UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

DAVID L. SMITH,
LYNN A. SMITH, ET AL

Defendants,

10 Civ.457 (GLS/CFH)

David Stoelting
Attorney for Plaintiff
Room 400
3 World Financial Center
New York, N.Y. 10281

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William J. Brown, Esq.
Receiver
3400 HSBC Center
Buffalo, N.Y. 14203

David L. Smith 19471-052
Federal Medical Ctr. – Devens
Satellite Camp
Box 879
Ayer, M.A. 01432
Acting pro se and as appointed legal representative for Lynn A. Smith

CHRISTIAN F. HUMMEL

U.S. MAGISTRATE JUDGE

MOTION TO MODIFY
ASSET FREEZE TO ALLOW THE
RELEASE OF CERTAIN PROPERTY

WHEREAS, on April 20, 2010, the Commission filed a Complaint and an Order to Show Cause seeking emergency relief and, on that same date, the Court granted the Commission's

request for a temporary restraining order that, among other things, froze the assets of the defendants and the relief defendant (Docket No. 5) (the "Freeze Order") and, on July 22, 2010, the Court entered the Preliminary Injunction Order that, among other things, continued the Freeze Order over the assets of the defendants and relief defendant (Docket No. 96) and appointed William J. Brown as Receiver ("Receiver"); and

WHEREAS, on June 26, 2015, the Court entered its Final Judgement as to Defendant David L. Smith (Docket No. 835), and its Final Judgement as to Defendant Lynn A. Smith (Docket No. 837) (Collectively the "Judgements"); and

WHEREAS, some of that property subject to the Freeze includes the retirement accounts of David L. Smith and Lynn A. Smith, specifically David Smith's interest in the McGinn Smith Incentive Savings Plan (the "Plan") and his Individual Retirement Account ("IRA"); and for Lynn A. Smith her Individual Retirement Account ("IRA"); and

WHEREAS, in a letter dated December 27, 2018 addressed to David Smith from William J. Brown, Receiver, the Receiver indicated that he had been informed that the "Plan" now required a minimum distribution ("RMD") as required by the IRS Regulations governing such plans, and that under the disgorgement order obtained by the SEC and reflected in the Final Judgement at Docket NO. 835; and specifically under Article VIII of that Order which authorizes the Receiver "to liquidate and monetize any assets recovered from or on behalf of or in conjunction with Defendant Smith and to deposit the proceeds thereof in an appropriate account"; and thus it was his stated "intention to take the proceeds of the RMD upon the later of January 17, 2019 or receipt and to place them in an appropriate account for distribution to investors in accordance with the Plan of Distribution approved by the Court";

WHEREAS, David L. Smith, age 73, and Lynn A. Smith, age 72, both acknowledge that they have met the age requirement of age 70 ½ to initiate their respective RMDs, for David Smith in both the "Plan" and his IRA, and for Lynn A. Smith in her IRA, they believe that they must begin to receive these distributions as required by law; and

WHEREAS, both David L. Smith and Lynn A. Smith plan to ask the Court to unfreeze their retirement assets so that they may begin to take these distributions as required and manage those assets for their benefit; and

WHEREAS, the Smiths will argue those assets are exempt from the disgorgement order, first, because they are exempt assets under the New York State "Homestead Act," "Civil Practice Law and Rules §5205," and second, while acknowledging as the Commission plans to argue that under SEC "disgorgement orders" some courts have disregarded state law exemptions, and MAY so order, that it is not settled law, the Judges in the district courts have been recognized to have discretion when considering to disregard state law exemptions, but when discretion is decided in favor of the SEC disgorgement, the SEC must adhere to the restrictions that are imposed upon disgorgement as confirmed by multiple cases of law, including the recent decision in the Supreme Court of the United States, *Kokesh v. SEC*, 137 S. Ct. 1635 (2017); and

WHEREAS, the *Kokesh* Decision was rendered post the disgorgement order for the Smiths and must now be considered and applied to any future decisions; and because the Decision clearly renders the opinion that disgorgement operates as a penalty under § 2462, accordingly, any claim for disgorgement in a SEC enforcement action must adhere to the limitations and principles of § 2462; and since the SEC has not met, nor can they meet these limitations and principles as required by law, the Court should release the retirement assets of the

Smiths immediately so as they may meet the RMD requirements and continue to manage those assets for the benefit of their retirement; and

WHEREAS, for the reasons and arguments stated below, petitioner David L. Smith, acting pro se and on behalf of Lynn A. Smith, respectfully request the Court to unfreeze their respective retirement assets upon due consideration of this Motion.

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EXHIBITS

William J. Brown, as Receiver
of McGinn, Smith & Co., Inc., *et al.*

Tel: 716.847.7089
www.mcginnsmithreceiver.com

One Canalside
125 Main Street
Buffalo, NY 14203

December 27, 2018

David Smith 19471-052
FMC Devens
Federal Medical Center
Satellite Camp
P.O. Box 879
Ayer, MA 01432

Re: SEC vs. McGinn Smith & Co., Inc., et al.; 10-CV-457

Dear Mr. Smith:

I am writing to you in my capacity as Receiver of McGinn Smith & Co., Inc., et al. ("McGinn Smith").

I have been informed that you have a $5,534.85 required minimum distribution ("RMD") due from the McGinn Smith Incentive Savings Plan (the "Plan").

In my capacity as Receiver of McGinn Smith, I intend to authorize the withdrawal of the RMD and cause its delivery to me in your name. The purpose of this letter is to give you an opportunity to provide me with any basis upon which you might claim that the Receiver would not be authorized to proceed as outlined below.

In a decision by Judge Homer at Docket No. 221, Judge Homer denied your motion to unfreeze your account in the Plan from the freeze which was imposed on April 20, 2010 because if a disgorgement order was ultimately issued in the action, the money in your Plan account would be important in facilitating repayment.

Such a disgorgement order was obtained by the SEC and is reflected in a final judgment at Docket No. 835. Article VIII of that Order authorizes the Receiver "to liquidate and monetize any assets recovered from or on behalf of or in connection with Defendant Smith and to deposit the proceeds thereof in an appropriate account." Docket No. 835 at page 9. Since state law exemptions do not apply with respect to disgorgement, my intention is to take the proceeds of the RMD upon the later of January 17, 2019 or receipt and to place them in an appropriate account for distribution to investors in accordance with the Plan of Distribution approved by the Court.

I am advising you of the foregoing in order to give you an opportunity to respond if you so desire, although I believe, in my capacity as Receiver, that there is no legitimate basis for you to object.

Very truly yours,

William J. Brown
Receiver

EEEht
Doc #01-2754670.3

cc: David Stoelting
Kevin McGrath
William J. Dreyer, Esq.

Lynn A Smith

From: SMITH DAVID (19471052)

Sent Date: Friday, January 11, 2019 8:06 AM

To: smithlyn2307@gmail.com

Subject: Legal representation

United States District Court
Northern District of New York
Christian F. Hummel
U.S. Magistrate Judge

Honorable Judge Hummel,

Please accept this authorization for David L. Smith to act as my representative for any proceedings that take place in your court concerning matters affecting me and my estate. David L. Smith has my authority to make any motions, pleadings, arguments, and representations advanced on my behalf.

Thank you for your consideration.

Respectfully,

Lynn A. Smith

2 Rolling Brook Dr.
Saratoga Springs, N.Y. 12866

Exhibit 3): Email from David Stoelting at the SEC listing case history that they would use to challenge state exemptions.

Dear Dave,

Of course. Sometimes things get lost in communication.

I received an email response from Stoelting on where the $100,000 came from. In essence, the SEC takes the position that they have grounds to make an application to the court to disregard the NYS homestead act now that the disgorgement order is in place. Here is Stoelting's email to me (I hope you are sitting down):

Lauren
Thanks for the email on the draft Order.. We ve had a chance to confer with the Receiver and can offer some thoughts.

