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UNITED STATES DISTRICT COURT
FOR THE
SOUTHERN DISTRICT OF NEW YORK

JOEL HARNETT, et al., Plaintiffs, v. SECURITIES AND EXCHANGE COMMISSION, et al., Defendants.	77 Civ. 3110 (VLB)

RESPONSE OF THE DEFENDANT SECURITIES AND EXCHANGE COMMISSION TO THE ORDER TO SHOW CAUSE ENTERED BY THE COURT ON JULY 22, 1977

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On July 22, 1977, this Court entered an order directing the Securities and Exchange Commission, a defendant herein, to show cause why an order should not be entered directing that "the report of the Securities and Exchange Commission, including but not limited to the report of the New York Regional Office of the Securities and Exchange Commission," be produced and delivered to the Court for in camera inspection to enable the Court to determine whether the report or any part thereof should be released pursuant to the Freedom of Information Act ("FOIA"), 5 U.S.C. 552. The Commission was further ordered to bring to the Court on the return date of the order "the complete Securities and Exchange Commission report relating to the sale of municipal bonds and securities of the City of New York and the finances of the City of New York and all of the transactions relating thereto * * *."

The Commission responds herein to that part of the Court's order directing the Commission to show cause why Commission records should not be released pursuant to the FOIA. In a separate motion, filed this day, the Commission has moved for an order of the Court (1) striking that portion of the Court's show-cause order which directed the Commission to bring to Court a completed report of the investigation; and (2) setting for hearing, at the same time as the hearing on the show cause order, the Commission's motion to dismiss this action, filed with the Court on

July 22, 1977. As we have observed, we believe that the Commission's motion to dismiss the complaint should provide the basis for a complete disposition of this case. In the event, however, that the Court should proceed, as suggested in its show-cause order, to consider whether any Commission records should be released pursuant to the FOIA, the Commission respectfully brings the following points to the Court's attention.

1. Proceeding by Way of an Order to Show Cause is Inappropriate in the Circumstances of this Case.

The Freedom of Information Act provides that the defendant is permitted to "answer or otherwise plead" within 30 days after service of the complaint. 5 U.S.C. 552(a)(4)(C). Pursuant to this statutory provision, the Commission has filed a motion to dismiss the complaint herein. Orderly procedure requires that the pending motion to dismiss be considered first. If that motion is denied, in whole or in part, the Commission will then be required by the Rules of Civil Procedure to answer the complaint within ten days after notice of the Court's action. At that time, a consideration of the merits of the case, if any, would be appropriate.

By bringing on this matter by way of an order to show cause, in the absence of any justification therefor, the plaintiffs are attempting to deprive the defendants of their statutory right to have this matter decided in a fair and orderly manner. Government entities, however, no less than private citizens, are entitled to proceed in an orderly manner in conducting the defense of litigation. See, e.g., Martin v. Neushall, 396 F.2d 759 (C.A. 3, 1968). An order to show cause is not a satisfactory substitute for a trial on the merits; by choosing to proceed in this manner, the plaintiffs are acting in derogation of the right of the defendants to respond to the complaint in due course and to assist the Court in arriving at an informed determination on the merits.

Accordingly, the Commission respectfully requests that the Court vacate its order to show cause entered on July 22, 1977.

2. In any Event, Draft Material Relating to the New York City Investigation is Exempt From Compelled Production Under the Freedom of Information Act.

Should the Court wish to consider the merits of the plaintiffs' action at this time, it is in any event abundantly clear that they have no right to compel the Commission to produce draft material, or any material, relating to the Commission's ongoing investigation of New York City. As we have indicated, there is no "report" on the Commission's investigation. Bits and pieces of preliminary drafts of a "report" are in existence, and the staff is working diligently to complete its efforts. But, such draft materials as do exist are exempt by virtue of the FOIA exemptions for inter- and intra-agency memoranda, 5 U.S.C. 552(b)(5), and for investigatory records the disclosure of which would interfere with actual or potential law enforcement proceedings, 5 U.S.C. 552(b)(7)(A).

a. Exemption 5--Internal Memoranda

In enacting the Freedom of Information Act, Congress included an exemptive provision for inter-agency or intra-agency memoranda which is designed to meet the problems which would be created if internal communication within an agency were needlessly inhibited. 5 U.S.C. 552(b)(5). The legislative history of Exemption 5 demonstrates that Congress intended to incorporate generally the recognized rule that "confidential intra-agency advisory opinions * * * are privileged from inspection." Kaiser Aluminum & Chemical Corp. v. United States, 141 Ct. Cl. 38, 39, 157 F. Supp. 939, 946 (1958) (Reed, J.). As Mr. Justice Reed there stated:

> "There is a public policy in this claim of privilege for this advisory opinion—the policy of open, frank discussion between subordinate and chief concerning administrative action." Id. at 48, 157 F. Supp. at 946.

