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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)

SUPPLEMENTAL RESPONSE OF THE DEFENDANT SECURITIES AND EXCHANGE COMMISSION TO THE ORDER TO SHOW CAUSE ENTERED BY THE COURT ON JULY 22, 1977, AND IN SUPPORT OF ITS MOTION TO DISMISS

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Preliminary Statement

On July 22, 1977, this Court entered an order, pursuant to a motion by the plaintiffs on July 21, 1977, directing the defendant Securities and Exchange Commission (the "Commission") 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 that report or any part thereof should be released pursuant to the Freedom of Information Act (the "FOIA"), 5 U.S.C. 552.

On July 26, 1977, at 10:00 a.m., the Court heard arguments of the parties on the order to show cause, as well as on the Commission's motion to dismiss for failure to pursue their administrative remedy. The Court then directed the parties to file supplemental papers by Thursday, July 28, 1977, and any papers responding thereto by Friday, July 29, 1977. Pursuant to the Court's direction, this memorandum is submitted to supplement the Commission's previous response to the Court's order to show cause, as well as the Commission's motion to dismiss.

Although this memorandum is submitted primarily to supplement the Commission's previous discussion of Exemptions 5 and 7(A) of the FOIA as they relate to the draft materials in question, the Commission wishes to reiterate, at the outset, the prematurity and inappropriateness of this action. The plaintiffs instituted this action solely under the FOIA (Complaint ¶5), and proceeded by way of an extraordinary motion to show cause without first affording the defendants an opportunity to file a responsive pleading to the complaint—all without having bothered to present a request under the FOIA to the Commission. Accordingly, as we have previously discussed in the memorandum in support of the Commission's motion to dismiss, this action should be dismissed because the plaintiffs have failed either to pursue or exhaust their administrative remedies.

The Commission further urges that if the Court should permit this suit to proceed at all, the subject matter of the suit should be limited to the portions of the draft report which are in existence at the present time. Even if the plaintiff Marshall's exchange of letters with the Commission's General Counsel (set forth in the complaint) could be construed as a request under the FOIA--and the Commission does not believe it fairly can be so read—the only record sought in those letters was a completed report of investigation. Accordingly, plaintiffs cannot broaden Mr. Marshall's request at the litigation stage by seeking access, as requested in the complaint, to all investigatory records relating to the matter of the New York City investigation.

Discussion

I. THE DRAFT PORTIONS OF THE REPORT OF INVESTIGATION OF THE STAFF OF THE COMMISSION ARE EXEMPT FROM PRODUCTION UNDER THE FOIA.

Draft material relating to the Commission's City of New York investigation is exempt from compelled production under the FOIA. As we have previously noted, the staff of the Commission is diligently working on a report, to be forwarded to the Commission's headquarters 1/ but at this time, there exist only draft pieces of such a report in various stages of completion. This material is exempt from compelled disclosure under the FOIA exemptions for inter- and intra-agency memoranda and for investigatory records the disclosure of which would interfere with actual or potential law enforcement proceedings. 5 U.S.C. 552(b)(5) and (7)(A).

A. The Draft Portions of the Report of Investigation are Exempt Since They are "Investigatory Records Compiled for Law Enforcement Purposes," Disclosure of Which Would "Interfere with Enforcement Proceedings." 5 U.S.C. 552(b)(7)(A).

The FOIA reflects a deliberate attempt to effect broad disclosure of records relating to governmental activity, but without impairment of necessary governmental functions, including the law enforcement function. The seventh exemption of the FOIA excludes from that Act's coverage "investigatory records compiled for law enforcement purposes," and production of such records cannot be compelled under the FOIA to the extent that such disclosure is likely, *inter alia*, to "interfere with enforcement proceedings * * *." 5 U.S.C. 552(b)(7)(A). There is thus a significant difference under the FOIA between the status of investigatory records *after* law enforcement action has been concluded, and the status of such records when, as here, the investigation in which such records were compiled is still pending, and when, therefore, the Commission has yet to determine whether, and against whom, to institute law enforcement proceedings of any type.

1/ *See* affidavits of William D. Moran, dated July 22 and 28, 1977, and filed herein.

