UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK
---X
SECURITES AND EXCHANGE COMMISSION,

Plaintiff,

NOTICE OF MOTION

-against-

10 Civ. 457 (GLS/CFH)

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, DAVID L. SMITH,
LYNN A. SMITH, DAVID M. WOJESKI, Trustee
of the David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04, GEOFFREY R. SMITH,
LAUREN T. SMITH, and NANCY McGINN.

Defendants,

LYNN A. SMITH, and NANCY McGINN,

Relief Defendants, and

DAVID M. WOJESKI, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,

Intervenor.

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PLEASE TAKE NOTICE, that upon the annexed Memorandum of Law in Support of Rule 60(b) Motion, and upon all proceedings previously conducted in this case, defendant David L. Smith will move before the Honorable Gary Sharp, United States District Judge, United States District Court, Northern District of New York, 445 Broadway, Albany, NY, for (1) an order granting Smith's motion for an order relieving David L. Smith of his obligations under the previously imposed disgorgement order in this matter, and ordering the return of $4,372,508.74 collected as unlawful "disgorgement" from Smith and his nominees, and (2) for a direction to the Receiver that he refrain from disbursing funds until after this motion is decided.

Dated: New York, New York
June 3, 2021

Respectfully submitted,

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK
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SECURITES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

10 Civ. 457 (GLS/CFH)

McGINN, SMITH & CO., INC., *et al.*,

Defendants.

---X

DAVID L. SMITH'S MEMORANDUM OF LAW
IN SUPPORT OF RULE 60(b) MOTION

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June 3, 2021

INTRODUCTION

The disgorgement order in this case is void under *Liu v. SEC*, 140 S. Ct. 1936 (2020), because it does not adhere to the limitations on the equitable remedy of "disgorgement," which this Court has authority to grant only when properly constituted. *Liu* and its predecessor, *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), stand for the proposition that a defendant may not be ordered to disgorge an amount other than a net amount which he personally obtained after legitimate expenses. This proposition has since been codified in an amendment to Section 21(d) of the Securities Exchange Act of 1934, and it applies to this case because this case was still pending at the time of the passage of the amendment. That amendment authorizes courts to order disgorgement of funds representing "unjust enrichment by the person who received such unjust enrichment as a result of such violation." 15 U.S.C. § 78u(d)(3)(A)(ii). Therefore, the U.S. Securities and Exchange Commission can lawfully obtain disgorgement only of funds received by Mr. Smith personally as a result of his violation that represent unjust enrichment. There is no authority under either Supreme Court precedent or the recent Section 21(d) amendment to collect funds in excess of the amount by which a defendant was unjustly enriched, nor to impose any prejudgment interest, and no authority to obtain funds from any so-called "relief defendants." According to the SEC, David Smith received only $1,736,000 as ill-gotten gains, but the Receiver has collected $6,108,508.74 from David Smith and Geoffrey (son) and Lynn (wife) Smith. Accordingly:

Under Federal Rule of Civil Procedure 60(b), the Court should declare the disgorgement order void and relieve defendant David Smith from his obligations thereunder.

Smith and his wife and son are entitled to the return of $4,372,508—the difference between the amount turned over to the Receiver and the amount David Smith received as unjust enrichment.

Further, we request that the Receiver be directed to refrain from disbursing funds until after this motion is decided.

BACKGROUND

I. THE SEC'S COMPLAINT AND SUMMARY JUDGMENT MOTION

On April 20, 2010, the SEC filed the complaint in this matter against McGinn Smith & Co., David L. Smith, Timothy M. McGinn, and others, and naming Lynn Smith as a relief defendant, alleging violations of the securities laws. The complaint sought, among other things, "A Final Judgment directing the Defendants and the Relief Defendant to disgorge their ill-gotten gains, plus pre-judgment interest." Complaint (ECF 1) at 34. The SEC also obtained an order freezing the defendants' assets.

