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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Hogan & Hartson,
Plaintiff - Appellant
v.
David M. Butowsky,
Defendant - Appellee

No. 77-7570

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION
IN OPPOSITION TO THE MOTION OF PLAINTIFF - APPELLANT
FOR A STAY PENDING APPEAL

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Preliminary Statement

On Wednesday, November 23, 1977, appellant Hogan & Hartson, a law partnership in Washington, D.C., moved this Court for a stay pending an application for a further stay pending an appeal. On that day, the Honorable Charles E. Stewart, United States District Judge, denied appellant's application for a temporary restraining order which had sought to prohibit the appellee, David M. Butowsky, Esquire, from filing in the District Court and from publicly distributing a "Report of Investigation of Special Counsel" ("Report" or "Special Counsel's Report"), which summarizes the four and one-half year investigation which the appellee has conducted as the court-appointed special counsel in the Commission's injunctive action, Securities and Exchange Commission v. Robert L. Vesco, et al., S.D.N.Y, 72 Civ. 5001 (CES) ("the Vesco case"). 1/

1/ As we point out, *infra*, the plaintiff's separate lawsuit in the district court is an impermissible collateral attack on an order entered

Included in that report, among other things, is a critical evaluation by the Special Counsel of the conduct of Hogan & Hartson as legal counsel to International Controls Corporation ("ICC"), one of the defendants in the Vesco case, as well as a recommendation that ICC pursue certain legal remedies which it may have against Hogan & Hartson. In addition to an injunction against filing and public distribution of the Report, appellant sought a declaratory judgment that the Report of the Special Counsel violated appellant's Fifth Amendment rights of due process and that said Report, as it relates to Hogan & Hartson, is unauthorized by the March 16, 1973 Final Judgment of Permanent Injunction and Appointment of Special Counsel and Directors entered in the Vesco case.

The Commission respectfully submits that this lawsuit is an eleventh hour attempt by appellant to divert and frustrate the energies of the Special Counsel in pursuing his task of reporting on and

1/ (footnote continued from page 1)

by Judge Stewart in Securities and Exchange Commission v. Robert L. Vesco, 72 Civ. 5001 (CES), in which the Commission is plaintiff. The defendant in Hogan & Hartson v. David M. Butowsky, 77 Civ. 5661, the separate action, is Special Counsel to International Controls Corp., a defendant in 72 Civ. 5001 (CES). Plaintiff Hogan & Hartson in 77 Civ. 5661 seeks to enjoin and restrain the doing of an act -- the filing of the Report -- which was specifically ordered by the District Court in 72 Civ. 5001.

Accordingly, the Commission possesses the requisite standing to oppose the motion for a stay of the filing of the report, as ordered in the action in which it is plaintiff. Should there be any doubt of its standing, the Commission respectfully requests leave of this Court to make this opposition and for any further proceedings.

prosecuting claims ICC may have against individuals and entities, including Hogan & Hartson. Further, by the institution of a separate action, appellant apparently intended the lawsuit to be conducted in a vacuum, without representation of the interests of defendants in 72 Civ. 5001 which will be directly affected by its outcome.

We are advised that counsel for Mr. Butowsky intends to file a complete response in opposition to Hogan & Hartson's request for a stay by this Court. The Commission submits this opposition as well. The Court is respectfully referred to the attached Affidavit of Gregory C. Glynn and the Exhibits thereto.

Statement of Facts

On November 27, 1972, the Commission, pursuant to its authority under the federal securities laws, brought a civil injunctive action against Robert L. Vesco and 41 other individuals and entities charging the defendants with a complex scheme of corporate looting and theft. One of the defendants was ICC, a corporation controlled by Vesco. On March 16, 1973, the District Court caused to be entered a Final Judgment, consented to by ICC and the Commission which, among other things, included provisions for the appointment by the Court of a Special Counsel to ICC and a new interim Board of Directors of ICC. David M. Butowsky, Esq., was appointed by the Court as Special Counsel.

According to the terms of the Final Judgment the Special Counsel is charged with the responsibility to "conduct a full investigation and arrange for and oversee an accounting into the financial and other affairs of International Controls, and report to...[the] Court and plaintiff Commission

his findings and recommendations for action." (§3(a) of Final Judgment) He is further directed to "take all appropriate action, including but not limited to, the institution and prosecution of suits on behalf of International Controls to recover all assets or monies improperly used, taken, wasted, misappropriated, dispensed, obligated or paid to anyone * * *." (§3(b) of Final Judgment) As embodied in the Final Judgment, it was the intention of the parties and the Court that the Special Counsel would prepare and file with the Court and the Commission a report of the findings of his investigatory efforts.