The legislative history of the FOIA, when originally enacted, emphasized the risk of an adverse effect upon prospective adjudicatory proceedings as the principal reason for the seventh exemption. The Senate Report explained that the disclosure of such files, "prepared by Government agencies to prosecute law violators," "* * * could harm the Government's case in court." 2/ Based on this history, while there never was any question that "active" enforcement files were exempt, some courts had expressed the view that disclosure was required after litigation was concluded and there was no prospect of further enforcement action. See, e.g., Bristol-Meyers Co. v. Federal Trade Commission, 424 F.2d 935 (C.A. D.C.), certiorari denied, 400 U.S. 824 (1970). After the Court of Appeals for the District of Columbia Circuit in Weisberg v. United States Department of Justice, 489 F.2d 1195 (C.A. D.C., 1973) (en banc), certiorari denied, 416 U.S. 993 (1974), overruled the view it had earlier articulated in Bristol-Meyers, and held that the exemption applied indefinitely to investigatory files as a whole, the Congress amended the exemption to its present form. See Pub. L. 93-502, 88 Stat. 1561 (Nov. 21, 1974). But, the legislative amendment, and its history, only serves to emphasize the necessity of protecting records relating to ongoing investigations from premature, compelled disclosure prior to the completion of enforcement activities.

The amendment was not intended to introduce an era of "open" investigations in which, prior to the completion of enforcement proceedings, the public (as well as persons suspected of having violated the law) 3/

2/ S. Rep. No. 813, 89th Cong., 1st Sess. p. 9 (1965); see also H.R. Rep. No. 1497, 89th Cong., 2d Sess. p. 11 (1966).

The Senate Report also noted that it is "necessary for the very operation of our Government to allow it to keep confidential certain material, such as the investigatory files of the Federal Bureau of Investigation." S. Rep. No. 813 at p. 3.

3/ Plaintiffs herein are, of course, not the subject of the Commission's investigation in the matter of the City of New York. But, the FOIA does not distinguish between categories of requestors;

would have the right to know the nature and extent of the information which enforcement authorities have obtained in the course of an investigation. The legislative history demonstrates that the purpose of the drafters of the amendment to the seventh exemption was to reassert, as one of the concepts underlying the original enactment of that exemption, that investigatory records need not be disclosed where to do so might interfere with the government's enforcement proceedings through the premature release of evidence. 4/ In introducing the amendment on the Senate floor, Senator Hart made his purpose clear:

> "My reading of the legislative history suggests that Congress intended that this seventh exemption was to prevent harm to the Government's case in court _by not allowing an opposing litigant earlier or greater access to investigative files than he would otherwise have_.
>
> "Recently, the courts have interpreted the seventh exemption to the Freedom of Information Act to be

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3/ (continued)

thus, if the records were required to be made available at this time to the requestors, they would have to be made available to "any person" seeking access to them under the Act. 5 U.S.C. 552(a)(3). The "interference" that would result from disclosure to the subjects of potential law enforcement actions is too plain to require elaboration.

Moreover, the plaintiffs themselves have indicated that wide public dissemination of any information they receive as a result of this action can be expected. As indicated _infra_, the premature publicity that would be engendered for the Commission's investigation would result in other forms of interference for the Commission's future law enforcement efforts.

4/ The amendment to the seventh exemption was introduced by Senator Hart during the floor debate in the Senate on May 30, 1974. Neither the bill initially passed by the House (H.R. 12471) nor the bill considered and reported on by the Senate Committee on the Judiciary (S. 2543) would have amended this exemption. Accordingly, the legislative history of the amendment consists of the Senate floor debate on S. 2543 and H.R. 12471, 120 Cong. Rec. S9310-S9342 (May 30, 1974), the Conference Report, H.R. Rep. No. 93-1380, 93rd Cong., 2d Sess. (1974), the Senate and House debate thereon, 120 Cong. Rec. S17828-S17830 and S17971-S17972 (October 1, 1974), H10001-H10009 (October 7, 1974), and the Senate and House debate on the President's veto, 120 Cong. Rec. H10705-H10706 (November 18, 1974), H10864-H10875 (November 20, 1974) and S19806-S19823 (November 12, 1974).

> applied whenever an agency can show that the document sought is an investigatory file compiled for law enforcement purposes—a stone wall at that point. The court would have the exemption applied without the need of the agency to show why the disclosure of the particular document should not be made.
>
> "That, we suggest, is not consistent with the intent of Congress when it passed this basic act in 1966."