In July 2014, the SEC moved for summary judgment on its disgorgement claim. The SEC sought a disgorgement award of $124 million, which allegedly represented "the proceeds of [the defendants'] fraud still owed to investors . . . plus prejudgment interest," and included "all of the unpaid principal they raised from their victims." *See* SEC Memo. of Law in Support of Motion for Summary Judgment (July 8, 2014) (ECF 708) at 14-16.

David Smith opposed, arguing that the disgorgement amount could not exceed (already collected) criminal restitution ordered to compensate victim losses in the parallel criminal proceeding, which totaled $5,748,722. *See* David L. Smith's Memo. of Law in Opposition to SEC Summary Judgment Motion (Attachment 22 to ECF 785) at 6-9.

In reply, the SEC urged the Court to apply what it characterized as "the standard measure of disgorgement in offering fraud cases," an amount "tied to the total amount raised minus the amount returned." SEC Reply (ECF 801) at 7. The SEC also claimed that it had "submitted uncontroverted evidence that total investor losses . . . [were] approximately $100 million." *Id.*

On February 7, 2015, the Court issued a Memorandum-Decision and Order ("MDO I") (ECF 807) granting the SEC's summary judgment motion. The Court found that it had broad discretion to order McGinn and Smith to "disgorge" their "profits," but found that it could not determine the proper disgorgement amount based on the SEC's submissions. MDO I at 37-39. The court exercised its "discretion" to include prejudgment interest "on any disgorged gains." *Id.* at 39-40. The Court further "agree[d] with the SEC that the proper metric for calculating disgorgement in actions such as this is subtracting the amount returned to investors from the total amount raised through the fraudulent offerings." *Id.* at 41. The Court found that "the SEC need only demonstrate 'a reasonable approximation of profits causally connected to the violation.'" *Id*. at 42 (quoting *SEC v. Contorinis*, 743 F.3d 296, 305 (2d Cir. 2014)).

The SEC filed supplemental submissions arguing that "the total amount" the defendants had raised in fraudulent offerings was $126,932,000; that $39,498,782 had been returned to investors as principal or interest, such that the "Net Disgorgement Amount" should equal $87,433,218; and that prejudgment interest totaled $11,668,132. SEC Memorandum in Support (ECF 809) at 2-6. Smith opposed, arguing that the government had proved only $6,336,440 in investor losses at the criminal trial. (ECF 815) at 4-5.

II. THE DISGORGEMENT ORDER

On March 30, 2015, the Court issued its disgorgement order. *See SEC v. McGinn*, 98 F. Supp. 3d 506 (N.D.N.Y. 2015). The Court was "satisfied that the SEC has demonstrated that $87,433,218 in disgorgement, plus prejudgment interest in the amount of $11,668,132 [was] appropriate." *Id*. at 519. The Court accepted the primary disgorgement award of $87 million as representing "the total amount raised through the fraudulent offerings," minus "the amount returned to investors." *Id*. at 520. Conversely, "McGinn and Smith [had] not met their burden in response 'to show that [their] gains were unaffected by [their] offenses.'" *Id*. at 521 (quoting *SEC v. Razmilovic*, 738 F.3d 14, 31 (2d Cir. 2013)). In awarding prejudgment interest, the Court noted that neither McGinn nor Smith had objected to the imposition of prejudgment interest and held that its decision as to whether to award prejudgment interest was "governed by the equities, reflecting considerations of fairness rather than a rigid theory of compensation." *Id.* at 522 (quoting *Contorinis*, 743 F.3d at 307-08).

III. SECOND CIRCUIT AFFIRMANCE

In a summary order, the Second Circuit affirmed the disgorgement order. *See SEC v. Smith*, 646 Fed. Appx. 42 (2016). The Second Circuit deemed waived David Smith's argument on appeal that the disgorgement award should have represented only net profits after taking into account legitimate business expenses. *Id.* at 43-44.