Your position that the statutory exemption for the Smiths "would be closer to a total of $300,000" fails to take into account that some courts have disregarded state law exemptions in SEC enforcement actions seeking disgorgement. In a litigated context, the SEC would take the position that as to its claim for disgorgement and prejudgment interest, the Court should disallow the Smiths claim to the statutory homestead exemption of CPLR 5206. Disgorgement is "a distinctly public-regarding remedy, available only to government entities seeking to enforce explicit statutory provisions." FTC v. Bronson Partners, LLC, 654 F.3d 359, 372 (2d Cir. 2011). State law exemptions may be disregarded in the enforcement of a disgorgement judgment. SEC v. Huffman, 996 F.2d 800, 802-03 (5th Cir. 1993); SEC v. AMX, Intern., Inc., 7 F.3d 71, 75-76 (5th Cir. 1993); SEC v. Musella, 818 F. Supp. 600, 602 (S.D.N.Y. 1993); SEC v. Aragon Capital Advisors, LLC, 2011 WL 3278907 at *7, (S.D.N.Y. July 26, 2011); SEC v. Solow, 682 F.. Supp.2d 1312, 1325-26 (S.D. Fla. 2010, aff d 396 Fed. Appx. 635 (11th Cir. 2010). Recently in SEC v. Garber, 1:12-cv-9339-AT (S..D.N.Y.), Judge Torres held that the New York State exemption for an individual retirement account, CPLR 5205(c), did not apply where the Commission sought disgorgement. A copy of Judge Torres decision is attached.

In a consensual resolution, in order to allow the sale of the Saratoga Springs home, which is in all parties interests, we would be prepared to allow for an exemption cap of $100,000 for the Smiths. We would also be willing to have this amount paid to the Smith from the excess equity following payment of lien creditors, closing costs, etc. Since the amount of the excess equity can t be predicted, the Receiver and the Smiths could split the excess equity until the Smiths receive their $100,000, and after that point the remainder would go the Receiver for distribution to investors.

Please advise in the next week whether this is agreeable. If we are unable to reach an agreement on a consent order then the SEC intends to make a motion with the Court seeking an Order appointing the Receiver as the agent to sell the home. In such a motion we would argue that the homestead exemption should not apply.

BACKGROUND

In April of 2010, the Commission (SEC) filed a complaint against defendants David Smith and Timothy McGinn, along with various entities owned and controlled by McGinn and Smith, alleging multiple violations of the federal securities laws. Upon the filing of the complaint, the SEC moved for and was granted a freeze on all of the assets of the defendants and relief defendants pending adjudication of that complaint. Subsequently, the complaint was stayed pending the action to be taken by the U.S. Attorney Office (USAO), United States District Court, Northern District of New York. Ultimately, the USAO handed down an indictment of McGinn and Smith and in a 4 ½ week trial over the period January to February 2013 held in the Court of Judge David N. Hurd in Utica, N.Y. the defendants were found guilty of multiple securities law violations on February 6, 2013 and were sentenced on August 7, 2013. Smith received a ten year sentence.

With the criminal conviction of Smith, the SEC moved for Summary Judgement of the assets of Smith, his wife, and a trust established for his children for the benefit of the alleged defrauded investors. In a Decision ordered by Judge Gary L. Sharpe on March 30, 2015 the Summary Judgement was granted and the assets of the Defendants David L. Smith and Lynn A. Smith and the Trust established for their children were ordered to be disgorged for the benefit of investors and to be overseen by the appointed Receiver, William J. Brown. Judge Sharpe's Order was affirmed on April 18, 2016 by the United States Court of Appeals for the Second Circuit. Receiver Brown has retained control of the various Smith assets since April 2010.

The one asset that has received some dispensation from the freeze is the home of David and Lynn Smith at 2 Rolling Brook Dr., Saratoga Springs, N.Y. 12866. In a motion by the plaintiff SEC and Citizens Bank for an order to modify the preliminary injunction as to the Smith

residence for the purpose of a forced sale by foreclosure action, U.S. Magistrate Judge David R. Homer on August 24, 2012 denied the motion, citing "first, because it is the Smith's primary residence, it is likely beyond the reach of the SEC in this action at least to the extent of the New York State Homestead exemption. Under N.Y.C.P.L.R. §5206, real property owned and occupied as the primary residence is, to a certain degree, exempt from the satisfaction of money judgements." Judge Homer's Decision would be applicable to the Smith's retirement accounts since the New York Homestead exemption under N.Y.C.P.L.R. §5205 applies the same exemption to retirement accounts. Ultimately, the Saratoga residence was allowed to be sold under an Order modifying the asset freeze issued by this Court in November 2017. This order was a result of an agreement between the SEC and the Smiths, and is believed to be, at least in part, due to the SEC's recognition that Judge Homer's ruling had the standing of settled law since the SEC had a full and fair opportunity to litigate the issue and did not seek rehearing or otherwise challenge that ruling, and that the Smiths might very well prevail if they moved to realize the entirety of the equity from a sale.

The discretion afforded district courts to disregard state exemptions is not absolute, and when that discretion is in favor of SEC disgorgement, the disgorgement must adhere to the principles of a "penalty" under § 2462 (*Kokesh v. SEC*, 137 S. Ct. 1635 (2017))). We will demonstrate that the SEC has not and cannot meet those principles.

In addition to the purely legal arguments that the petitioners will make, they will also ask the Court that when using their discretion, that they give serious consideration to the principles of the law in general, that is in the final analysis the law should strive to be just and fair. The Supreme Court has ruled "First that SEC disgorgement is imposed by the courts as a consequence for violating public laws. i.e., a violation committed against the United States,

rather than an individual. Second, SEC disgorgement is imposed for punitive purposes (*Kokesh v. SEC*, 137 S. Ct. 1635 (2017))". Petitioners ask the court to consider just how much punishment the government feels necessary and entitled to in order to satisfy the punitive purposes of the law.

It is not the intention of the petitioners to litigate the past decisions, only to point out that their family has lost almost the entirety of what was once a sizable estate, an estate not built on ill-gotten gains from defrauded investors, but rather from a lifetime of hard, honest labor, family inheritance, successful investing, and a prudent management of their resources. The Smiths are now left with two possible assets as a result of the SEC disgorgement: some portion of the equity from the eventual sale of their home and the assets of their retirement accounts. Those remaining assets are necessary to meet living expenses for the rest of their natural lives since, due to their age and the diminished employment prospects for Mr. Smith as a convicted felon, they are unlikely to be able to develop an income sufficient to meet those expenses.

They believe the retention of the retirement accounts serves the spirit of the state exemptions, to allow those burdened with substantial liability to retain a modicum of assets so that they do not become a burden of the state and can retire with some dignity and purpose and have a second chance to conduct their lives in a productive manner within the limits of their age and limited resources.

SUMMARY OF ARGUMENT

Petitioners believe it is timely to argue for the release of their retirement accounts because they both are beyond the age of 70 ½ , the age required by IRS regulations to commence taking "Required Minimum Distribution – RMD." They are asking the court to modify the asset freeze currently in place on certain retirement assets (Mr. Smith's interest in the McGinn, Smith

Incentive Savings Plan (the "Plan"), and his IRA and Lynn Smith's IRA) because the Receiver has notified Mr. Smith of his intent to accept the RMD from the "Plan" and presumably of his intention to ultimately apply all the assets of the "Plan" and respective IRAs of David Smith and Lynn Smith to the benefit of the Investors' Fund for distribution per the Final Judgement rendered by Judge Sharpe on June 26, 2015 and reflected in Docket No. 835 and Docket No. 837.

The Smiths will argue that post Judge Sharpe's Order, the Supreme Court in its Decision for *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) has brought clarity to the issue of disgorgement and how it is to be applied, and in doing so the Court's Decision held that SEC disgorgement operates as a penalty under § 2462 and must be applied subject to the limitations and principles of § 2462; and as regards to the retirement accounts the SEC has never met, nor can they meet, the requirements of § 2462. Therefore, the retirement assets should not remain under the control of the Receiver for the ultimate contribution to the Investor's Fund, but rather should be released to the Smiths.