120 Cong. Rec. S9329-9330 (emphasis added). Senator Hart continued, making it clear that the status of active investigatory matters was not to be affected by the amendments to Exemption 7:

> "Then as now, we recognized the need for law enforcement agencies to be able to keep their records and files confidential where a disclosure would interfere with any one of a number of specific interests, each of which is set forth in the amendment that a number of us are offering.
>
> * * *
>
> "Let me clarify the instances in which nondisclosure would obtain: First, where the production of a record would interfere with enforcement procedures. This would apply whenever the Government's case in court—a concrete prospective law enforcement proceeding—would be harmed by the premature release of evidence or information not in the possession of known or potential defendants. This would apply also where the agency could show that disclosure of the information would substantially harm such proceedings by impeding any necessary investigation before the proceeding." 5/

In light of the foregoing, it seems clear that, in amending the seventh exemption, Congress specifically meant to overrule the decisions holding that records properly classified as "investigatory" are exempt forever, but to continue to protect *bona fide* investigatory records from disclosure under the FOIA until the completion of law enforcement proceedings (except to the extent they might otherwise be available through discovery

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5/ 120 Cong. Rec. S9329-9330 (emphasis added). This legislative history thus refutes the plaintiffs' contention, at oral argument, that Exemption 7(A) is not available because the Commission does not presently have any law enforcement proceeding pending. The exemption, as common sense requires, was intended to protect as well the investigation that precedes the institution of formal enforcement proceedings.

procedures). This purpose was recently recognized by the Court of Appeals in New England Medical Center Hospital v. National Labor Relations Board, 548 F.2d 377, 382 (C.A. 1, 1976), which stated:

> "There is solid evidence in the legislative history that the sponsors of the 1974 Amendments acknowledged the right of an investigative 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 Sen. 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." The Court of Appeals for this Circuit had previously agreed with this view in Title Guarantee Co. v. National Labor Relations Board, 534 F.2d 484, 491 (C.A. 2), certiorari denied, 429 U.S. 834 (1976). There the court agreed with the NLRB that a source of interference stemming from premature disclosure of investigatory records would be the opportunity that would thereby be afforded suspected violators to "frustrate the proceedings or construct defenses which would permit violations to go unremedied."

In a statement of the law directly applicable to the circumstances of this case, the court in New England Medical Center, supra, 548 F.2d at 383, held:

> "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 courts in arbitrating the [agency's] control of what documents to retain and what documents to surrender immediately prior to an enforcement proceeding." 6/

6/ Accord, Title Guarantee Co. v. National Labor Relations Board, supra, 534 F.2d 484; 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 Molybedenum Co. v. National Labor Relations Board, 539 F.2d 63 (C.A. 10, 1976).

As we noted in our initial response to the Court's order to show cause, 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. Affidavit of William D. Moran (July 28, 1977) ¶ 4. Eventually, the Commission will have to consider the report of the staff 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. As the annexed affidavit of the Commission's Regional Administration makes clear, the premature release of the report would not only detract from the Commission's ability to finish the report on a timely basis, it could affect the quality of the report as well. Premature disclosure could also prejudice the Commission's ability to prosecute successfully any law enforcement proceeding that might result by prematurely revealing the evidence in the Commission's possession; at a minimum, such disclosure would needlessly complicate and prolong any such proceeding by injecting issues relating to the possible infringement of the rights of those ultimately named in such proceedings. To disrupt the sensitive process now going on by 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 prejudice the Commission's obligation to complete its law enforcement efforts.

B. The Draft Portions of the Report of Investigation are Part of an Internal Memorandum which is Exempt From Disclosure Under the FOIA, 5 U.S.C. 552(b)(5).