ARGUMENT

I. *KOKESH*, *LIU*, AND AMENDMENTS TO SECTION 21(d)

As it did in this case, for decades the SEC has used disgorgement as a purported "equitable" remedy, but which in reality constituted an additional, extralegal penalty that was imposed for law enforcement purposes of deterrence and punishment. The Supreme Court put an end to that practice in a pair of recent decisions, *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), and *Liu v. SEC*, 140 S. Ct. 1936 (2020). Congress followed early this year with an amendment to the remedy provisions of the Securities Exchange Act of 1934, which codified the Supreme Court's teaching in those two cases that proper disgorgement is a form of equitable remedy that is separate from penalty provisions and is limited to unjust enrichment by a defendant in an SEC enforcement proceeding (and nothing more). *See Liu*, 140 S. Ct. at 1940.

First, in *Kokesh*, the Supreme Court held that the remedy of "disgorgement," as courts and the SEC had imposed it for decades, is a penalty, not an equitable remedy, and, therefore, was subject to the five-year statute of limitations applicable to penalties. 137 S. Ct. at 1639. The Court noted that the term "disgorgement" was being applied to monetary orders that were imposed for punitive purposes and for violations of public laws, and that disgorged funds often went to the government rather than to compensate victims. *Id.* at 1643-44. As a result, these orders were penalties and subject to a five-year statute of limitations. *Id. Kokesh* also rejected the government's argument that disgorgement, as applied in SEC enforcement cases then, had been remedial. The Court reasoned that SEC disgorgement was punitive and not remedial because it often exceeded a defendant's "profits gained as a result of the violation"; required a defendant to pay money that third parties, not the defendant himself, received; and did not account for legitimate business expenses. *Id.* at 1644-45.

Because *Kokesh* was a limitations period challenge, the propriety of disgorgement as a remedy imposed at the time was not properly before the Court. The Supreme Court, therefore, expressly left open the question of whether, under the principle of the separation of powers, courts possess the authority to impose disgorgement penalties as they had, and as the SEC had requested, for years. 137 S. Ct. at 1642 n.3.

Three years later, in *Liu v. SEC*, 140 S. Ct. 1936 (2020), the Court answered the question: courts do not have the authority to impose those extra-statutory, penal disgorgement orders. *Liu* set forth the parameters of when a "disgorgement" order constituted permissible equitable relief under 15 U.S.C. § 78u(d)(5) as opposed to an extra-statutory penalty. Consistent with *Kokesh*, *Liu* held that courts must "restric[t] the remedy [of disgorgement] to an *individual wrongdoer's net profits* to be awarded for victims." *Id*. at 1942 (emphasis added). Therefore, "courts must deduct legitimate expenses before awarding disgorgement." *Id.* at 1950. The Court similarly rejected the SEC's position that obtaining disgorgement awards for the United States Treasury, as opposed to returning funds to investors, is permissible equitable relief. *Id*. at 1948.[1] *Liu* also rejected the practice of holding defendants jointly and severally liable for disgorgement orders. The Court stated that joint-and-several liability is "at odds with the common-law rule requiring individual liability for wrongful profits," and that the practice "could transform any equitable profits-focused remedy into a penalty." *Id*. at 1949 (citing *Contorinis*, 743 F.3d at 302, as an example of an impermissible disgorgement award). The practice of joint and several liability, moreover, "runs against the rule to not impose joint liability in favor of holding defendants 'liable to account for such profits only as have accrued to themselves . . . and not for those which have accrued to another, and in which they have no participation.'" *Id*. (quoting *Belknap v. Schild*, 161 U.S. 10, 25-26 (1896)).

Liu admitted of a particular circumstance "for partners engaged in concerted wrongdoing" which "allows some flexibility to impose collective liability." 140 S. Ct. at 1949. The only example of such a partnership that the Court provided is found in *Ambler v. Whipple*, 87 U.S. 546 (1874). In that case, Ambler and Whipple had formed

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[1] The Court left open the possibility that funds could properly be deposited with the Treasury "where it is infeasible to distribute the collected funds to investors." *Liu*, 140 S. Ct. at 1948-49.