The governing securities statutes do not provide for any federal court remedy of "disgorgement." Rather, they "permit courts to order a "civil penalty" subject to various limitations and "equitable relief" that may be appropriate or necessary for the benefit of investors. See 15 U.S.C. § 78u (d) (3) (providing for civil monetary penalties for securities law violations); 15 U.S.C. § 78u (d) (5) (providing for equitable relief for parallel securities law violations). The federal securities laws do not permit the SEC to obtain monetary relief unless it fits into one of these two categories of remedies. If "disgorgement" describes a civil penalty, then § 2462 limitations apply. In its *Kokesh* Decision, the Supreme Court unequivocally

determined that disgorgement is a "penalty" within the meaning of § 2462. Justice Sotomayor delivered the opinion for a unanimous Court.

While the *Kokesh* Decision calls into question the entirety of the disgorgement order and how it was applied to the Smiths' assets, petitioners realize that order was appealed and denied, and that the only recourse open to the Smiths is an appeal to the Supreme Court, which they doubt would be timely and is moot because the Smiths lack the resources to pursue such an appeal.

However, as regards to the retirement assets, those assets are believed to be under state exemption as a result of their qualifying under N.Y.S. Homestead Act and New York Civil Practice Law and Rules (C.P.L.R.) §5205. Petitioners contend that those assets have never been adjudicated and determined that their exempt status did not apply and therefore they were under the control of the Receiver. Therefore, if the SEC now wishes to move for those assets to be included in the disgorgement order they must meet the requirements of § 2462.

The SEC and Receiver evidently intend to rely on Article VIII of the Final Judgement to justify the appropriation of Smith's "Plan" (and presumably a subsequent appropriation of the IRA accounts – see Receiver Brown's letter of December 27, 2018, Exhibit 1). Article VIII states that "any assets recovered by or under the control of the Receiver collected from the Defendant Smith pursuant to the prior orders of this court are deemed to be assets of the Distribution Fund effective upon the entry of this Final Judgement and the Receiver is authorized to liquidate and monetize any assets recovered from or on behalf or in connection with Defendant Smith and to deposit the proceeds thereof in an appropriate account." The SEC and the Receiver also presumably intend to rely on Brown's statement in his letter of December 27, 2018 that "since state law exemptions do not apply with respect to disgorgement, my intention is

to take the proceeds of the RMD upon the later of January 17, 2019 or receipt and to place them in an appropriate account for distribution to investors in accordance with the Plan of Distribution approved by the Court." Brown's assertion that state law exemptions do not apply with respect to disgorgement is in error. In fact, district courts have simply ruled that in some cases the courts MAY supersede state exemptions under certain circumstances and the ability to do so lies within the discretion of the courts. Thus, this is not settled law, and in fact other courts may choose to uphold the state exemptions.

We have argued that until the exemption is adjudicated the exemption remains in force, and therefore, such exempt assets have not been received nor are under the control of the Receiver. Since the SEC never filed an appeal or asked for a hearing regarding the exemption status of the retirement accounts, and it is believed that the time for filing an appeal has long since expired, and Judge Sharpe's Order included those "assets under the control of the Receiver", and did not specifically mention to include exempt assets, it is believed that Judge Sharpe was probably aware of their exempted status and chose not to include them in his Order.

Thus, if this Court now chooses to rule on the status of the exempted assets, it must do so with the knowledge that § 2462 must be applied. Here the SEC could not develop any theory that would meet the limitations imposed on the "penalty" assessed under § 2462. The amount of penalty for such violation shall not exceed the greater of (I) $100,000 for a natural person or $500,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation. Section 305 of the Sarbanes-Oxley Act of 2002 added the provision that allows obtaining additional monetary relief in the form of "equitable relief."

The SEC has never proved, nor could they, that the defendant was the beneficiary of ill-gotten or pecuniary gains, and even if they could conjure up such gains in the form of authorized

fees or commissions, that amount would not begin to approach the amount the defendants have already had disgorged.

As regards to equitable relief, pursuant to *Great-West Life and Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002), order for courts to provide equitable relief in the form of in order to turn over funds or property, the funds or title to property sought must be specifically identified and directly traced as the proceeds of wrongdoing. At no time were funds or property from the allegedly defrauded investors ever found to have been deposited in the "Plan" or the IRA accounts of the Smiths.

We have also argued specific to Lynn Smith's IRA that under her disgorgement order specific assets were listed, including: (1) her stock account, (2) the Bank of America checking account, (3) the Vero Beach proceeds, and (4) the Trust account. No mention was made of her IRA account. The Order that named the aforementioned assets relied on the supposition that all those assets were under joint ownership and that Mr. Smith exercised joint control. No such claim was made or could be made regarding Lynn Smith's IRA account. It is presumed that because no such claims of joint ownership were made, and that the account was exempt under N.Y.C.P.L.R. §5205, that the asset was not intended for purposes of disgorgement.

Our arguments have included reference to Judge Homer's ruling of August 24, 2012 as to "the likelihood that the Smith's home residence was beyond the reach of the SEC," and our belief that ruling would naturally extend to the retirement accounts as both assets fall under the New York State Homestead Act, with C.P.L.R. §5205 for retirement accounts and §5206 for primary home residences. The SEC never appealed that ruling, the time has long since expired for their opportunity to appeal, and we believe it should be considered settled and accepted law, thus giving exempted status to the Plan and the IRA accounts. Certainly it should carry

substantial weight when, and if, this Court decides to rule on the exemption status of the retirement accounts.

Finally, we have argued that it is our belief that both parties accept the fact that the Court has discretion in determining whether exempt assets can be disregarded when SEC disgorgement is applied. We have argued that when the Court in its discretion rules on the exempt status they be mindful that the Supreme Court has previously ruled that disgorgement is imposed for punitive purposes and that the extensive disgorgement penalties already imposed are more than sufficient in light of the Court's mission to assure that the law is administered in a fair and just manner.

Argument

I

DISGORGEMENT AND THE OPERATIVE STATUTES THAT GOVERN RELIEF THE SEC MAY SEEK AND FEDERAL DISTRICT COURTS CAN ORDER

The SEC is authorized by Congress to seek and federal courts are authorized to grant monetary relief pursuant to statutory provisions authorizing the imposition of "money penalties," see 15 USC § 78 (u)(d)(3) or the statutory provision authorizing "equitable relief" for "the benefit of investors," 15 USC §78 u (d)(5). None of the provisions uses the term "disgorgement."

The Sarbanes-Oxley Act of 2002 added a provision to the Securities Exchange Act of 1934 that allows obtaining additional monetary relief in the form of "equitable relief." This provision states:

"Equitable Relief – In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any federal Court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors."

However, it is critical to note that when employing such authorization, the SEC and courts must abide by the limitations and principles embedded in the law. As will be demonstrated later, the SEC has not and cannot meet those limitations when applied to the Smiths' retirement accounts.

Prior to Sarbanes-Oxley there was no explicit provision for equitable monetary relief in the securities laws, so federal courts implied the equitable power to order monetary relief variously identified as "restitution" or "disgorgement," for violation of the securities laws. Congress had never explicitly included disgorgement among the remedies the SEC can seek in federal court. However, despite the lack of legislation, the SEC has been seeking disgorgement for decades, and courts have been granting it. Over time, courts came to accept the notion that disgorgement is an inherently ancillary equitable remedy.

Thus, Sarbanes-Oxley codified the federal courts' ability to grant monetary relief, but subjected it to two important limitations: (1) it used the phrase "equitable relief" to describe the power granted which had defined parameters; and (2) the power was granted only where it may be appropriate for the benefit of investors.