We submit that Exemption 7 provides a complete exemption for all of the material in the Commission's investigatory file, and no further exemption in the FOIA is necessary. But, in fact, Exemption 5 is also applicable here. A report of investigation is an intra-agency memorandum which qualifies for the protections afforded such records by Exemption 5. Kent Corp. v. National Labor Relations Board, 530 F.2d 612 (C.A. 5, 1976); Safeway Stores, Inc. v. Federal Trade Commission, 428 F. Supp. 346 (D. D.C., 1977). In this regard, it is important to distinguish raw investigative materials from a report of investigation: the former is the evidence collected in the course of the Commission's investigation—the "facts;" the latter is the staff's selection, compilation, analysis, distillation and discussion of the relevant facts, those facts that tend to show the presence or absence of violations of the federal securities laws. The disclosure of a report of investigation would necessarily disclose the reasoning process and rationale of the authors of the report and, for this reason, such reports have been held to be exempt under Exemption 5 in their entirety. 7/

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, applicable in a discovery

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7/ See, e.g., Renegotiation Board v. Grumman Aircraft Engineering Corp., 421 U.S. 168 (1975); Kent Corp. v. National Labor Relations Board, 530 F.2d 612 (C.A. 5, 1976); Brockway v. Department of the Air Force, 518 F.2d 1184 (C.A. 8, 1975); Montrose Chemical Corp. v. Train, 491 F.2d 63 (C.A. D.C., 1974); Safeway Stores, Inc. v. Federal Trade Commission, 428 F. Supp. 346, 347 (D. D.C., 1977);

context, 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.). 8/ As Mr. Justice Reed there stated:

> "There is a public policy involved 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

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8/ Exemption 5 specifically refers to the civil discovery context, since it applies to memoranda "which would not be available by law to a party * * * in litigation with the agency." 5 U.S.C. 552(b)(5). The House Report on the FOIA says that Exemption 5 was intended to require disclosure only of those intra-agency memoranda which would "routinely be disclosed" in private litigation. H.R. Rep. No. 1497, 89th Cong., 2d Sess. 10 (1966). The Supreme Court, in the two major cases construing Exemption 5, has recognized that "Exemption 5 incorporates the privileges which the Government enjoys under the relevant statutory and case law in the pre-trial discovery context." Renegotiation Board v. Grumman Aircraft Engineering Corp., 421 U.S. 168, 184 (1975). Accord, National Labor Relations Board v. Sears, Roebuck & Co., 421 U.S. 132 (1975). Thus, such privileges as the attorney-client and work product privileges are encompassed by Exemption 5. See Hickman v. Taylor, 329 U.S. 495 (1957).

The Supreme Court has also held that that the relevant criterion is whether the document in question would be available through the civil discovery process, rather than in a criminal discovery context, where "the private party's claim is most compelling." National Labor Relations Board v. Sears, Roebuck & Co., supra, 421 U.S. at 149 n.16. In this connection, it is clear that, if the Commission instituted a civil injunctive action as a result of its investigation, the report of investigation would not be available through civil discovery, even to the defendant himself. Securities and Exchange Commission v. National Student Marketing Corp., 68 F.R.D. 157 (D. D.C., 1975); Sterling Drug, Inc. v. Federal Trade Commission, 450 F.2d 698 (C.A. D.C., 1971); International Paper Co. v.

(footnote continued)

> the exchange of ideas among agency personnel would not be completely frank if they were forced to 'operate in a fish bowl.'" 9/

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." 10/

8/ (continued)

Federal Power Commission, 438 F.2d 1349 (C.A. 2, 1971). In Securities and Exchange Commission v. Aldred Investment Trust, 224 F. Supp. 626, 627 (S.D. N.Y., 1963), Judge Weinfeld, in refusing to allow certain discovery to the defendants, stated:

> "Neither does the Court agree that the defendants 'are entitled to examine the material which was submitted to the Commission on the basis of which it authorized the institution of this action' * * *. Whether there is a need to institute an action is a matter for the Commission to decide * * *."

If the defendants in any action which the Commission may institute as a result of the New York City investigation could not obtain the report to the Commission, a fortiori, the report is not available to the plaintiffs herein, who cannot make out a need for, or right to, access greater than any other member of the public.

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

10/ Statement by President Johnson upon signing Pub L. 89-487 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).

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). In Grumman, the Supreme Court held that reports prepared by the regional boards and divisions of the Renegotiation Board, to be presented to the Board for a final decision as to whether certain government contracts provide for excess profits for contractors, and which contained detailed factual portions summarizing and analyzing information compiled in the course of the staff's inquiry, were just the sort of "predecisional memoranda prepared in order to assist an agency decision-maker in arriving at his decision" contemplated by the fifth exemption of the FOIA. Id. at 184. The Court reached this conclusion with respect to those reports

> "[b]ecause only the full Board has the power to make the decision whether excess profits exist; because both types of reports involved in this case are prepared prior to that decision and are used by the Board in its deliberations; and because the evidence utterly fails to support the conclusion that reasoning in the reports is adopted by the Board as *its* reasoning, even when it agrees with the conclusion of a report * * *." Id. (emphasis in original).