a partnership to patent and sell an invention of Ambler's. *Id*. Whipple cut out Ambler and instead formed another partnership with a third party, Dickerson, and this second partnership earned—and was continuing to earn—profits from a new patent based on Ambler's invention at the time Ambler brought suit. *Id*. The Court held Whipple liable to Ambler for half of both patents, and the profits therefrom, under their original partnership agreement. *Id*. at 559. "As to Dickerson," the Court continued, "while he is not a trustee under [the Ambler-Whipple partnership agreement], we are of opinion that he has so far knowingly connected himself with and aided in the fraud on Ambler that he cannot resist Ambler's right to an undivided half of both the patents to Dickerson and Whipple, and of the profits made *or to be made out of them*. What rights or remedies he may have against Whipple we do not decide." *Id*. (emphasis added). In other words, under his agreement with Whipple, Dickerson was entitled only to a share of Whipple's half of the patents' earnings under the Ambler-Whipple partnership agreement. Put yet another way, under his agreement with Dickerson, Whipple could not share with Dickerson—and Dickerson could not keep—profits that rightly belonged to Ambler. Any assets received or to be received by Dickerson, therefore, can be traced to Whipple (and ultimately to Ambler) as Whipple shared sums that belonged to Ambler. This is a straightforward equitable tracing exercise.

The most reasonable way to reconcile *Liu*'s prohibition against joint and several liability with its allowance of "some flexibility to impose collective liability" on "partners engaged in concerted wrongdoing" is if *Liu* restricted the latter to the limited circumstances of *Ambler*. That is, under *Liu*, "collective liability" *may* be appropriate only if each person subject to the disgorgement order 1) participated in the wrongdoing (as the Court noted Dickerson did) and 2) controls and benefits from the corpus of the assets to be disgorged (as Whipple and Dickerson did by application of their partnership agreement). In other words, *Liu* left open a possibility that wrongdoers acting as partners may retain control over assets held or controlled jointly, and *that* may justify imposition of a disgorgement order under which all of the wrongdoers or any of them—as partners with power to control specifically-identified, unjustly-received or kept assets—could be ordered to exercise their power over the assets to pay them over to victims. The wrongdoers can then sort out their proper individual contributions among themselves, as the Court suggested Whipple and Dickerson could have done. *Ambler* at 559 ("What rights or remedies [Dickerson] may have against Whipple we do not decide.")

Liu arose in the context of Section 21(d)(5) of the Exchange Act of 1934, which authorized the imposition of equitable relief for the benefit of investors. At the time, neither that section nor the remainder of Section 21—the relevant set of provisions authorizing initiation of civil enforcement actions by the SEC and specifying available remedies—mentioned the word "disgorgement." Congress has since amended Section 21 to explicitly include disgorgement as a remedy. *See* 15 U.S.C. § 78u(d)(7). The amendments also codified the parameters *Liu* drew around disgorgement; courts have the power to order disgorgement of only "any *unjust enrichment by the person who received* such unjust enrichment as a result of the violation." 15 U.S.C.

§ 78u(d)(3)(A)(ii) (emphasis added).[2] This amendment appears consistent with *Liu* (and with *Kokesh* before that), and to the extent any part of the statute is *in*consistent with *Liu*, the amendment appears to *narrow* the Supreme Court's decision by doing away with the limited circumstance *Liu* allowed for collective partnership liability. The statutory amendments "apply with respect to any proceeding that [was] pending on, or commenced on or after, the date of enactment . . . ." National Defense Authorization Act for Fiscal Year 2021, H.R. 6395, § 6501.

As noted, Congress's amendments of the Exchange Act expressly to allow disgorgement, and to circumscribe disgorgement to "unjust enrichment by the person who received such unjust enrichment," appear to track the principles set out in *Liu* and *Kokesh*. First, the phrase "unjust enrichment by the person who received such unjust enrichment" limits the remedy of disgorgement to funds received (1) by the defendant only and not by third-party beneficiaries (regardless of whether they are dubbed "relief defendants"), and (2) after legitimate expenses have been deducted, as sums representing those expenses could not be fairly viewed as unjustly received and kept sums in the defendant's possession. These are the same limitations articulated in *Liu*, as described above. Second, Congress has maintained the distinction between

