients' property in the custody of the affiliated company might be subject, under any reasonably foreseeable circumstances, to the claims of the advisor's creditors; (2) advisory personnel have the opportunity to misappropriate clients' property; (3) advisory personnel ever have custody or possession of or direct or indirect access to clients' property or the power to control the disposition of such property to their parties for the benefit of the advisor or its affiliated persons; (4) advisory personnel and personnel of the affiliated company who have possession or custody of, or control over, or access to, advisory clients' property are under common supervision; or, (5) advisory personnel hold any position with the custodian or share premises with the custodian and, if so, whether they have, either directly or indirectly, access to or control over clients' property.

Clearly, Devon had the power to control the disposition of client assets and to misappropriate those assets. Both the purported custodian, FMS, and Devon are controlled by Black who has signatory authority over FMS' accounts. Therefore, Devon cannot use the artifice of FMS to avoid compliance with the custody rules set forth under Rule 206(4)-2(a).

Devon failed to comply with this rule. By not having an independent verification of funds, the fraudulent valuation and the trading losses were able to go undetected. Accordingly, Devon, aided and abetted by Black, violated and continues to violate Rule 206(4)-2(a) of the Advisers Act.

D. Black Aided and Abetted and Continues to Aid and Abet Devon's Client-Custody Violations of the Advisers Act

Black aided and abetted, and continues to aid and abet Devon in its violations of Sections 206 of the Advisers Act, and Rules 206(4)-2(a), thereunder. The Private Securities Litigation Reform Act of 1995 expressly authorizes the Commission to bring injunctive actions against those who aid and abet violations of certain securities laws. See e.g. SEC v. H. Thomas Fehn, 97 F.3d 1276 (9th Cir. 1996)(attorney held to have aided and abetted violations of Sections 10(b) and 15(d) of the Exchange Act and related provisions). In order to establish Black's liability for aiding and abetting these violations, the Commission must show: (1) that there has been a commission of an underlying securities violation; (2) that the alleged aider-abettor had knowledge of that act; and (3) that the aider-abettor knowingly and substantially participated in the wrongdoing. Gould v. American-Hawaiian Steamship Co., 535 F.2d 761, 780 (3rd Cir. 1976); Rochez Brothers, Inc. v. Rhoades, 527 F.2d 880, 886 (3rd Cir. 1975) ("Rochez II") (stating the third element alternatively as "substantial assistance in effecting" the wrongful act); Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 799 (3d Cir. 1978), cert. denied, 439 U.S. 930 (1978); Healey v. Catalyst Recovery of Pennsylvania, Inc., 616 F.2d 641, 651 (3rd Cir. 1980).

The existence of the first element -- primary violations by Devon of the antifraud and custody provisions, can clearly be established as set forth above. The second element -- rendering substantial assistance --is satisfied by virtue of the central role

Black plays in all of Devon's operations. Black, as the sole principal of Devon and the only person who controlled Devon's ability to comply with these provisions, certainly was aware of the violations. It is his responsibility alone to ensure that Devon is in compliance with custody provisions of the Advisers Act. Finally, Black had the requisite awareness that his role was part of an overall activity that was improper. Black knowingly and substantially participated in these violations. It was solely through Black's actions that Devon accepted advisory client funds, through its affiliated entity FMS, also controlled by Black, and thereafter purchased and traded the securities, misappropriated funds, sustained the losses, and then actively sought to conceal the losses. Black caused Devon's failure to comply with the applicable custody requirements, and is, therefore, liable under the Adviser's Act for Devon's violations. Black's conduct clearly constitutes aiding and abetting liability.

E. There is a Strong Likelihood that Defendants' Wrongdoing Will be Repeated

Among the factors courts consider in assessing the likelihood that defendants will repeat their wrongdoing are the character of the violation, the degree of scienter involved, whether a defendant has acknowledged the wrongfulness of his conduct and given sufficient assurances that it will not be repeated, and the degree to which a defendant's occupation or activities may present future opportunities to violate the law. See Unifund Sal Kemp v. Peterson, 940 F.2d at 113; SEC v. Savoy Industries, Inc., 587 F.2d at 1149, 1168 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979)

and SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 100-01 (2d Cir. 1978). In the present case, there is a high probability the defendants will continue to violate the federal securities laws unless restrained and enjoined. Devon has been overvaluing its portfolio since at least January 1996, and shows no sign of revaluing the underlying security. Black has in fact done quite the opposite, he has gone to great lengths to hide this valuation by divesting Devon of custody and creating false account statements. In light of the nature of Devon's advisory clients, local governmental units, primarily school districts, the public interest in stopping this fraud from continuing is great. By concealing the $50 million losses, Devon is able not only to retain existing advisory clients, but attract new advisory clients and hence additional capital to fund the fraud.

The facts indicate that injunctive relief is warranted in this case, and will best serve the public interest in preventing future violations. Given the history of Devon, it is highly likely that the defendants will continue to violate the securities laws unless enjoined.