Since early 1973 when the Final Judgment was entered, ICC has been operated by a Court-appointed Board of Directors. At the same time, the Special Counsel has undertaken the considerable task of sorting out the Vesco scheme and compiling the materials, factual and documentary, in order that he may apprise ICC, the Court and the Commission of ICC's legal liabilities as a result of its involvement in the Vesco matter, as well as inform ICC, and prosecute on its behalf any claims which it may have against other individuals or entities. 2/ We are informed that the Report of the Special Counsel has been completed and is now ready for filing. With the information he has amassed, Special Counsel is now ready to undertake whatever appropriate legal proceedings he may be authorized to institute.

With the winding down of the Special Counsel's investigatory efforts and an emphasis on revitalizing ICC's corporate status, a group of

2/ Cf., International Controls Corp. v. Vesco, 490 F.2d 1334 (C.A. 2), certiorari denied, 417 U.S. 932 (1974) (Kaufman, J).

shareholders has urged the Court to permit an election to be held in order that the shareholders may elect a board of directors to replace the Court-appointed board and thereby return management to the shareholders or owners of the corporation. The Court approved a plan of election which, though originally scheduled for December, 1977, has been deferred until April, 1978. In an effort to expedite and insure the efficient administration of the election, Judge Arnold Bauman has been appointed a Special Master by the Court to supervise the election. The Special Master has, in turn, obtained a court order approving a plan for the conduct of the election which contains a carefully arranged schedule for the implementation of that election.

At the same time, various entities, including principally the IOS Dollar Funds, which have substantial claims against ICC have been negotiating with ICC with a view toward settlement of these claims. Settlement of these claims is contingent upon Court and Commission approval. Settlement is also conditioned upon the court-appointed liquidators of the entities being satisfied in their fiduciary capacities, on review of the Report of the Special Counsel, among other things, that the negotiated settlements are not unreasonable in light of the information contained in that Report. Under the current deadline, submissions of settlements are to be made to the Court by December 31, 1977. In any event, all matters relating to the settlements should be concluded by early February, 1978, in order to insure that the shareholders of ICC receive the necessary information with the documents and proxies that will be transmitted to them for the April, 1978 election.

On November 23, 1977, two days prior to the intended filing of the Report by Special Counsel, Hogan & Hartson, through its attorneys Lord, Day & Lord, filed this independent action in the district court 77 Civ. 5661 (CES) seeking to enjoin the Special Counsel from filing the Report. The Complaint alleges that certain portions in the Report which discuss appellant's conduct, portions which they claim are defamatory in nature, are violative of appellant's due process rights and are beyond the scope of the Court's authorization. In effect, Hogan & Hartson seek the prior restraint of the public, but not the private, dissemination of the Report. Appellant seeks such a remedy notwithstanding the fact that it has long been aware of the contents of the report and, other than asserting its general objection to said contents, it has not made any revisory comments, except as set forth in the Affidavits of John W. Castles, 3rd, and David M. Butowsky, Esq.

The district court rejected Hogan & Hartson's claims of irreparable injury, violation of constitutional rights and improper conduct by the Special Counsel. Accordingly, it denied appellant's motions for a temporary restraining order and for a stay.

This Memorandum is submitted by the Commission in order that it may protect its interests in the Vesco case as well as the interests of the public which will be affected adversely if the careful timetable which has been established by the court in the Vesco case is disturbed by any stay granted by this Court.

Argument

THE APPELLANT IS NOT ENTITLED TO A STAY BY THIS COURT.

Four factors are appropriate for this Court to consider in determining whether to grant the appellant's motion for a stay pending appeal:

- (1) Has the appellant made out a substantial case on the merits?
- (2) Has the appellant shown that without a stay it will be irreparably injured?
- (3) Would the issuance of a stay substantially harm other parties interested in the proceeding?
- (4) Where lies the public interest? 3/

3/ Virginia Petroleum Jobbers Association v. Federal Power Commission, 259 F.2d 921 (C.A. D.C., 1958); accord, Eastern Airlines, Inc. v. Civil Aeronautics Board, 261 F.2d 830 (C.A. 2, 1958).

The Court of Appeals for the District of Columbia Circuit, in Washington Metropolitan Area Transit Authority v. Holiday Tours, et al., No. 77-1379 (C.A.D.C., July 5 1977), recently refined the test originally articulated in Virginia Petroleum Jobbers Association, supra, to reduce the burden a movant for a stay must meet. The Court held that when the balance of the equities, as measured by the other three factors, weighs in favor of a stay, a party need not show that it will probably succeed on the merits but only that it "has made a substantial case on the merits." Slip Op. at 5. In reaching tht decision, the Court relied on two decisions of this Court, Hamilton Watch Co. v. Benrus Watch Co., 206 F.2d 738 (C.A. 2 1958) and Charlie's Girls, Inc. v. Revlon, Inc., 483 F.2d 953 (C.A. 2 1973).