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[2] "After all, such 'statutory references' to a remedy grounded in equity 'must, absent other indication, be deemed to contain the limitations upon its availability that equity typically imposes,'" *see Liu*, 140 S. Ct. at 1947 (quoting *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 211 n.1 (2002)), and Congress provided no indication in its amendments of Section 21 that it intended to depart from the limitations that inhere in the equitable remedy of "disgorgement" (described in *Kokesh* and *Liu*); nor did Congress indicate an intent to fashion a new remedy of "disgorgement" divorced from its established meaning in equity.

the remedy of disgorgement and the statute's penalty provisions. *See* 15 U.S.C. § 78u(d)(3) (titled "Civil money penalties *and* authority to seek disgorgement") (emphasis added). The statute has provisions establishing a civil monetary penalty regime and the authority of the courts to implement that regime, *see id.* §§ 78u(d)(3)(A)(i), 78u(d)(3)(B)-(C), and the amendments allowing for and defining disgorgement are separate from the penalty provisions, *see id.* §§ 78u(d)(7), 78u(d)(3)(A)(ii). Congress even created separate limitations periods for disgorgement actions. *Id.* § 78u(d)(8). These distinctions between penalty provisions and disgorgement provisions track the distinctions drawn in *Kokesh*, as described above. Moreover, given Congress's express distinction between authorized disgorgement and the penalties available to courts and the SEC, disgorgement under 78u(d)(3)(A)(ii) must incorporate the limitations of *Liu* and *Kokesh*—otherwise, it would be a civil monetary penalty and not a separate equitable remedy.

In addition to the restrictions inherent in the equitable remedy of disgorgement, the statutory amendment of Section 21(d) further precludes the award of prejudgment interest as part of authorized disgorgement. Congress specifically authorized the SEC to "enter an order requiring accounting and disgorgement, *including reasonable interest*," in administrative enforcement proceedings, *see* 15 U.S.C. § 78u-2(e) (emphasis added), but included no such provision for prejudgment interest in enforcement proceedings in federal district court, *see id.* § 78u(d). The SEC may not transpose an administrative proceeding remedy into a district court enforcement action. *See AMG Capital Management, LLC v. FTC*, 141 S. Ct. 1341

(2021) (holding that agency may not obtain equitable monetary relief authorized in administrative proceedings but not in district court enforcement proceedings). If Congress had wanted to authorize the SEC to seek, and courts to order, an assessment of interest on unjustly received funds, it would have done so. *See, e.g.*, *Meghrig v. KFC Western*, 516 U.S. 479, 485 (1996) ("Congress thus demonstrated in CERCLA that it knew how to provide for the recovery of cleanup costs, and that the language used to define the remedies under RCRA does not provide that remedy.").

Before and after the adoption of 78u(d)(3)(A)(ii), a disgorgement order that exceeds the bounds of *Liu*—for example, by imposing joint and several liability or requiring disgorgement of prejudgment interest or funds that the offender did not actually receive—is not authorized by statute, and therefore presents a separation of powers violation. A monetary order, regardless of its label as "disgorgement," that exceeds the limitations of *Liu* and *Kokesh* is in reality a penalty. However, the SEC has no power to seek, and courts have no power to impose, an extra-statutory penalty that Congress carefully withheld from the remedies available under § 78u(d). *See Whalen v. United States*, 445 U.S. 684, 689 (1980) (stating that it is a "basic principle" that "within our federal constitutional framework the legislative power, including the power to define criminal offenses and to prescribe the punishments to be imposed upon those found guilty of them, resides wholly with the Congress"); *Welch v. United States*, 136 S. Ct. 1257, 1268 (2016) ("[A] court lacks the power to exact a penalty that has not been authorized by any valid criminal statute."); *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) (recognizing that "an agency literally has no power to act" absent a conferral of power upon it by Congress). *Cf. AMG Capital v. FTC*, 141 S. Ct. at 1345-52 (holding that agency had no authority to obtain, and court had no authority to order, equitable monetary relief provided for by statute in administrative enforcement proceedings, but not in court enforcement proceedings).