The importance of this underlying policy was echoed again and again during legislative analysis and discussions of Exemption 5. The House Report explains the exemption as follows:

> "Agency witnesses argued that a full and frank exchange of opinions would be impossible if all internal communications were made public. They contended,

> and with merit, that advice from staff assistants and the exchange of ideas among agency personnel would not be completely frank if they were forced to 'operate in a fish bowl.'" 1/

As the President further observed on signing the FOIA into law, "Officials within Government must be able to communicate with one another fully and frankly without publicity." 2/

As many courts, including the Supreme Court, have held, predecisional memoranda prepared in order to assist an agency decision maker in arriving at his decision are exempt from disclosure under the FOIA. Renegotiation Board v. Grumman Aircraft Engineering Corp., 421 U.S. 168 (1975); National Labor Relations Board v. Sears, Roebuck & Co., 421 U.S. 132 (1975). Even in its eventual final form, the purpose of a report of the Commission's New York Regional Office to the Commission will be to assist the Commission in determining what, if any, response to make to the facts uncovered during the New York City investigation. In its present condition, the draft material that ultimately might, after appropriate modification, comprise parts of a final report, relate not only to recommendations that might eventually be made to the Commission, but to recommendations made, and expressions of views and opinions exchanged, among members of the staff of the New York Regional Office with respect to what form the report to the Commission should ultimately take. Such "deliberative materials" have always been held to be exempt from compelled disclosure. 3/

1/ H.R. Rep. No. 1497, 89th Cong., 2nd Sess. 10 (1966). See also, S. Rep. No. 813, 89th Cong., 1st Sess. 9 (1965).

2/ Statement by President Johnson upon signing Pub. L. 84-487 on July 4, 1966, reprinted in Attorney General's Memorandum on the Public Information Section of the Administrative Procedure Act (June 1967), p. ii (emphasis added).

3/ See, e.g., Aspin v. Department of Defense, 348 F. Supp. 1081, 1082 (D. D.C., 1972), affirmed, 491 F.2d 24 (C.A. D.C., 1973); International Paper Co. v. Federal Power Commission, 438 F.2d 1348, 1358-1359 (C.A. 2, 1971); Wu v. National Endowment for Humanity, 460 F.2d 1030, 1034 (C.A. 5, 1972); Ditlow v. Volpe, 362 F. Supp. 1321, 1327 (D. D.C., 1973), reversed on other grounds sub nom. Ditlow v. Brinegar, 494 F.2d 1073 (C.A. D.C.), certiorari denied, 419 U.S. 974 (1974).

(footnote continued)

Although it is to be expected that the final report to the Commission, as well as the material now at various stages of preparation, will contain summaries of the evidence uncovered during the Commission's investigation, such materials are protected by Exemption 5, as well as the actual recommendations, expressions of opinions and similar matters. In Montrose Chemical Corp. v. Train, 491 F.2d 63 (C.A. D.C., 1974), the court held that a summary of evidence presented at public hearings was protected from disclosure by Exemption 5, since the summary had been prepared by staff members of the Environmental Protection Agency to assist the administrator of the agency in deciding whether to ban DDT. The court stated that the purpose of Exemption 5 was "to protect not simply deliberative material, but also the deliberative process of agencies," and that "[t]o probe the summaries of record evidence would be the same as probing the decision-making process itself." 491 F.2d at 68, 71. Just as was the case in Montrose, the "evaluation and selection of certain facts" by the staff of the Securities and Exchange Commission should not be disclosed in this case. Id. at 70. That is, however, what would necessarily occur as a result of any public disclosure of any portion of the draft material here in issue.

b. Exemption 7(A)--Investigatory Records

The records here in issue are also exempt from disclosure pursuant to the FOIA because they are investigatory records the disclosure of which

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3/ (continued)

In issue in Safeway Stores, Inc. v. Federal Trade Commission, 428 F. Supp. 346, 347 (D. D.C., 1977), a recent action arising under the FOIA, was a "170-page staff report culminating a non-public investigation of the retail food store industry," which had been "transmitted to the Commission and rejected." The agency's claim that the report was exempt pursuant to Exemption 5 was upheld, the court holding that an in camera inspection of the documents in question was unnecessary, since it was clear that the report was "involved in a predecisional deliberative process." Since reports to an agency by its staff are exempt from disclosure even after consideration of the completed report by the agency, a fortiori the draft material here in issue is similarly protected against such disclosure.