A. The Appellant Has Not Made Out A Substantial Case On The Merits.

The thrust of this litigation is to attack collaterally an order which was properly entered in the Commission's injunctive action, Securities and Exchange Commission v. Vesco, supra, without applying to that Court and without providing notice or an opportunity to be heard by the several parties to that action. ^{4/} Appellant's attempt to circumvent these parties was essentially unsuccessful below, because the action was transferred to Judge Stewart, who is presiding on the Vesco case.

Procedural matters aside, appellant's complaint in the court below articulates two legal grounds which it believes undermines the propriety of the Special Counsel's investigation and report: (1) the procedure employed

^{4/} A consent decree has "the same force and effect as any other judgment, and is a final adjudication of the merits." Securities and Exchange Commission v. Thermodynamics, Inc., 319 F. Supp. 1380, 1382 (D.C. Colo., 1970), affirmed, 464 F.2d 457 (C.A. 10, 1972) certiorari denied, sub nom. Strawn v. Securities and Exchange Commission, 410 U.S. 927 (1973). Approval of the terms of a consent order is a "judicial act," Pope v. United States, 323 U. S. 1, 12 (1944), which "involves a determination by the chancellor that it is equitable and in the public interest." United States v. Radio Corporation of America, 46 F. Supp. 654, 655 (D. Del., 1974).

In the Vesco action, one of the terms of the consent decree provides that "the Court shall retain jurisdiction of this matter for the purpose of enforcing and amending this Final Judgment." If appellant believes it was maligned by an act arising out of the administration of the consent decree, it's remedy was to seek to intervene in the Vesco action and not to attack collaterally the order through the institution of a separate lawsuit. Black and White Children of the Pontiac School System v. School District of Pontiac, 464 F.2d, 1030 (C.A. 6, 1972), McAleer v. American Telephone and Telegraph Company, 416 Supp. 435, 438 (D.D.C., 1976). Accordingly, the viability of appellant's maintaining this lawsuit at all is questionable.

by the Special Counsel in the course of his investigation and compiling his report allegedly violated Hogan & Hartson's Fifth Amendment rights to procedural due process, and (2) the Report which the Special Counsel proposes to file is not authorized by the March 16, 1973 decree of the District Court and, in any event, the filing of such report with respect to Hogan & Hartson would serve no judicial purpose.

The District Court, in denying appellant's application for relief, found the constitutional claim to be without merit. We submit that the district court was correct in its analysis. Since the principles of due process are flexible ones, "appropriate to the nature of the case," Mullane v. Central Hanover Trust Company, 339 U.S. 306, 313 (1950) and "depend[ing] on the importance of the interests involved and the nature of the subsequent proceedings, [if any]," Boddie v. Connecticut, 401 U.S. 371, 378 (1971), it is necessary at the outset to ascertain both the nature and function of the Special Counsel's Report.

As we have noted previously, the Special Counsel was appointed by the Court pursuant to the terms of the consent decree and Final Judgment in the Commission's injunctive action. The consent decree embodied an agreement of the Commission, IOC and the District Court that the interests of all would be best served by the appointment of an independent counsel to investigate the circumstances of IOC's financial and other affairs; report upon his findings and recommendations for action; evaluate IOC's present legal liabilities; and prosecute those civil claims which IOC determined to pursue.

Thus, the Special Counsel's role is that of ICC's advisor-advocate. Although appointed by the Court, as Judge Stewart's November 23, 1977 Order denying a stay makes crystal clear, the Special Counsel's recommendations are not binding or adjudicative as an "official pronouncement" since he does not and cannot speak for the Court. His functions are purely investigative, advisory and fact-finding. He does not adjudicate and cannot take any action which itself will affect another's legal rights. We are advised that the Report itself will contain cautionary language advising the reader to this effect. Moreover, the fact that publication of his report may place appellant in an unfavorable light in terms of its reputation, without more, is insufficient to invoke the procedural protection of the Due Process Clause. Paul v. Davis, 424 U. S. 693, 701 (1976). 5/

The simple fact is that the Special Counsel's Report is to be used by ICC, the Commission, the Court and other interested parties as a tool to evaluate the position of the interest they represent. It provides a mechanism for marshalling and economizing the use of limited resources. In this context, it may provide an important basis for future action but it does not itself dictate what that action will be. And, because no adjudication or binding determination of anyone's legal rights

5/ Wisconsin v. Constantineau, 400 U.S. 433 (1971), relied on by appellant, gives no support. In Paul v. Davis, supra, 424 U.S. at 708, Constantineau was limited to providing relief only where, in addition to being defamed by a government official, "governmental action" also deprives an individual of a right. There is no such action here.

can be made, the full panoply of rights traditionally associated with judicial due process are not necessary. Hannah v. Larche, 363 U. S. 420, 422 (1960).