The phrase chosen by Congress, "equitable relief" is one that has been carefully and clearly interpreted by the Supreme Court in multiple cases, most notably *Great-West Life and Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002). *Great-West Life and Annuity Insurance Co.* and others have binding precedents and establish three things: (1) the term "equitable relief"

is a term with limitations; (2) that labeling some requested relief "disgorgement" does not make it "equitable relief;" and (3) that for an order to turn over money or property to qualify as true "equitable relief," it must be an order to return money or property identified as belonging in good conscience to the plaintiff that could clearly be traced to particular funds or property in the defendant's possession. In other words, under the Court's precedents, only when money or specifically identified property of the defendant can be traced to the wrongdoing is the disgorgement permissible under equitable remedy. The assets already disgorged from the Smiths or soon to be disgorged did not meet that criteria, and certainly no assets of the plaintiffs could even begin to be traced to the defendants' retirement accounts. Thus, any disgorgement order of the retirement accounts would be in contravention to existing law. Specifically, pursuant to *Great-West Life and Annuity Insurance Co.*, in order for the courts to provide equitable relief in the form of an order to turn over funds or property, the funds or title to the property sought must be specifically identified and directly traced to the proceeds of wrongdoing. Equity jurisprudence provides that the claimant, here the SEC, bears the burden of proving the specifically identified and properly traced asset to be equitably discharged.

Any disgorgement amount that is not equitable (which is the case for the defendants) must be considered when calculating the maximum penalty amount under 15 U.S. C. § 786 (d) (3) (B) (iii). The enforcement actions in a federal district court are thus subject to a maximum penalty of "the gross amount of pecuniary gain to the defendant as a result of the violation." Because disgorgement ordered for the SEC operates as a penalty under § 2462 *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), and because there is no other statutory penalty authority, any amount that is disgorged must be added to the calculation of the maximum penalty amount, unless the disgorgement relates to the return of specifically identified assets. Otherwise, the SEC is

impermissibly circumventing the statutory maximums. Those maximums shall not exceed the greater of (I) $100,000 for a natural person or $500,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation.

Since the SEC has not and cannot identify and trace those assets, and since the amounts disgorged to date far exceed any pecuniary gains yet to be identified, any further distributions from the currently exempt retirement accounts would have to be considered in excess of the maximum penalty amount.

Because it is the defendants' belief that the SEC plans to advance the argument that some courts have disregarded state law exemption in SEC enforcement actions seeking disgorgement, we believe that the further discussion of disgorgement and in particular the unanimous ruling of the Supreme Court in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), is important for the court to consider.

The *Kokesh* decision readily demonstrates that SEC disgorgement constitutes a penalty within the meaning of §2462. The question the court was asked to answer was whether §2462, which applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, also applies when the SEC seeks disgorgement." The Court decided in the affirmative. Therefore, when applying disgorgement, the SEC and courts must follow all of the statutory and constitutional restrictions and civil penalties that apply. When those restrictions are applied to the Smiths' retirement accounts, the SEC is not entitled to disgorgement regardless of their ability to argue that federal courts may supersede state exemptions.

Thus, having established disgorgement as a penalty subject to §2462, the SEC is subject to the following penalty amounts:

1) Penalty for each violation shall not exceed the greater of $100,000 for a natural person, or
2) The gross amount of the pecuniary gain to such defendant as a result of the violation, and
3) Additional monetary relief in the form of "equitable relief" under Sarbanes-Oxley and the "Fair Funds Provision."

In the case of (1) above, the Smiths have already paid disgorgement far in excess of $100,000. In (2) the SEC has failed to demonstrate pecuniary gains as required by them bearing the burden of proof, and even if they attempt to demonstrate such gains as the $5,248,722 restitution ordered in the criminal case, that restitution was identified as investor losses, not gains to the defendant. Finally, in (3) the SEC is left under "equitable relief" to specifically identify and trace assets as a result of the wrongdoing, which they have not done, nor can they do. The defendant Smith never had possession of such property or money. All such monies are contained in investment vehicles designed for the benefit of the investor as outlined in the governing prospectus. In particular, the assets of the retirement accounts never possessed such property or money, and the SEC would have no ability to trace those particular funds or property to the defendants' retirement accounts.

Great-West Life and Annuity Insurance Co. is not a unique example of the court's rigorous application of the limits created by equity jurisprudence. In *Grupo Mexicano de Sarrollo, SA. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), the Court was presented with "the question whether, in an action for money damages, a US District Court had the power to issue a preliminary injunction preventing the defendant from transferring assets in which no lien or equitable interest was deemed." The Court found that the district court had no such power because such power does not conform to established principles of "equity." The retirement

accounts of the Smiths have never received monies or property in which a lien or an equitable interest could be claimed, and therefore it could be argued the retirement accounts should have never been frozen to begin with.

Previous to *Kokesh*, when employing disgorgement as an equitable remedy, which the SEC has done for decades with lower court compliance, the SEC should have been held to limitations promulgated in a number of decisions which identified the amount to be disgorged as specifically identified ill-gotten gains. See the following:

1. "Disgorgement serves to remedy securities law violations by depriving violators of the fruits of their illegal conduct" (*SEC v. Fishbach Corp.* 133 F. 3d 170, 175- 2nd Cir 1997)
2. "Disgorgement is an "equitable remedy" imposed to force a defendant to give up the amount by which he was unjustly enriched" (*FTC v. Bronson Portmus* 654 F 3d, 359, 372 2nd cir. 2011)
3. "Because disgorgement does not serve a punitive function, the disgorgement amount may not exceed the amount obtained through the wrongdoing." (*SEC v. Cavanaugh*, 445 F 3d 105, 117- 2nd Cir. 2006)[1]

Thus, the theory was to remove the ill-gotten gains realized by the wrongdoers. That was the limitation. It was not necessarily designed to compensate the victims. "At the same time; however, as it operates to make the illicit action unprofitable for the wrongdoer, disgorgement need not serve to compensate the victims of the wrongdoing." (*Bronson* 654, F. 3d at 374).

[1] In *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), the Supreme Court ruled disgorgement is punitive.

It wasn't until the passage of Sarbanes-Oxley Act of 2002 that a provision added to the Securities Exchange Act of 1934 allowed for monetary relief in the form of "equitable relief" that may be appropriate or necessary for the benefit of investors under 15 U.S.C. §78 u(d)(5).

In other words, disgorgement is not intended to wholly compensate investors for their losses, but rather to deter wrongdoing by forcing the wrongdoers to give up their ill-gotten gains as a result of their actions. Here, the SEC has not, nor can they, demonstrate ill-gotten gains for the defendants, and even under the most imaginative theory begin to approach the amount already disgorged. Therefore, the remaining retirement assets of the Smiths should be unfrozen and returned to the Smiths.

The court's broad discretion to impose disgorgement liability is well established (*First Jersey*, 101 F. 3d at 1474-75), but it is also a well-established principle of disgorgement that "the court may only exercise its equitable power only from property causally related to the wrongdoing (*SEC v. First City Fir.* Corp., 890 F 2nd 1215, 1231, D.C. Circuit 1989).

As previously discussed, and prior to *Kokesh*, disgorgement was determined to be an equitable remedy, with "its primary purpose is to deprive violators of their ill-gotten gains" (*SEC v. Fishbach Corp.*, 133 F. 3d, 170-175, 2nd Cir, 2997) and the amount of the disgorgement "is determined by the amount of profit realized by the defendant" (*SEC v. AbsoluteFuture.com*, 393 F. 3d, 94, 96, 2nd cir 2004). And while the court's discretion allows for "the amount of disgorgement ordered need only be a reasonable approximation of profits casually connected to the violation" (*First Jersey*, 101 F. 3d at 1474-75), the operative for disgorgement is "profits," not investor losses.

