U.S. DISTRICT COURT - N.D. OF N.Y.
FILED
MAY 09 2019
AT ____ O'CLOCK
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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

10 Civ.457 (GLS/CFH)

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

Defendants,

David Stoelting
Attorney for Plaintiff
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New York, N.Y. 10281

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Acting pro se and as appointed legal representative for Lynn A. Smith

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GARY L. SHARPE

SENIOR U.S. DISTRICT JUDGE

DEFENDANT'S BRIEF IN OPPOSITION TO THE PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION TO MODIFY THE ASSET FREEZE AND TO ALLOW THE RELEASE OF CERTAIN PROPERTY

Defendant David L. Smith respectfully submits this brief in opposition to the response submitted by the Securities and Exchange Commission of April 12, 2019.

The Plaintiff SEC in its response makes several false claims, introduces disingenuous arguments, and ignores current law in regards to disgorgement, specifically as a result of the Supreme Court decision in Kokesh v. SEC, 137 S. Ct. 1635 (2017.).

When the SEC's arguments are dismissed or reviewed in proper context as a result of the following reasons, Defendant's Motion to modify the asset freeze and to allow for the release of the retirement accounts should be granted.

The SEC response initiates its arguments by making the false claim that the Final Judgment ordering disgorgement of $87,433,218 represented profits from the alleged McGinn, Smith fraud. This incorrect identification of the $87,433,218 as profits (or ill-gotten gains) is the basis for the disgorgement claim. The fact is that the $87,433,218 is the calculated loss to investors as a result of taking the gross amount of money raised by McGinn, Smith in various securities offerings minus the amounts returned to them in the form of interest and principal payments. The incorrect use of the term "profits" instead of the correct designation as "losses" is the only way the SEC can justify its disgorgement claim. Disgorgement has now been clearly identified as a "penalty" under §2462 as a result of the Kokesh S.C. decision, and as a consequence must adhere to the civil penalties that apply, which include the gross amount of pecuniary gains (profits) to the defendant as a result of the violation. In addition, by law, those gains must be clearly traced to the particular funds or property in the defendants' possession.

In the Defendants' motion, it was emphatically stated that there were no pecuniary gains, that the SEC had never attempted to identify such gains, and had never attempted to trace those funds to the defendants' possession as required by law. In fact, the criminal case brought by the

U.S. Attorney's Office (USAO) never made such a claim despite reviewing the case for two years prior to indictment. The criminal case primarily claimed that investors suffered losses of approximately $5.7 million for reason of failure to disclose the appropriate risk to investors in violation of the Securities and Exchange Acts of 1933-34.[1]

Now the SEC wants to convince the court that the USAO, after two years of investigation, overlooked some $87 million dollars of gains that accrued to Mr. Smith and Mr. McGinn. The facts are, and are explicitly documented, that those monies the SEC claims were profits were actually invested on behalf of the investors as intended. That those dollars resulted in losses can be attributed to several reasons, including the misjudgment and mismanagement of the principals, Smith and McGinn, but they cannot be traced to ill-gotten gains as required for disgorgement.

The second claim in the SEC response that is disingenuous at best is that Smith has made no payments towards the satisfaction of his obligations. The facts argue quite differently. The SEC through its appointed receiver has confiscated assets from the Smiths believed to be in the $7-8 million range, although the receiver has never provided an accounting. Those assets include real estate, a trust for their children, Lynn Smith's stock account, bank accounts, and private investments in McGinn, Smith entities and private placement offerings. The fact that the receiver has not yet used those assets to make payments to investors is no fault of the Smiths, and since the Receiver has publically stated his intent to use those assets as investor payments, it is false to suggest that despite the control of those assets for nine years, they don't qualify as a payment simply because the Receiver has made the decision not to advance the monies to investors.

[1] The joint and several final verdict included approximately $241,000 of restitution for failure to report income taxes.

The SEC's response regarding state law exemptions such as N.Y.C.P.L.R. §5205 actually supports Smiths' motion as it cites several cases that give the Courts broad discretion to enforce disgorgement orders, including that they may in certain circumstances disregard such state exemptions. Smith agrees, arguing that in its use of discretion, the Court should consider the intent and the spirit of the exemption to prevent the defendants from becoming a ward of the state. Also, in the spirit of fairness, the Court in its discretion should consider that the Smiths will have eventually forfeited almost the entirety of their estate accrued over 40 years, and that estate was not acquired as a result of ill-gotten gains as required for disgorgement, but rather through honest efforts of savings and investment.

The SEC next attempts to dismiss the principal argument of the defendants that post Kokesh disgorgement must adhere to the penalty provisions of §2462. Their argument is not only not persuasive, it not surprisingly avoids the conclusions of the Kokesh decision by trying to focus on other aspects of the decision, namely the question of the statute of limitations. While the statute of limitations was central to the Kokesh case, the overriding conclusion the Supreme Court came to was that disgorgement operates as a penalty under §2462. In the opinion of Justice Sotomayor, who delivered the opinion, "this case presents the question whether §2462 applies to claims of disgorgement imposed as a sanction for violating a federal securities law. The Court holds it does." Thus, by ruling that disgorgement qualifies as a penalty, all of the penalty provisions must be adhered to, not just the five year limitation. Those other provisions include the monetary penalties, of identified and traced assets that the SEC has not met, nor are they able to. The SEC conveniently fails to address the principal provisions of §2642.