II. AN ORDER FREEZING ASSETS IS NECESSARY AND APPROPRIATE

It is clear that the Commission may seek, and this Court in the exercise of its broad equitable powers may order, disgorgement and restitution of ill-gotten gains. SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978); SEC v. Shapiro, 494 F.2d 1301, 1309 (2d Cir. 1974); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1105-1106 (2d Cir. 1972). Pursuant to Section 20(d)(1) of the Securities

Act, Section 21(d)(3) of the Exchange Act and Section 209(e) of the Advisers Act, the Commission also may seek, and the Court may order, the payment by the defendants of civil money penalties for the violations described above. In order for this Court to preserve its power effectively to order disgorgement, restitution and the payment of money penalties, it may temporarily freeze assets "to assure a source to satisfy that part of the final judgment which might [ultimately] be ordered. . ." SEC v. General Refractories, Co., 400 F. Supp. 1248, 1259 (D.D.C. 1975); Accord, SEC v. Unifund Sal, 910 F.2d 1028 (2d Cir. 1990); SEC v. International Swiss Investments Corp., 895 F.2d 1272, 1276 (9th Cir. 1990); SEC v. Manor Nursing Centers, Inc., 458 F.2d at 1105-06.

It is well recognized that an order for disgorgement or other final monetary relief will often be rendered meaningless without an asset freeze during the pendency of the action. See, e.g., International Controls Corp. v. Vesco, 490 F.2d 1334, 1347 (2d Cir.), cert. denied, 417 U.S. 932 (1974); SEC v. Vaskevitch, 657 F. Supp. 312, 315 (S.D.N.Y.1987).[6]

The need for temporary relief assumes added importance in cases brought, as here, to protect the public interest. "[W]hen

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6 An order freezing assets may be imposed even in the absence of a preliminary injunction. See, SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 103 n.13 (2d Cir. 1978) (failure to show likelihood of recurrence required to justify an injunction does not relieve a defendant found to have violated the securities laws from the obligation to disgorge); SEC v. Scott, 565 F. Supp. 1513, 1536-38 (S.D.N.Y. 1983), aff'd, 734 F.2d 118 (2d Cir. 1984).

the public interest is involved in a proceeding of this nature, [a district court's] equitable powers assume an even broader and more flexible character than when only a private controversy is at stake." FSLIC v. Sahni, 868 F.2d 1096, 1097 (9th Cir. 1989), citing SEC v. Manor Nursing Centers, Inc., 458 F.2d at 1106.

There is a compelling need to freeze the assets of Devon, FMS and Black. As set forth in detail above, Black through Devon and FMS, engaged in a deliberate scheme designed to hide a trading loss of $50 million. Accordingly, the assets of the defendants should be frozen to ensure, to the extent possible, the payment of any disgorgement to the defrauded advisory clients, which include school districts, as well as money penalties which may ultimately be ordered.

III. REQUEST FOR AN ORDER APPOINTING A TRUSTEE TO, AMONG OTHER THINGS, CONDUCT AN ACCOUNTING

The Commission requests that the order appoint a trustee for Devon and FMS to, among other things, conduct an accounting of Devon and FMS, and provide an orderly and equitable distribution of assets. The trustee in this matter will serve to protect assets belonging to Devon's advisory clients until such time as all outstanding securities positions can be unwound and the Court can determine an appropriate plan for distribution. In light of the strong evidence of overvaluation of collateral and trading losses, it is essential for the Commission to verify the actual amount of monies invested with Devon. An accounting will also speed discovery and discourage defendants and their agents from secreting their assets during the pendency of the litigation in anticipation

of a final order requiring the disgorgement of profits and the payment of civil penalties. See, e.g., SEC v. International Swiss Investments Corp., 895 F.2d at 1274, 1276; FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1114 (9th Cir. 1982).

IV. REQUEST FOR AN ORDER FOR EXPEDITED DISCOVERY AND THE PRESERVATION OF DOCUMENTS

The Commission has filed this action expeditiously, in order to obtain the emergency relief discussed in this Memorandum. Prompt resolution of this action is critical to prevent further unlawful conduct and protect investors. In order to achieve a prompt resolution, the Commission requests that expedited discovery be permitted in the manner described in the Commission's proposed order.

Finally, to protect the documents necessary to create a complete record in this matter, the Commission seeks an order preventing alteration or destruction of documents. It is essential that documents be preserved in order to be able to make a full accounting. Good faith preservation of documents cannot be assumed in the context of a fraudulent scheme, particularly in light of the phenomenal amount of trading losses.

V. SERVICE OF PAPERS ON DEFENDANTS AND RELIEF DEFENDANT

The Commission asks this Court to authorize service upon defendants by facsimile transmission or express courier (e.g., Federal Express), addressed to their counsel or their last known business or residence addresses. This is a reliable form of service. Although the Commission will also make every effort to effect service by other means permitted under Federal Rule of Civil

Procedure 4, service by express courier or facsimile transmission will maximize the possibility that the defendants will receive prompt actual notice of all orders of this Court and the other papers filed in this action.

CONCLUSION

For the reasons set forth above, the Commission requests that the Court enter an order granting the emergency relief sought.

Respectfully submitted,

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