In the one forum for adjudication of the alleged violations, the criminal trial, the primary findings were for conviction of the violation of various securities laws, mostly in regards to failure to disclose certain risks to the investors. That conviction determined that there were losses in the amount of $5,748,722, which was a joint and several liability with Mr. Smith's co-defendant. Those losses were ordered to be repaid in the form of restitution, offset by any distributions to the investors from funds recovered by the Receiver. That has been done, and in amounts multiple times the restitution ordered. Assets disgorged from the Smiths have contributed to that Fund for Investors. The point here is that the restitution was so ordered for losses assumed by investors, not for ill-gotten gains by the defendants. Now, in its request for further disgorgement, what the SEC is attempting to do is circumvent the law, which states disgorgement must be specifically identified and traced assets to the wrongdoing, by asking for additional disgorgement for losses incurred by investors.

Thus, the SEC is asking the court to order further disgorgement above and beyond what they have failed to identify as the specific ill-gotten gains. That is in contravention of existing law. "The amount a court may order a wrongdoer to disgorge may not exceed the total amount of gain from the illegal action" (*SEC v. Contorinis,* US Court of Appeals, 2nd Circuit, February 18, 2014). "That is not to say the amount of disgorgement a court can order from a wrongdoer is bounded only by the court's discretion; to the contrary, it is set at the maximum of the total gain from the illicit action" (*SEC v. Contorinis,* US Court of Appeals, 2nd Circuit, February 18, 2014). All of this case law is applicable only where equitable relief can be ordered under 15 U.S.C. § 78 u(d)(5) and the SEC's request for disgorgement is tied to specifically identified, wrongfully obtained money or property. This the SEC has never attempted to do and cannot do. Thus, where the SEC's request for disgorgement is unconnected to specific, wrongfully obtained money or

property, then it is in reality just a claim for a money judgment and, therefore, a request for civil penalties authorized be 15 U.S.C. § 78 u (d)(3) and other civil penalty provisions.

Moreover, since the Supreme Court ruled unanimously in *Kokesh* that SEC disgorgement constitutes a penalty, then § 2462 applies to "civil penalties" under 15 U.S.C. § 78 u (d)(3). Those penalties may amount to (I) $100,000 for a natural person or $500,000 for any other person, or (II) the gross amount of the pecuniary gain to such defendant as a result of the violation. The SEC has never identified such gross pecuniary gain, nor can it, and any such gains that might develop under any realistic and honest theory would never approach the amount of disgorgement that the Smiths have already made. Therefore, any additional disgorgement represented by proceeds of the retirement funds would not be permissible. There is no possible reading of the alleged actions by Smith that his firm's 401-K retirement account and his and his wife's IRA accounts were the beneficiaries of ill-gotten gains that can be traced to the accounts as required under equitable relief; thus, the SEC cannot meet the limitations and principles of the penalty provisions of §2462, which they are required to do for disgorgement purposes.

The SEC has already or has plans to disgorge all of the assets of the defendants, including the assets of a trust established for their children. The only assets remaining to the Smiths are some yet to be determined equity from the sale of their home, shared with the SEC, and directed solely to Mrs. Smith, and the retirement accounts of Mr. Smith which approximate $160,000 and Mrs. Smith which approximates $30,000. The total of the home equity and retirement accounts would be less than 5% of the amount to be disgorged from the Smiths' total assets.

Thus, in the Smiths' case, the SEC moved for and was granted an amount of disgorgement representing alleged losses, not ill-gotten gains as required, and now seek to use that decree by Summary Judgment, having already confiscated 95% of the Smiths' assets, to get

the remaining 5% of assets that are otherwise protected by state law exemptions (The Homestead Act). Petitioners argue that this court in using its lawful discretion should attempt to correct the previous amount of disgorgement that is not adhering to the limitations and principles of §2462 as required.

Even when disgorgement was erroneously defined as "equitable relief;" the SEC had not adhered to the limiting principles enunciated in *Great-West Life and Annuity Insurance Co.*. Because the SEC made little or no effort to tie the relief ordered to the wrongfully obtained "particular funds or property in the defendant's possession" (*Great-West Life and Annuity Insurance Co.*, 534, U.S. at 213), the SEC was actually seeking civil penalties under the guise of disgorgement. This incorrect use of equating disgorgement with equitable relief, combined with lower courts' failure to apply either the established limitations on equity or the statutory limits on civil penalties, have resulted in the SEC requesting, and Courts grating, powers "not of flexibility but of omnipotence" (See *Grupo Mexicano*, 527 US at 322).

However, now that the Supreme Court in *Kokesh* has confirmed that disgorgement is a penalty under §2462, the SEC can no longer have it both ways; that in seeking disgorgement under equitable relief without capping the award amount of the ill-gotten gains wrongfully obtained, and thus in reality seeking it under civil penalties, but not being forced to comply with the limitations of civil penalties. When the SEC is now forced to comply with §2462 in regards to the Smiths' assets, the disgorgement is limited and the retirement assets no longer available.

II

RETIREMENT ASSETS ARE UNDER STATE EXEMPTION OF THE NEW YORK STATE HOMESTEAD ACT AND C.P.L.R. §5205, AND AS SUCH ARE NOT UNDER THE CONTROL OF THE RECEIVER

FOR CONTRIBUTION TO THE INVESTORS' FUND.

Petitioners will argue that their retirement accounts (the McGinn Smith Savings and Investment Plan, "the Plan", and their respective IRAs) are exempt under New York Civil Practice Law (C.P.L.R.) §5205 from application to the satisfaction of money judgments. CPLR §5205 states "all trusts, custodial accounts, annuities, insurance contracts, monies, assets or interests established as part of, and all payments from, either any trust or plan, which is qualified as an individual retirement account (IRA) under section four hundred either or section four hundred eight A of the U.S. Internal Revenue Code of 1986…shall be considered a trust which has been created by or which has proceeded from a person other than a judgment debtor…is exempt from application to the satisfaction of a money judgment."

For purposes of brevity, petitioners will not provide extensive case history for this exemption because petitioners believe the SEC has no issues whether the accounts qualify under CLPR §5205. Rather, it is believed the SEC plans to argue that on cases of enforcement of disgorgement judgments, courts may in their discretion disregard the state law exemptions. Our belief stems from discussions held with our previous attorney, Lauren Owens of Dreyer Boyajian, who when discussing the sale of our primary residence and our intent to claim an exemption under CPLR §5206 with David Stoelting of the SEC, Mr. Stoelting made known that the SEC planned to challenge our assertion for the exemption. (see Exhibit 3) Since CPLR §5205

and §5206 fall under the same law we presume the SEC will make the same argument. That belief was further reinforced with the letter received from William J. Brown, dated December 27, 2018, to David Smith, in which Mr. Brown stated "since state law exemptions do not apply with respect to disgorgement…"

In Mr. Stoelting's email he references several lower court decisions (see Exhibit 3) to support his supposition that state law exemptions may be disregarded in the enforcement of a disgorgement judgment. Petitioners don't argue with that position, having earlier stated that there is sufficient case history in the SEC's position. We simply point out that the position is not settled law, that decision rests within the discretion of the court so that some courts may support the exemption and some may not, depending on the circumstances. In Mr. Stoelting's email, he indicated that he planned to support his arguments by pointing to the recent decision by Judge Torres supporting the SEC in *SEC v. Garber*, 1:12-cv-9330 AT (S.D.N.Y.). Stoelting supplied a copy of the Torres decision for defendant's review. Thus, in our arguments we will reference that decision and others that Mr. Stoelting referenced in his email.

While the SEC will have the opportunity to respond to this motion and we don't know exactly what their arguments will be, we do have the record of Mr. Brown's December 27, 2018 letter which includes several statements that would indicate at least the basis for some of their expected arguments; therefore, we will challenge those assertions with some brief responses.