II. THE DISGORGEMENT ORDER IS VOID

A. Under *Kokesh*, *Liu*, and the Amendments to Section 21(d), the Disgorgement Order is Void

This case remains pending before this Court—in its final judgment, the Court expressly retained jurisdiction over the action, *see* ECF 835 at 10, and the Court has continued to issue orders in this action. Indeed, the most recent order issued in this matter is from May 7, 2021. *See* ECF 1186. More importantly, the equitable receiver continues to make investor distributions (and collect fees) pursuant to the disgorgement order to this day, as overseen currently by Judge Hummel.

The disgorgement order here directly and indirectly exceeded the bounds of permissible "equitable relief" under 15 U.S.C. § 78u(d)(5), *Liu v. SEC*, and the disgorgement amendment to 15 U.S.C. § 78u(d). Therefore, it must be invalidated as an unauthorized penalty. The amount of disgorgement awarded here was based on the SEC lumping together seemingly every dollar that McGinn Smith & Co. and any trust investment structure had ever raised and subtracting amounts distributed to investors with no effort to determine which defendant received which funds, whether those funds constituted unjust enrichment, or whether they resulted from wrongdoing. Nor did the disgorgement order calculate and subtract legitimate business expenses or market losses. The disgorgement order also failed to offset the criminal restitution. Unless unjust enrichment amounts are returned to victims to remedy victim losses, they do not constitute equitable disgorgement under *Kokesh*; they are instead an unauthorized penalty. Thus, since victim losses were remedied by restitution paid, any further order of disgorgement is an unauthorized penalty. In other words, sums returned to victims as restitution diminish the amount subject to disgorgement. On top of this, the substantial fees of the equitable receiver in this case are being collected from money seized from the Smiths without any offset to the disgorgement order, which further constitutes an unauthorized penalty as opposed to equitable relief strictly limited to net profits. That is, an equitable receiver should be compensated by the Court or by the beneficiaries of his or her work (i.e. anyone who seeks distributions from the receiver). By deducting those fees from the corpus of money collected, without any deduction from the amount of disgorgement due, the order, as a practical matter, has imposed an additional penalty on David Smith equal to those fees. There is no statutory basis for that penalty and it is void.

The Court should declare the disgorgement order void as to David Smith and relieve him of his obligations under it. The Court should also order the return to David Smith and his wife and son any money or property collected by the Receiver from them in excess of the $1,736,000, which represent the individual "net profits" of David Smith—or, in the words of Section 21(d) amendment, the unjust enrichment by David Smith that David Smith received as a result of the violation—to which the equitable relief of disgorgement is "restricted." *See Liu*, 140 S. Ct. at 1942; 15 U.S.C. § 78u(d)(3)(A)(ii).

The record reflects that Smith received distributions of $1,736,000 from the McGinn Smith entities. The SEC's accountant, Kerri L. Palen, calculated that figure in her affidavit and supporting exhibits, which the SEC submitted as part of its Statement of Material Facts in support of its summary judgment motion. *See* (ECF 712). Ms. Palen's detailed review found that David Smith had received $1,736,000, and she specifically labelled them Smith's "proceeds of fraud." (ECF 712 at 87-134, Exhibit 26). It is indisputable that Smith never received or possessed the $87 million in investor funds that formed the basis of the disgorgement order in this case. As of April 2020, the Receiver had collected $6,108,508.74 from David Smith, Geoffrey Smith, and Lynn Smith. *See* April 14, 2020 Email from Receiver to Geoffrey Smith with Attachment (attached hereto as **Exhibit 1**).

B. Rule 60(b) Requires Relief from the Void Disgorgement Order

Under Rule 60(b), "the court may relieve a party or its legal representative from a final judgment, order, or proceeding" for a number of reasons." Fed. R. Civ. P. 60(b). One of those reasons is when "the judgment is void," Fed. R. Civ. P. 60(b)(4), and, unlike the other subsections, which are discretionary, a court is required to grant the 60(b) motion without regard to time restrictions if the judgment was void. *See Orner v. Shalala*, 30 F.3d 1307, 1310 (10th Cir. 1994).