would interfere with a Commission investigatory proceeding. 5 U.S.C. 552(b)(7)(A). It is indeed difficult to conceive of any greater "interference" that could result from the disclosure of investigatory records than the interference that would be visited upon the Commission's investigation, if disclosure of the records in issue were to be required at this most critical time. At this stage, the primary work being conducted by the staff of the Commission involves the weighing and evaluation of the evidence collected during a lengthy investigation. Eventually, the Commission will have to consider the report of the New York Regional Office in order to determine what, if any, further action would appear to be required in the public interest and in the interest of investors in securities issued by the City of New York. To disrupt this sensitive process through the premature public release of any records relating to this investigation, even prior to the time that those records have been received and considered by the Commission itself, could only be viewed as an utterly irresponsible act.

As stated by the court in New England Medical Center Hospital v. National Labor Relations Board, 548 F.2d 377, 383 (C.A. 1, 1976):

> "Exemption 7(A) applies whenever disclosure would 'interfere' with an enforcement proceeding, and it is difficult to conceive of a greater interference than one which would involve the court in arbitrating the [agency's] control of what documents to retain and what documents to surrender immediately prior to an enforcement proceeding." 4/

4/ Significantly, the court in New England Medical Center, in reaching its conclusion that the records in question were exempt pursuant to Exemption 7(A), held that an in camera inspection of those records was unnecessary. The court noted in this regard that

> "the FOIA is sufficiently flexible to accomodate the agency's interest in swift and effective enforcement proceedings by allowing it to withhold certain information temporarily without close judicial oversight."

548 F.2d at 385. The court's observation that in camera inspection is unnecessary when the records sought relate to an active investigation or enforcement proceeding is consistent with the Supreme

(footnote continued)

Accord, Title Guarantee Co. v. National Labor Relations Board, 534 F.2d 484 (C.A. 2), certiorari denied, 429 U.S. 834 (1976); Roger J. Au & Son, Inc. v. National Labor Relations Board, 538 F.2d 80 (C.A. 3, 1976); Goodfriend Western Corp. v. Fuchs, 535 F.2d 145 (C.A. 1), certiorari denied, 429 U.S. 895 (1976); Climax Molybdenum Co. v. National Labor Relations Board, 539 F.2d 63 (C.A. 10, 1976).

Although Exemption 7 was amended in 1974 in order to provide access to some records contained in investigatory files where no enforcement action was likely to result, the 1974 Amendments have no effect on the records here in issue. As the Court recognized in New England Medical Center, supra, 548 F.2d at 382,

> "there is solid evidence in the legislative history that the sponsors of the 1974 Amendments acknowledged the right of an investigatory agency to avoid the possible harm to a prospective law enforcement proceeding that might occur through 'premature release of evidence or information not in the possession of known or potential defendants.' 120 Cong. Rec. 17033 (remarks of Senator Hart)."

Accordingly, the court concluded that forcing the premature release of active investigatory records "would come within this recognized category of interference" by "threaten[ing] the agency's ability to prosecute cases with dispatch." 5/

4/ (continued)

Court's observation in Environmental Protection Agency v. Mink, 410 U.S. 73, 91-92 (1972), that a "flexible, common-sense approach" to the FOIA should be adopted, an approach that is not "unnecessarily rigid." The Court went on to indicate, in the context of an Exemption 5 issue, that affidavits or even "surrounding circumstances" could show that certain documents met the requisite criteria for exemption. Here, we submit that "surrounding circumstances" and the affidavit of William D. Moran more than adequately demonstrate that the records sought by the plaintiffs are exempt. In camera inspection is not required, and should not be unnecessarily imposed on the Commission.

5/ Accord, Title Guarantee, supra, 534 F.2d at 491, where the court identified as a source of interference stemming from premature disclosure of investigatory records the opportunity that would be afforded suspected violators to "frustrate the proceedings or construct defenses which would permit violations to go unremedied."

CONCLUSION

For the foregoing reasons, the Court should vacate its Order to Show Cause entered on July 22, 1977. The Court should initially consider the Commission's pending motion to dismiss, and should, for the reasons stated in the memorandum filed in support thereof, dismiss this action. If the Court does, nevertheless, proceed to consider the merits of the plaintiffs' claims under the FOIA to access to the draft materials in issue, the Court should find that the documents requested by the plaintiffs herein are exempt from compelled disclosure pursuant to Exemptions 5 and 7(A) of the Freedom of Information Act. This action should be dismissed, with costs and reasonable attorney's fees awarded to the Commission.

Respectfully submitted,

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