Being that both parties argue that in an SEC enforcement action for disgorgement the district court may disregard state exemptions our argument rests on the belief that (1) the discretion used must take into account the specific circumstances of the case under consideration, and (2) in order for the disgorgement to proceed, the SEC must meet the limitations of equitable relief and the limitations of a penalty under §2462 now that the Supreme Court in its *Kokesh*

decision has declared disgorgement to be a penalty. Those limitations and principles were outlined in Argument (I) of this motion's brief. A review of the *SEC v. Garber*, Feinstein, et al which was filed January 10, 2017, Analisa Torres, District Judge presiding, is an opportunity to review both the use of discretion and the need for the SEC to follow the law when implementing the decision.

In this case, the Plaintiff SEC, moved for a turnover order as to Defendant Jordan Feinstein pursuant to the Federal Rules of Civil Procedure 69(a) and NYCPLR 5225. The SEC's motion was granted. The Court based its decision on previous lower court decisions, several of which have already been referenced by the Petitioners in their arguments under (I), including:

"Disgorgement is a distinctly public-regarding remedy, available only to government entities seeking to enforce explicit statutory provisions" (*FTC v. Bronson Partners*, LLC, 654 F. 3d; 359, 372; 2nd Circuit 2011). An equitable remedy is "a method of forcing a defendant to give up the amount by which he was unjustly enriched" (*SEC v. Commonwealth Chem. Sec., Inc.* 574 F. 2d 90, 102; 2nd Cir 1978). The purpose is to "deter violations of the laws by depriving violators of their ill-gotten gains" (*SEC v. Fishbach*, 133 F. 3d; 170, 175; 2nd Cir 1997).

Having used some of the same arguments in (I), Smith does not dispute Judge Torres' right to make her decision. In the Decision, Judge Torres disagreed with Feinstein's argument that NYCPLR §5205 was intended to "exempt all IRAs (and by extension all qualified retirement accounts) from attachment." The court relied on the *SEC v. Huffman*, Fifth Circuit, where the court ruled "the district court had broad discretion in fashioning the equitable remedy of a disgorgement order." "It may decide that some property should be exempt from such an order, and may take state law as its guide." In Mr. Stoelting's email, he also cites the decision in Huffman. However, this decision actually reinforces the arguments that Petitioners are making.

The Court ruled that "disgorgement wrests ill-gotten gains from the hands of the wrongdoer," and "it is an 'equitable remedy' (now invalid post *Kokesh*) meant to prevent the wrongdoer from enriching himself by his wrongs." "Disgorgement does not aim to compensate victims of the wrongful acts, as restitution does." "Thus, a disgorgement order might be for an amount more or less than that required to make the victims whole." Those are exactly the arguments the Petitioners made in (I). Thus, by using Hoffman, the SEC actually supports the Petitioners' argument. However, what the SEC attempts and hopes to do is cite a decision that opines that disgorgement is an "equitable remedy," but then ignore the limitations of such, namely that they must identify and trace the ill-gotten gains.

In the case of *Feinstein*, there were extraordinary circumstances that justified the courts' decision to supersede state law. Judge Torres used her discretion wisely. The decision gave particular importance to the SEC's indication that on the date Feinstein was served with a restraining notice, the balance of Feinstein's IRA was $390,000, which the SEC claimed would have covered the disgorgement. According to the SEC, Feinstein ignored the restraining notice and used more than $250,000 from the IRA over the next nine months for living expenses. In other words, Feinstein did not use the IRA as intended for retirement, but instead used the funds to simply continue living in a style that he was accustomed to.

That is not the case with the Smiths. As a result of a freeze on all of their assets now approaching nine years, Mr. Smith's imprisonment since August of 2013, and Mrs. Smith's inability to earn only an extremely modest living from substitute teaching supported by approximately $1,100 a month from Social Security and the N.Y.S. Teachers' Retirement Fund, Mrs. Smith has been reduced to a subsistence lifestyle. The Smiths' financial situation provides

a good example of arguing that here, discretion available to maintain the state exemptions is prudent, fair, and maintains the intent and purposes of the state exemptions.

In William J. Brown's letter of December 27, 2018 to David Smith, Mr. Brown informed Mr. Smith of his intention to start disgorging Mr. Smith's interest in the McGinn, Smith Incentive Savings Plan ("the Plan") as a result of the need for Mr. Smith to start receiving his Required Minimum Distribution (RMD). In his letter, Mr. Brown made several assertions that give guidance to the justification that he, as Receiver, and the SEC would depend on to initiate the disgorgement. Petitioners assume that those same arguments for justification will be applicable to the Defendants' IRAs.

Mr. Brown referred to Judge David Homer's Decision at Docket No. 221 denying Defendant Smith's motion to unfreeze his plan account "because if a disgorgement order was ultimately issued in the action, the money in your plan account would be important in facilitating payment."

First of all, that order was made prior to the Supreme Court Decision of the *SEC v. Kokesh*, where the court ruled that disgorgement acts as a penalty and must adhere to the penalty limitations under §2462. We have previously made the case in (I) that the SEC has not, nor can they, adhere to those limitations, thus making any disgorgement order for the retirement accounts unlawful.

Second of all, the motion to deny was prior to the criminal trial when the court was unsure of the outcome and potential restitution to be ordered. However, that restitution has now been satisfied, and we are now only considering civil penalties for which ERISA plans are exempt.

Finally, post that decision, the court did permit Smith to access his "Plan" to the best of his recollection in October- November 2012 in the amount of $160,000 to help pay for his legal costs associated with his impending trial. Thus, precedent has been set in using discretion to unfreeze the retirement assets for the benefit of Mr. Smith.

As additional justification for the initiation of disgorgement, Brown referred to the disgorgement order reflected in a final judgment at Docket No. 835, pointing out that Article VIII of that order authorizes the receiver "to liquidate and monetize any assets recovered from or on behalf of or in connection with Defendant Smith and to deposit the proceeds in an appropriate account."

Petitioners would argue that while Brown relies on this Order and Decree, specifically Section VIII of the Final Judgment, he fails to take into account the specific language of the Order, that language being those "assets recovered by and under the control of the Receiver." Petitioners believe that an asset that is exempt from the order of disgorgement has not been recovered nor is it under the control of the Receiver. Until that exempted asset is adjudicated to be no longer exempt, the asset is not under the control of the Receiver. Then, even if the court rules that the asset is not entitled to exemption, the disgorgement must now proceed under the limitations and principles of §2462. Thus, under §2462 the disgorgement is limited to the penalties to be applied: (1) maximum $100,000. (2) identified and traced all ill-gotten gains. It is well established that any ill-gotten gains deposited to IRA or retirement accounts are subjected to disgorgement. But if no ill-gotten gains can be identified or traced to the retirement accounts, then disgorgement would be in contravention to existing law. Since the SEC has never so identified or traced such ill-gotten gains to the Smiths' retirement accounts, nor could they, these accounts are not subject to disgorgement.

III

LYNN SMITH'S IRA WAS NEVER MENTIONED IN DOCKET NO. 837 AND WAS NEVER INTENDED TO BE UNDER THE CONTROL OF THE RECEIVER

Petitioners argue that the IRA should have never been frozen to begin with because there were no traceable ill-gotten assets into the account and the sole argument that the SEC advanced and the court relied on in its disgorgement order was that Lynn Smith's assets were in reality jointly owned with David Smith, which in regards to Lynn Smith's IRA was not the case. In Judge Sharpe's decision and order of 3/30/15 relating to the disgorgement of Lynn Smith's assets, Judge Sharpe states that the court is "considering the SEC's request for disgorgement of profits (which the SEC never identifies or traces, and also addresses the disputes surrounding certain assets that remain frozen. The relevant assets include the following: (1) assets held in L. Smith's name including (a) a checking account with Bank of America, (b) a stock account maintained at RMR Wealth Management, and (c) proceeds from the sale of a vacation home in Vero Beach, Florida." The only other asset held was Lynn Smith's IRA and it specifically was not mentioned. Judge Sharpe goes on to state in justifying his order, "Generally, federal courts have jurisdiction over and may order equitable relief against a relief defendant in a securities enforcement action if she: (1) has received ill-gotten gains; and (2) does not have a legitimate claim to these funds." (*SEC v. Cavanaugh*, 155 F. 3d 129, 136 2nd Cir. 1998) Lynn Smith's IRA never received any ill-gotten gains and the SEC never even attempted to trace any such gains because they knew they were incapable as the gains did not exist. Thus, the SEC has not met the limitations of §2462 and the assets of Lynn Smith's IRA should be released immediately.