Similarly, the draft materials in question here are predecisional memoranda which may ultimately comprise part of the staff's report. The Commission will then determine, based upon the facts, analyses and recommendations presented to it, whether, and with respect to what parties, it is appropriate to pursue the various types of remedial relief provided for violations of the federal securities laws, as well as whether additional legislation or rules may be necessary. These draft materials, as well as the final staff report,

> "are thus precisely the kind of predecisional deliberative advice and recommendations contemplated by Exemption 5 which must remain uninhibited

> and thus undisclosed, in order to supply maximum assistance to the [agency] in reaching its decision." Id. at 186.

In Montrose Chemical Corp. v. Train, supra, 491 F.2d 63, 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." Id. 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 in issue. 11/

11/ A similar result was reached in Kent Corp. v. National Labor Relations Board, 530 F.2d 612, 624 (C.A. 5, 1976), where the court held reports of investigation exempt in their entirety, noting:

> "In our view, even the factual matters in these reports * * * are protected by the work-product privilege. Writing in contemplation of forthcoming unfair labor practice litigation, an attorney must be able not only to discuss doctrinal theories but also to 'assemble information, [and] sift what he considers to be the relevant from the irrelevant facts' without feeling that he is working for his adversary at the same time. Hickman v. Taylor, 329 U.S. at 511 * * *. The feeling would be well justified if we allowed the FOIA to be used to force disclosure of such materials."

See also Brockway v. Department of the Air Force, 518 F.2d 1184, 1193-1194 (C.A. 8, 1975), where the court held factual statements of witnesses compiled in a safety report on an airplane crash to be exempt in their entirety. The court indicated that its decision was in accord with the statement of the Supreme Court in National Labor Relations Board v. Sears, Roebuck & Co., supra, 421 U.S. at 151, that the purpose of the long-recognized privilege against disclosure of internal memoranda is "to prevent injury to the quality of agency decisions."

Thus, 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 in their entirety by Exemption 5, as well as by Exemption 7(A).

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 modifications, 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. 12/

12/ 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 1349, 1358-1359 (C.A. 2, 1971); Wu v. National Endowment for Humanities, 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).

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.

The report of investigation currently in progress is a predecisional, internal memorandum, used in the process of determining what action to take as a result of the New York City investigation. The draft report consists, in its entirety, of "deliberative materials"— those facts selected by the staff as having particular significance, combined with expressions of the staff's opinions as to what those facts might show. There are necessarily no segregable portions that can, or should, be publicly disclosed at this time. Accordingly, the Court should find the draft report exempt, in its entirety, under Exemption 5 of the FOIA.

II. IN CAMERA INSPECTION IS NOT REQUIRED IN THE CIRCUMSTANCES OF THIS CASE, AND SHOULD NOT BE IMPOSED UNNECESSARILY UPON THE COMMISSION OR THE COURT

The FOIA provides that in any suit instituted under the Act seeking access to agency records, the court "may examine the contents of such agency records *in camera* to determine whether such records or any part thereof shall be withheld" under any of the Act's exemptive provisions. 5 U.S.C. 552(a)(4)(B) (emphasis added). The *in camera* inspection provision is permissive, and was intended to be utilized only where necessary. In this regard, speaking with particular reference to the *in camera* inspection provision, the Supreme Court has stated 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 that case, in the context of an Exemption 5 issue, that affidavits or even "surrounding circumstances" could, in an appropriate case, show that records met the requisite criteria for exemption. *Environmental Protection Agency v. Mink*, 410 U.S. 73, 91-92 (1972). 13/

13/ In *Mink*, the Supreme Court indicated that a court should not compel disclosure of classified documents in order to sift out non-secret portions. The 1974 amendments to the FOIA overruled the Court on this point, by amending the Act to provide that *in camera* inspection of such records could occur when necessary, the same as

(footnote continued)

In New England Medical Center Hospital v. National Labor Relations Board, supra, the court took note of this direction from the Supreme Court, and found that the application of this principle was particularly appropriate in an Exemption 7(A) context. Accordingly, in reaching the conclusion that the records there in issue were exempt, the court specifically held that an in camera inspection was unnecessary. In this regard, the court stated