A judgment is void under 60(b)(4) where "the rendering court was powerless to enter it," *Combs v. Nick Garin Trucking*, 825 F.2d 437, 442 (D.C. Cir. 1987), or "proceeded beyond the powers granted to it by law" *McRae v. District of Columbia*, Civ. Action No. 05-2272 (RBW) (D.D.C. Mar. 19, 2007) (citing *Eberhardt v. Integrated*

Design & Constr., Inc., 167 F.3d 861, 871 (4th Cir. 1999)).[3] Formulated another way, "[a] judgment is void under [Rule 60(b)(4)] only if the court that rendered it lacked jurisdiction of the subject matter, or of the parties, or if it acted in a manner inconsistent with due process of law." *Grace v. Bank Leumi Trust Co. of N.Y.*, 443 F.3d 180, 193 (2d Cir. 2006) (quotations omitted).

Here, the Court had no power to impose, and the SEC had no power to seek, a disgorgement order in the current form against the Smiths. *See La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) (recognizing that "an agency literally has no power to act" absent a conferral of power upon it by Congress). Because the disgorgement order far exceeds David Smith's individual net profits of $1,736,000, it constitutes an unauthorized penalty. *See Liu*, 140 S. Ct. at 1942. The order also fails to offset against the disgorgement amount the millions of dollars being extracted from the Smiths to pay the receiver's fees, which further exacerbates the order as an invalid penalty. *See Kokesh*, 137 S. Ct. at 1644 ("When an individual is made to pay a noncompensatory sanction to the Government," as opposed to an aggrieved party, "as a consequence of a legal violation, the payment operates as a penalty."). In addition, the receiver incurred additional fees collecting the disgorgement award that would have been avoided had the SEC sought and the Court ordered disgorgement limited to the proper amounts actually obtained by Smith. Given the context, the fees obtained from Smith by the receiver constitute a taking or illegal exaction. *See*

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[3] *Available at* https://casetext.com/case/mcrae-v-district-of-columbia.

Mallow v. United States, 161 Ct. Cl. 446 (Cl. Ct. 1963) ("[I]n being tried, convicted and fined by courts-martial that had no jurisdiction over him, the plaintiff was deprived of property (i.e., of his money) without due process of law, in violation of the due process clause of the Fifth Amendment to the Constitution."); *Aerolineas Argentinas v. United States*, 77 F.3d 1564 (Fed. Cir. 1996) (expanding illegal exaction doctrine to include instances in which a party was required to pay money to a third party, not to the government).

Furthermore, the practice of joint and several liability is inconsistent with equitable disgorgement, which is an *in rem* remedy tied to a specific right in property, *see Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213-14 (2002), a point which the Supreme Court acknowledged in *Liu*, *see* 140 S. Ct. at 1949; *SEC v. Yang*, 824 Fed. Appx. 445, 447 (9th Cir. 2020) (remanding, in light of *Liu*, because "it [was] unclear whether the district court limited its disgorgement orders imposed against the two individual defendants to their specific conduct where, for example, it made them both jointly and severally liable for the disgorgement amounts ordered against the entity defendants"). The disgorgement order here, inconsistent with *Liu*, made no effort to distinguish between money received by the defendant entities and money received by David Smith. The entities took in tens of millions of dollars, but David Smith received (and was personally enriched by) only a relatively small portion ($1,736,000) of that amount as "proceeds of fraud." *See* (ECF 712 at 87-134, Exhibit 26). McGinn likewise received—again according to the SEC itself—only a relatively small amount, $2,118,579. *See* (ECF 712 at 42-43, Exhibit 7). Thus, even if Smith and

McGinn fell within the "collective liability" of partners exception left open in *Liu* (but seemingly closed by Congress's amendments to 78u(d)), their collective gains would total approximately $4 million, not the $87 million of the disgorgement order. *See United States v. Contorinis*, 692 F.3d 136, 146-48 (2d Cir. 2012) (holding that defendant convicted of insider trading could not be ordered to forfeit as "ill-gotten gains" the money that his employer hedge-fund received, or the losses avoided, as a result of insider trading; only the funds he had actually received were forfeitable).[4] In other words, Smith cannot be ordered, consistent with "equitable relief" under 15 U.S.C. § 78u(d)(5) and (7) and *Liu*, to disgorge money that he did not actually receive or maintains no control over. Plus, there is no evidence that Smith and McGinn diverted to each other the money, benefits, or control of the gains that they actually did receive individually (a small fraction of the $87 million order), meaning that they do not fall within the limited "collective liability" exception that the Supreme Court left open. *See Liu*, 140 S. Ct. at 1949. Thus, David Smith could properly be ordered to disgorge, as "equitable relief," only the $1,736,000 of "ill-gotten gains" he received.