Judge Sharpe went on to state that alternatively, "if an asset belonging to a relief defendant is, in reality, also an asset of a defendant," then application of the two-part Cavanaugh test is appropriate. This was the theory that the SEC advanced and the court accepted regarding Lynn Smith's stock account. The Order went on to state that in determining whether a defendant and relief defendant jointly own an asset, "the central inquiry concerns the element of control [implicating] the concept of equitable ownership." The Order spent considerable time in describing that control David Smith had over Lynn Smith's stock account. No effort was ever made to demonstrate similar control over Lynn's IRA. "In addition to the element of control, other factors determine joint ownership:

(1) The length of time the asset was held;

(2) Whether the defendant had an interest in and benefitted from the asset;

(3) Whether the defendant had transferred assets from his name into the asset;

(4) Whether the defendant contributed to acquire the asset initially; and

(5) Whether the defendant ever withdrew any funds from the asset.

The SEC has never attempted to apply any of those tests, nor could they. Lynn Smith's IRA was an asset of long standing, had contributions from her personal salary, and there have never been any withdrawals.

Judge Sharpe's opinion goes on to state, "Here, the SEC relies entirely on the joint or equitable ownership theory." Thus, they are not alleging ill-gotten gains, and because there is no plausible theory to support joint ownership with Lynn Smith's IRA, the asset should be released to her immediately.

It is likely that Judge Sharpe never included Lynn Smith's IRA as an asset to be disgorged because without a theory of ill-gotten gains, which the SEC never attempted to advance, and without any plausible connection to joint ownership, disgorgement of the IRA asset has no basis. Thus, the asset's state exemption cannot be ignored through the discretion of the court and should be released.

IV

JUDGE HOMER'S RULING OF 8/24/12 WOULD EXTEND TO THE RETIREMENT ACCOUNTS AND SHOULD BE CONSIDERED SETTLED LAW

In a Memorandum-Decision and Order issued by David R. Homer, US Magistrate Judge, on August 24, 2012, Judge Homer denied a joint motion of plaintiff SEC and Citizens Bank to permit a forced sale of the Smith's Saratoga residence by Receiver Brown.

In that Decision, Judge Homer opined, "First, because it is the Smiths' primary residence, it is likely beyond the reach of the SEC in this action at least to the extent of the New York Homestead exemption. Under NYCPLR §5206, real property owned and occupied as the principal residence is, to a certain degree, exempt from the satisfaction of money judgments." Here, Judge Homer's recognition of the state exemption for the Smith residence should be naturally extended to their retirement accounts as both assets fall under the same law, with retirement assets being held exempt under NYCPLR §5205.

Petitioners argue that the court is bound by Judge Homer's prior decision. Judge Homer ruled that the exemptions apply, the SEC had a full and fair opportunity to litigate the issue, and did not seek a rehearing or otherwise challenge that ruling. We would call that "either law of the case" or "res judicata."

In Brown's letter of December 27, 2018 to David Smith, he states in defense of his intentions to disgorge the retirement accounts, a prior decision by Judge Homer to deny the defendants' motion to unfreeze the Plan account because "if a disgorgement order was ultimately issued in this action, the money in your Plan account would be important in facilitating repayment." However, as Judge Homer noted in his August 24, 2012 Decision, "the criminal charges paralleling the civil claims brought by the SEC in this action contains a forfeiture allegation generally paralleling the asset forfeiture sought here." The criminal charges resulted in a joint liability with Mr. Smith's co-defendant of approximately 5.7 million dollars for restitution. That restitution order has now been satisfied by means of the Investor Distribution Fund. Receiver Brown has declared in previous reports to the court that he will ultimately provide distributions of approximately 23 million dollars, satisfying the distribution offset provided in the restitution order of Judge David Hurd by a multiple of approximately four times. Judge Homer's concern for the forfeiture allegation under the criminal indictment has been satisfied; thus, returning the court to the civil charges. Here the court must apply the principles of §2462, consider the existence of state law exemptions, consider prior rulings, and ultimately in the use of its permitted discretion decide what is fair and just under the law.

V

THE SUPREME COURT HAS RULED DISGORGEMENT IS IMPOSED FOR PUNITIVE PURPOSES, AND IN RESPECT TO THE COURT'S MISSION AND OBLIGATION TO ASSURE THAT THE LAW IS ADMINISTERED IN A FAIR AND JUST MANNER, THE DISGORGEMENT PENALTIES ALREADY IMPOSED ARE SUFFICIENT

In its decision in *Kokesh*, the Supreme Court reversed lower court opinions and held "SEC disgorgement operates as a 'penalty' under §2462." The Court states in its opinion that "First, the SEC disgorgement is imposed by the courts as a consequence for violating public laws, i.e. a violation committed against the Unites States rather than an aggrieved individual. Second, SEC disgorgement is imposed for punitive purposes. Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because 'deterrence is not a legitimate non-punitive governmental objective' (*Bell v. Wolfish*, 441 U.S. 520, 539, D. 20). Finally, SEC disgorgement is often not compensatory. Disgorged profits are paid to the district courts, which have discretion to determine how the money will be distributed. They may distribute the funds to victims, but no statute commands them to do so."

Petitioners have already made their arguments in (I) that under the penalty provisions of §2462, disgorgement must be implemented by means of adhering to the clearly stated limitations outlined, that is the $100,000 maximum for an individual, clearly identified pecuniary gains, and under the application of "equitable relief" permitted by the "fair funds" provision under the Sarbanes-Oxley Act of 2002. They have argued the SEC has not met those limitations, and even if they were allowed to try and do so, the amounts already disgorged from the Smiths would far exceed the amounts developed by any theory advanced by the SEC.

Thus, in this argument under V, Petitioners wish to address the notion of disgorgement's punitive purposes. We believe that when the court decides whether the retirement accounts should be retained by the Smiths using its lawful discretion, it should decide whether the punitive purposes have been appropriately served. The Smiths will argue that those purposes have been more than sufficiently served.

The Supreme Court has determined that disgorgement is not about satisfying investment losses, but rather about punitive action that will deter violators of the law and making sure that those who did so not benefit to the extent of their ill-gotten gains.

When considering whether the punishment has been sufficient for the Smiths, the petitioners point out that the law is about more than precedent. That is why we have judges and give them discretion. The law is allowed to take into account unique circumstances and include giving consideration as to "what is right," "what is fair," and "what is just."

The Smiths have already disgorged amounts far exceeding any ill-gotten gain that the SEC could conjure up. That by taking approximately 95% of the Smiths' net worth and the assets of a trust established for their children, the Smiths have been more than sufficiently punished, and that by leaving them their retirement account assets the court should be satisfied that the law has been applied and served in a just and fair manner.

Petitioners ask that the court consider the punishment the courts have already inflicted upon them and determine that is has been sufficient to meet the purposes of the law. When making that consideration, the court should not only consider Defendant David Smith, but relief defendants Lynn Smith, Geoffrey Smith, and Lauren Smith (now Mirich by marriage).

First, David Smith has lost the thing most dear to him, his long and well-earned reputation for integrity and exemplary character. Prior to these events no one would ever question or challenge that assertion. As a result of the consequences of these proceedings, Mr. Smith's reputation lies in tatters and is beyond redemption due to public perception. He has lost his business and his entire net worth, with only his retirement accounts remaining to be determined. He has been serving a ten year sentence as a result of his criminal conviction, and therefore has been of no financial assistance to his wife for the approximately five and a half years he has been incarcerated. He will be 76 years old at the time of his release with limited employment prospects due to his age and record as a convicted felon.