> "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. 14/

As these cases indicate, there is a basic reason why in camera inspection is not necessary in the circumstances of this case and accordingly should not be ordered. As recognized in New England Medical Center, and by every other appellate court that has considered the issue, for the period of time during which an investigation or law enforcement proceeding is active, the entire contents of the investigatory file are "temporarily" exempt pursuant to Exemption 7(A). When enforcement proceedings are concluded, or when such proceedings are no longer a prospect, this

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13/ (continued)

for any other records. H.R. Rep. No. 93-1380 (Conference Report on the 1974 Amendments), 93d Cong., 2d Sess., at 7. But, the Congress also indicated that "such in camera inspection need not be automatic," and that "[b]efore the court orders in camera inspection, the Government should be given the opportunity to establish by means of testimony and detailed affidavits that the documents are clearly exempt from disclosure." Id.

The court in New England Medical Center Hospital, supra, 548 F.2d at 385 n.9, took note of the recent legislative change and concluded: "We think that the flexible approach of EPA v. Mink, supra, still applies."

14/ As noted supra, in Safeway Stores, Inc. v. Federal Trade Commission, supra, 428 F. Supp. 346, the court held that a 170-page report of investigation was exempt without examining the record in camera.

exemption no longer applies. So long as it does apply, however, there is no purpose to be served by an _in camera_ inspection. The only relevant considerations are: (1) whether there is an active investigatory or law enforcement proceeding; and (2) whether the records in issue are relevant to that proceeding. If that much is proved to the court's satisfaction, no closer "judicial oversight" is required.

Here, the existence of an active investigation and the nature of the records involved is not in doubt. The plaintiffs' complaint and the other papers they have filed show that they seek a report of investigation—an investigation which, it cannot be disputed, is still active and a report, relating to that investigation, which is itself still in progress. The nature of the "interference" that will result is similarly shown by the affidavits filed by the Commission and by the "surrounding circumstances." These are the only relevant facts. _Inspection of the records in question will add nothing to the Court's knowledge of these facts_. Nevertheless, an order requiring production would in itself necessarily result in considerable disruption to the ongoing work of the New York Regional Office. Plaintiffs would doubtless benefit from the additional publicity they could generate if this Court were to issue an order directing the Commission to produce its unfinished report; but there is, quite simply, no legitimate purpose that would be served by such an order, and a risk of considerable damage to the public interest. The Commission, therefore, respectfully submits that the Court should not order production of the draft portions of the report for _in camera_ inspection.

III. THIS ACTION IS FRIVOLOUS AND WAS INSTITUTED AND LITIGATED IN BAD FAITH, AS EVIDENCED BY THE CONTINUING EFFORTS OF THE PLAINTIFFS TO USE THIS ACTION TO GENERATE PUBLICITY FOR MR. HARNETT'S MAYORAL CAMPAIGN; ACCORDINGLY, THE COURT SHOULD AWARD THE COMMISSION ITS COSTS IN DEFENDING THE ACTION, INCLUDING REASONABLE ATTORNEY'S FEES.

The plaintiffs' continuing use of this action to generate publicity for Mr. Harnett's mayoral primary campaign serves to underscore the Commission's contention, first raised in its memorandum in support of its motion to dismiss and reiterated, in a supplemental memorandum, in light of the plaintiffs' extraordinary motion to show cause and the unfounded speculations in Mr. Harnett's sworn affidavit filed therewith, that this action has been instituted and prosecuted by the plaintiffs in bad faith.

The press release issued by the plaintiffs on July 22, 1977, and transmitted by Mr. Marshall to the Court at its request, by letter dated July 26, 1977, is a further example of the efforts of the plaintiffs to use both the Commission and this Court as a springboard for Mr. Harnett's campaign. The protestation of Mr. Marshall that the plaintiffs' latest public offering was issued "without [his] knowledge, consent nor approval" is unavailing. Mr. Marshall is not merely counsel to the plaintiffs in this action, but a plaintiff himself; he cannot disassociate himself from the actions of his co-plaintiffs. Indeed, the plaintiffs to this action are all participants in the same calculated plan designed to ballyhoo Mr. Harnett's campaign.