The Commission believes that in the instant case appellant's due process rights were sufficiently protected by the presence of its counsel at the interviews conducted by the Special Counsel and his staff. To take those rights a step further and require, as the appellants claim, that the Special Counsel should afford appellant the right to cross-examine all witnesses would convert every private investigatory effort into a judicial contest and thereby defeat the purpose of the endeavor. This is particularly unnecessary, where, as here, Hogan & Hartson will have its opportunity to exercise, and a court will protect, all its constitutional rights in any subsequent civil proceeding instituted against Hogan & Hartson on behalf of ICC.

Finally, appellant's allegation that the Special Counsel's Report is unauthorized by the Court's order is simply refuted by the language of the judgment itself which directs the Special Counsel to "report to this Court and plaintiff Commission his findings and recommendations for action."

B. Appellant Has Not Shown That Without A Stay It Will Be Irreparably Injured.

Appellant contends that the release of the Report by the Special Counsel will cause it irreparable injury in two ways: first, it will compromise appellant's constitutional rights to due process and, second, it will severely damage its professional reputation. In our view, neither of appellant's fears are well founded.

We have noted previously that appellant is not entitled to any formal due process considerations until the Special Counsel initiates a lawsuit naming Hogan & Hartson as a defendant. Yet, assuming arguendo that appellant has asserted a valid claim, "[s]ince it is impossible to predict what future use may be made of this evidence, an injunction against all use at this time is premature and improper." Midwest Growers Cooperative Corp. v. Kirkimo, 533 F.2d 455, 466 (C.A. 9, 1976). The appellant will have a full opportunity to raise whatever defenses it has, cross-examine witnesses and have its "day in court" in any action instituted against it.

Appellant's other concern that certain unfavorable publicity will irreparably damage its professional reputation, is not well-taken either.

Firstly, we have previously noted that, contrary to Hogan & Hartson's allegations, the Report of the Special Counsel is not an "official pronouncement" of professional misfeasance, and that there will be a cautionary legend explaining the non-adjudicatory nature of the report and the fact that persons who may appear to be responsible for improper conduct have not had an opportunity to cross-examine witnesses who supplied information.

In short, the Report itself will point out that it is not conclusive. Moreover, by instituting this action, and detailing in the complaint several of the charges of wrongdoing contained in the Special Counsel's Report, appellant has itself effectively made a public disclosure of the information it seeks now to restrain. For example, we can conceive

of any further irreparable injury which may now befall Hogan & Hartson than that which they have voluntarily brought upon themselves through the institution of this lawsuit.

C. The Issuance Of A Stay Would Substantially Harm Other Parties Interested In The Proceeding.

Despite appellant's effort to bring this lawsuit as a separate action, it cannot be denied that its impact will not be upon Special Counsel Butowsky, the strawman defendant below, but upon those parties interested in the Vesco litigation, including the public shareholders of ICC.

The District Court was troubled by the requested disruption which would come to bear upon the carefully calculated timetable for settlement of outstanding claims against ICC and the return of control of the corporate management to the shareholders. These interests must be juxtaposed next to Hogan & Hartson's deliberate course of conduct which elicited from the Special Counsel, over the course of several months, information at his disposal which might be unfavorable to it, and then, at the very last minute, instituted this action. In light of these circumstances, Judge Stewart correctly concluded that "the harm resulting to ICC, its stockholders, the IOS entities and their stockholders and to the SEC in its obligations to the public if the injunctive relief sought is granted far outweigh any possible harm to plaintiff [appellant] if the relief sought is not granted." (Memorandum Decision, November 23, 1977, p. 8). The balance also comes out the same way in this Court.

D. The Public Interest Counsels Against The Issuance Of A Stay.

The Commission as plaintiff in the Vesco case opposes any request by Hogan & Hartson for a stay. Any delay in the filing of the Special Counsel's Report will work a substantial hardship on the time table for the ICC shareholders' meeting. Prior to executing proxies for this election, the shareholders of ICC should read and consider the long waited "history of ICC under Robert L. Vesco" which is the Special Counsel's Report. Also, there has been ongoing long, difficult and delicate negotiations between ICC and the IOS Dollar Funds regarding settlement of claims of the IOS Dollar Funds against ICC. Substantial sums of money are involved. The representatives of the IOS Dollar Funds, court-appointed liquidators from various jurisdictions, must in their fiduciary capacities, carefully study and analyze the Special Counsel's Report before deciding whether or not to settle their claims and, if so, for what sums of money. Lastly, the investing public has a right to know what happened to ICC and to the IOS Dollar Funds during the Vesco years. The plaintiff here, Hogan & Hartson, seeks a prior restraint on publication of the Special Counsel's Report. Such prior restraint, sought by Hogan & Hartson in the eleventh hour prior to filing of the Report ought not to be granted or condoned by this Honorable Court.

Conclusion

For the foregoing reasons, appellant's motion for a stay should be denied.

Respectfully submitted,

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