Lynn Smith has struggled financially and psychologically for the last nine years post the accusations and the freezing of all the family assets for that period. Her income has been limited to having only a predictable income of $1,100 per month from Social Security and the NYS Teachers' Retirement Fund. She has sporadically been able to supplement that income by a few thousand dollars a year from substitute teaching, but that is no longer available due to crippling arthritis and macro degeneration of her eyesight. While Mrs. Smith has remained stoic, loyal, and resolute through these draconian changes imposed on her through no fault of her own, she has not unsurprisingly suffered bouts of depression as a result of them. She has been a victim as much as anyone.

Believing that their punishment has been severe and complete, the Smiths ask the court in the interest of decency, fairness, and justice to release their retirement accounts and give them an opportunity to live what remaining years they have with some dignity and independence from the welfare of the state.

Under these circumstances, nine years has been a lifetime. The Smiths merely ask that they, believing that they have more than satisfied the imposition of the punitive intents of the law, be awarded the retirement assets that they firmly believe they are entitled to by law.

CONCLUSION

For the foregoing reasons the court should decide that the SEC's intentions to include the Smiths' retirement accounts for disgorgement purposes do not meet the very tests and limitations that are required. Now that the Supreme Court has clarified and determined that "disgorgement" is a penalty under § 2462, and its limitations apply to its implementation, this court should require the burden of proof, as jurisprudence requires, to be on the SEC to meet those limitations and principles. In addition, the court should use its accepted discretion in determining whether to disregard the state exemptions that currently exist for the Smiths' retirement accounts under NYCPLR §5205 by the ruling that circumstances, including the implication of Judge Hurd's decision of August 24, 2012, dictate that the exemptions should be honored. Finally, when employing its discretion, the court should give great weight as to whether the Smiths have sufficiently satisfied the law's punitive provisions by already having the vast majority of their assets subjected to the disgorgement.

We believe that when the court duly considers the aforementioned, they will correctly decide in favor of the Petitioners and release the retirement accounts of David and Lynn Smith immediately so that they may begin to meet the IRS Requirements for RMD and have access to their retirement funds to meet ordinary living expenses. We trust that the court will impose a fair settlement that successfully meets the arguments made in this motion.

Respectfully submitted, David L. Smith February 14, 2019

David L. Smith, pro se and as appointed representative for

Lynn A. Smith

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MCGINN, SMITH & CO., INC., DAVID L. SMITH, ET AL

Defendants,

10 Civ.457 (GLS/CFH)

CHRISTIAN F. HUMMEL

U.S. MAGISTRATE JUDGE

February 14, 2019

Dear Judge Hummel,

I respectfully request that the Court grant me permission to represent myself, Pro Se, and to represent my wife, Lynn A. Smith, in the enclosed matter of the "MOTION TO MODIFY THE ASSET FREEZE TO ALLOW THE RELEASE OF CERTAIN PROPERTY".

Neither my wife nor I are financially capable of retaining counsel to represent us and remain in substantial debt to previous counsel that has appeared before this Court on our behalf.

I believe that I am sufficiently versed in both the facts and the governing law that addresses the Motion, and Lynn A. Smith, having confidence in my ability to competently represent her, has provided written authorization for me to act as her representative.

It is my belief that this Court having issued an Order in November 2017 regarding a previous Motion filed by the SEC to modify the asset freeze is the proper court to file this "Motion" for due consideration.

Respectfully submitted,

David L. Smith
Federal Medical Center- Devens
Satellite Camp
Box 879
Ayer, MA 01432

Enclosures:

1. Lynn Smith's letter granting authorization of representation to David L. Smith

2. Affidavit of the mailing of the Motion to David Stoelting, Counsel for the Plaintiff SEC; William J. Brown, as Receiver; William Dreyer as Counsel of Record for David L. Smith; and James Hacker, former Counsel of Record for David L. Smith and Lynn A. Smith regarding a previous motion before the court and so ordered in November 2017.

Lynn A Smith

From: SMITH DAVID (19471052)

Sent Date: Friday, January 11, 2019 8:06 AM

To: smithyn2307@gmail.com

Subject: Legal representation

United States District Court
Northern District of New York
Christian F. Hummel
U.S. Magistrate Judge

Honorable Judge Hummel,

Please accept this authorization for David L. Smith to act as my representative for any proceedings that take place in your court concerning matters effecting me and my estate. David L. Smith has my authority to make any motions, pleadings, arguments, and representations advanced on my behalf.

Thank you for your consideration.

Respectfully,

Lynn A. Smith

2 Rolling Brook Dr.
Saratoga Springs, N.Y. 12866

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	**10 Civ.457 (GLS/CFH)**
DAVID L. SMITH,	:	
Defendant	:	
LYNN A. SMITH, ET AL	:	
Relief Defendant,	:	

CHRISTIAN F. HUMMEL

U.S. MAGISTRATE JUDGE

AFFIDAVIT OF DEFENDANT DAVID L. SMITH, ACTING PRO SE AND AS

AUTHORIZED REPRESENTATIVE FOR LYNN A. SMITH, RELIEF DEFENDANT

DAVID L. SMITH, being duly sworn, deposes and says:

1. On February 15, 2019, I copied by ~~registered~~ priority mail the "Motion to Modify the Asset Freeze to Allow the Release of Certain Property" filed with this Court on February 14, 2019 on behalf of Defendant David L. Smith and Relief Defendant Lynn A. Smith to the following:

Mr. William J. Brown, as Receiver
Phillips Lytle, LLP
One Canalside
125 Main St.
Buffalo, N.Y. 14203

and

Mr. David Stoelting
Attorney for Plaintiff
Room 400
3 World Financial Center
New York, N.Y. 10281

2. On February 14, 2019 I had emailed the "Motion to Modify the Asset Freeze to Allow the Release of Certain Property" filed with this Court on February 14, 2019 to the following:

Mr. William Dreyer, Counsel of Record
Dreyer Boyajian, LLP
75 Columbia Street
Albany, N.Y. 12210
WDreyer@dbls.com

and

Mr. James Hacker
Jones Hacker Murphy, LLP
28 Second Street
Troy, NY 12180
jhacker@joneshacker.com

Respectfully,

David L. Smith

On this 13 day of February 2019 before me, the undersigned notary public, personally appeared David Smith and proved to me through satisfactory evidence of identification, which were Id card to be the person whose name is signed on the preceding or attached document, and acknowledged to me that he/she signed it voluntarily for its stated purpose.

STEPHEN LARKIN, Notary Public
My Commission Expires April 19, 2024

Stephen Larkin
Notary Public, Commonwealth of Massachusetts
My Commission Expires April 19, 2024

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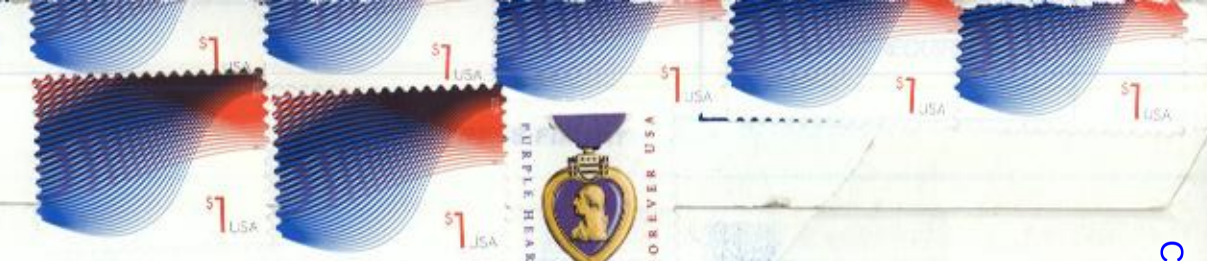

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Hon. Christian F. Hummel, U.S. Magistrate Judge

James T. Foley U.S. Courthouse
Room 441
445 Broadway
Albany, N.Y. 12207

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