The plaintiffs' bad faith in this regard continues. The Commission has been advised that Mr. Harnett, in an interview broadcast by the CBS radio network on Wednesday, July 27, 1977, the day after the show-cause hearing, again raised the red herring of "cover-up" and the innuendo that the Commission's staff's efforts diligently to complete a thorough and accurate report to the Commission on an extremely complex matter were, instead, politically motivated machinations to suppress the facts uncovered so far in the

investigation. In light of Mr. Marshall's representations to the Court that the plaintiffs attributed no such motivations to the Commission, the public remarks of his co-plaintff made the following day only serve to re-emphasize the Commission's contention that this action was instituted and has been prosecuted in bad faith.

Accordingly, the Commission is again constrained to submit that it is entitled to the award of the costs it has expended in the defense of this meritless action, including an allowance for reasonable attorney's fees.

CONCLUSION

For the reasons stated in our motion to dismiss and memorandum in support thereof, filed with the Court on July 22, 1977, the complaint should be dismissed, since the plaintiffs have failed to pursue the prescribed administrative remedy.

Alternatively, the Court should dismiss this action since all the records sought by the plaintiffs are exempt from production under the FOIA since they are intra-agency memoranda and investigatory records the disclosure of which would interfere with enforcement proceedings. _In camera_ inspection of the records should not be ordered.

The Court should award the Commission its costs in defending this litigation, including reasonable attorney's fees.

Respectfully submitted,

HARVEY L. PITT
General Counsel

PAUL GONSON
Associate General Counsel

JAMES H. SCHROPP
Special Counsel

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WILLIAM D. MORAN
Regional Administrator
New York Regional Office
Securities and Exchange
Commission
26 Federal Plaza
New York, New York 10007
(212) 264-1636

Dated: July 28, 1977

UNITED STATES DISTRICT COURT
FOR THE
SOUTHERN DISTRICT OF NEW YORK

JOEL HARNETT, SAVE OUR CITY, INC. and GORDON MARSHALL,

Plaintiffs,

v.

77 Civ. 3110 (VLB)

SECURITIES AND EXCHANGE COMMISSION and EXECUTIVE OFFICE OF THE PRESIDENT OF THE UNITED STATES,

Defendants.

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss:

WILLIAM D. MORAN, being duly sworn, deposes and says:

1. I am the Regional Administrator of the New York Regional Office of the Securities and Exchange Commission. I make this affidavit on personal knowledge in support of the Commission's Supplemental Response to the Order to Show Cause Entered by this Court on July 22, 1977.

2. The Commission's investigation in the matter of the City of New York was instituted in January, 1976, pursuant to the formal Order of Investigation received by the Court on July 26, 1977, for *in camera* inspection. That order specifies:

(a) the provisions of the federal securities laws pursuant to which the investigation is being conducted;

(b) the provisions of the federal securities laws which, it appeared to the staff of the Commission in January, 1976, may have been violated;

(c) the facts known to the staff of the Commission in January, 1976, which tended to show that violations of the federal securities laws might have occurred.

3. Following the entry of the formal Order of Investigation in January, 1976, by the Commission, a comprehensive inquiry was undertaken

by members of the staff of the Commission's New York Regional Office, acting under my direct supervision and guidance. Even at the present time, certain aspects of this information gathering process are continuing.

4. At the present time, however, the primary work of the New York Regional Office with respect to the investigation in the matter of the City of New York consists of organizing, indexing and analyzing the information received in the course of the investigation and, as indicated in my affidavit dated and filed with the Court in this action on July 22, 1977, the New York Regional Office is currently in the process of writing a comprehensive Report of Investigation.

5. Various portions of the New York Office's report of investigation are now in various stages of drafting or completion. As portions of the report are drafted, they are, in the normal course, edited, checked against the raw investigative records to verify the statements made in the draft report, and re-edited as necessary. Eventually, and as expeditiously as possible, a complete Report will be assembled and I will review it. The report will then be transmitted to the Commission's Director of Enforcement and the Commission's General Counsel in Washington, D.C. for their consideration and review. After their review, a staff report will be submitted to the Commission for its consideration. At that time, the Commission will consider what, if any, law enforcement action should be taken.