The SEC goes on to put forth the argument that Smith had attacked "the entirety of the disgorgement order." This is the use of hyperbole to the first order. What Smith stated in his motion

was "while the Kokesh decision calls into the question the entirety of the disgorgement order and how it was applied to the Smith's assets, petitioners realize that order was appealed and denied….", therefore acknowledging the standing decision regarding the non-retirement assets. Hardly an attack. What Smith argues is that the exemption for the retirement assets had yet to be adjudicated, notwithstanding Judge Homer's favorable ruling of August 2012, and if the SEC wishes to include those assets under the disgorgement order they must comply with §2462 or be in contravention of the law.

The SEC then goes on to state that the Supreme Court never questioned the authority of the Courts to order disgorgement in SEC enforcement cases, implying that defendants' argument suggested otherwise. Obviously, the Supreme Court in Kokesh did not question the concept of disgorgement, but they did rule that it must be enforced under the penalty provisions of §2462. The defendants' argument is that the SEC has never met those provisions, nor can they. The SEC then tries to support their irrelevant argument by stating several cases that upheld disgorgement post Kokesh. Most of those cases have attempted to challenge the Court's authority to order disgorgement. While during oral arguments, Justices Gorsuch and Sotomayor questioned whether the SEC had the requisite statutory authority to seek disgorgement in district court, those challenges have mostly been turned away. Incidentally, there is a current class action arguing that certain historical awards are also at issue. Jalbert v. SEC, 17-CV-12103 (D. MA. October 26, 2017), ECF. The Jalbert plaintiffs argue that because (I) the SEC can only collect penalties when specifically authorized by statute, and (2) Kokesh held that disgorgement, which is not specifically authorized by statute, is a penalty the SEC must return $14.9 billion in disgorgement that is has collected over the past six years. Jalbert's arguments would be similar to the defendants.

However, the defendants are not arguing the SEC's right to disgorgement, but only that it must adhere to the provisions of the penalties under §2462.

Finally, the SEC attempts to dismiss the defendants' argument that in Judge Sharpe's disgorgement order he stated that the only reason advanced by the SEC to hold Lynn Smith liable was the SEC's contention that Lynn Smith and David Smith were joint owners of the stock account and therefore David Smith's liability extended to the assets held in Lynn Smith's name. However, in regards to Lynn Smith's IRA there is no conceivable way to make the joint ownership argument. Thus, the SEC has come up with a new argument that the alleged fraudulent transfer of assets in the amount of $600,368 was an amount that David and Lynn were jointly responsible for, and therefore Lynn's IRA is an asset eligible to satisfy that liability, notwithstanding that the SEC provides information that is incorrect as to the amount of the liability (it is actually $442,368 as a result of the $150,000 offsets to Geoffrey and Lauren Smith disclosed in section III of the federal judgment filed 06/25/2015 and subsequent payment of $8,000 by Lauren Smith), their attempt fails for several reasons. This attempt to avoid the identification and tracing of ill-gotten gains to Lynn's IRA by shifting the liability from disgorgement to fraudulent conveyance fails because it is only the order of disgorgement that allows the court to use its discretion to penetrate the exemption for retirement accounts. A judgment as a result of alleged fraudulent conveyance is a civil judgment that is not permitted to penetrate an IRA as in the case of a court ordered disgorgement.

The second reason the SEC's argument fails is because Lynn has an excess of one million dollars (to the best of my recollection) represented by her individual ownership in Pine St. Capital that is outside her stock account with its alleged joint ownership and those monies will exceed the payment of the $442,368 and when applied will totally satisfy that judgment, leaving the entire IRA account available to her.

CONCLUSION

For the aforementioned reasons, the Plaintiff's opposition to the Motion should be rejected and the retirement accounts of Defendants Lynn and David Smith should be released to their control and benefit.

Respectfully submitted,

David L. Smith

David L. Smith

David L. Smith, Pro Se and appointed representative for Lynn A. Smith

ADDENDUM:

As a result of the ruling by Judge Sharpe rendered in his granting of the Defendants' request for a Rejoinder to the SEC's Response posted on May 2, 2019 that stated since David L. Smith is not a licensed attorney he is not entitled to represent Lynn A. Smith in any proceedings before this Court, Lynn Smith through a separate mailing to the Court has stated that she has read and fully understands the arguments and positions advanced in both the Motion of February 19, 2019 and the Rejoinder filed on May 7, 2019 and wishes the Court to accept both as representative of her own thoughts and arguments acting "pro se" and not through the representation of David L. Smith. She thanks the Court for this consideration.

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 ~~April~~ May 7 2019, I copied by ~~registered~~ first class mail the "Defendant's Brief In Opposition To The Plaintiff's Response To Defendant's Motion To Modify The Asset Freeze And To Allow The Release Of Certain Property" filed with this Court on ~~April~~ May 7, 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 ~~April~~ May 7, 2019 I had emailed the "Defendant's Brief In Opposition To The Plaintiff's Response To Defendant's Motion To Modify The Asset Freeze And To Allow The Release Of Certain Property" filed with this Court on ~~April~~ May 7, 2019 to the following:

Mr. William Dreyer, Counsel of Record
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and
Mr. James Hacker

Jones Hacker Murphy, LLP
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jhacker@joneshacker.com

Respectfully,

David L. Smith

On this 26 day of April, 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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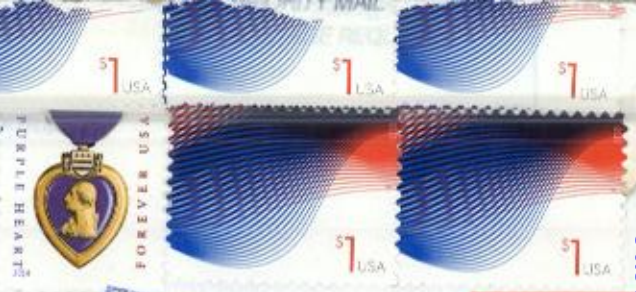

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