6. The files and documentary materials relating to this law enforcement action that have been gathered by my staff are presently needed by my staff to complete their efforts and to verify statements they are drafting. If these documents were required to be reproduced and transmitted to this Court, or the plaintiffs, much of the ongoing work of my staff would be required to stop.

7. Any public disclosure of the portions of my staff's Report that now exist in draft form would be extremely disruptive to the work of this Office in compiling and completing its Report on an expeditious schedule, and would complicate and necessarily interfere with the ongoing efforts of the New York Regional Office to complete its work in a timely manner. Premature public disclosure could affect the quality, and perhaps even the accuracy, of the final report by creating pressure to finish the report on an overly hurried schedule. Premature disclosure could also prejudice the Commission's ability to prosecute successfully any law enforcement proceeding that may result from the investigation in question; at a minimum, such premature disclosure could complicate and prolong any such proceedings by unnecessarily injecting issues relating to the possible infringement of the rights of those ultimately named in such proceedings. Finally, premature public release, particularly at this critical time, could interfere with, and seriously detract from, the ability of the Commission to consider the report of the New York Regional Office in a rational atmosphere conducive to arriving at a careful and reasoned decision.

WILLIAM D. MORAN
Regional Administrator
New York Regional Office
Securities and Exchange Commission
26 Federal Plaza
New York, New York 10007
(212) 264-1636

Subscribed to and sworn before me
this ____ day of July, 1977

NOTARY PUBLIC

UNITED STATES DISTRICT COURT
FOR THE
SOUTHERN DISTRICT OF NEW YORK

JOEL HARNETT, SAVE OUR CITY, INC. and GORDON MARSHALL,

Plaintiffs,

v.

77 Civ. 3110 (VLB)

SECURITIES AND EXCHANGE COMMISSION and EXECUTIVE OFFICE OF THE PRESIDENT OF THE UNITED STATES,

Defendants.

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss:

DANIEL SCHATZ, having been sworn, deposes and says:

1. I am an employee of the Securities and Exchange Commission (the "Commission") assigned to the Commission's New York Regional Office in the capacity of Securities Compliance Examiner.

2. I am currently assigned to act as custodian of the documents gathered for use in the pending investigative proceeding captioned, In the Matter of Transactions in Securities of the City of New York and Agencies of the State of New York, File No. NY-5147 ("City investigation").

3. I have previously performed similar functions as the custodian of documents in other cases and investigations conducted by the Commission, as well as cases conducted by the United States Attorney for the Southern District of New York.

4. The information set forth below is based upon my current efforts respecting the City investigation, my survey of the document room in the City investigation and my discussions with the attorneys and examiners assigned to the City investigation.

5. The New York Regional Office's investigatory files in the City investigation consist of approximately 100,000 documents, which are

contained in approximately 31 file drawers, 7 file cabinets and numerous cartons and file folders. In addition, there are 92 volumes of transcripts of testimony aggregating well in excess of 12,000 pages. Documents in the Commission's investigatory files range in size from single page items to booklets and books; many of the documents exist in original form only, or there is only one copy contained in the files. Included in the material are documents which consist, in whole or in part, of compilations, summaries, analyses, recommendations and opinions of members of the staff.

6. In addition to the foregoing, other documents amassed during the Commission's investigation are currently distributed among the staff members working on this matter and must be returned to the central filing system. These documents will increase the numbers already referred to.

DANIEL SCHATZ

New York Regional Office
Securities and Exchange Commission
26 Federal Plaza
New York, New York 10007
(212) 264-4121

Subscribed to and sworn before me
this ____ day of July, 1977

NOTARY PUBLIC

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

CERTIFICATE OF SERVICE

I, JOHN P. SWEENEY, hereby certify that:

1. I am over 21 years of age and employed by the United States Securities and Exchange Commission as an attorney in the Office of the General Counsel.

2. On the 28th day of July, 1977, I caused to be served a copy of the defendant Securities and Exchange Commission's Supplemental Response To The Order To Show Cause Entered By The Court On June 22, 1977, And In Support Of Its Motion To Dismiss and the second affidavit of William D. Moran by personal service upon:

Gordon Marshall, Esquire
60 East 42nd Street
New York, New York 10017
Attorney for Plaintiffs

JOHN P. SWEENEY
Attorney

Securities and Exchange Commission
Washington, D.C. 20549
Telephone (202) 376-8003

Dated: July 28, 1977