The *Liu* decision did not address prejudgment interest, but the imposition of prejudgment interest on the "equitable disgorgement" here was also an unauthorized

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[4] No collective liability can be imposed here because, for the reasons explained above, "collective liability" under *Liu* is something different from joint and several liability; it is liability imposed on wrongdoers who, as partners, collectively control the corpus of the funds subject to being paid to victims. Smith and McGinn are not in that situation. *See Liu*, *see also Ambler v. Whipple*, 87 U.S. 546 (1874) (equity permits imposition of collective liability where a person liable for patent infringement owns another infringing patent jointly with a business partner). And, they were not general partners as in *Ambler*; they had defined roles in various corporate and other entities.

penalty. In the disgorgement order, the Court treated prejudgment interest as a discretionary matter of fairness, relying on *SEC v. Contorinis*. *See McGinn*, 98 F. Supp. at 522. In equity, however, and thus under the SEC's statutory power to obtain equitable relief (including disgorgement) only interest actually earned on the particular funds or property wrongfully obtained in the defendant's possession can be recovered, *see Great-West*, 534 U.S. at 213, 213-214 n.2, and the Supreme Court used *Contorinis* as an example of how the caselaw had impermissibly expanded the true "equitable relief" of disgorgement, *see Liu*, 140 S. Ct. at 1946 n.3, 1949. Indeed, prejudgment interest unmoored from any interest that a defendant actually earned with the proceeds of a violation cannot fairly be described as "unjust enrichment by the person who received such unjust enrichment as a result of such violation." *See* 15 U.S.C. § 78u(d)(3)(A)(ii). Perhaps for this reason, Congress did not authorize prejudgment interest with the disgorgement amendments of Section 21(d). *See generally id.* § 78u(d). It is a penalty without statutory basis.

C. The Imposition of the Void Disgorgement Order Was an Unwaivable Separation of Powers Violation

Because, as recent Supreme Court decisions have declared and Congress has clarified, the SEC lacked authority to seek, and the Court lacked authority to impose, the monetary order issued here as "disgorgement," the arguments asserted here cannot have been "waived," as the Second Circuit found, in part. *See Smith*, 646 Fed. Appx. at 43-44. The Second Circuit did not have the benefit of the Supreme Court's delineation of the SEC's statutory power, and thus it treated the issue as one of simple appellate practice. With the benefit of the Supreme Court's guidance, however, it is now clear that the issue is one of executive power, and no party can confer power on the executive to impose or extract a penalty (by waiver or otherwise) that Congress has not itself conferred. *See CFTC v. Schor*, 478 U.S. 833, 850-51 (1986) (litigants cannot waive a structural separation of powers violation); *Pacemaker Diagnostic Clinic of America, Inc. v. Instromedix, Inc.*, 725 F.2d 537, 543-44 (9th Cir. 1984) (Kennedy, J.) (en banc) (same); *La. Pub. Serv. Comm'n*, 476 U.S. at 374 ("To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress. This we are both unwilling and unable to do."); *United States v. U.S. Fidelity & Guaranty Co.*, 309 U.S. 506 (1940) (voiding a judgment against the United States where the court lacked jurisdiction, *i.e.*, statutory authority, to impose it, even though the United States had not directly challenged the judgment). Even if Smith had expressly agreed to the disgorgement order, such a stipulation could not have conferred the power on this Court, withheld by Congress, to issue an order that exceeds the bounds of true equitable disgorgement (as delineated by the Supreme Court and Congress) and acquiesce in an order that is in reality an unauthorized penalty. *See Schor*, 478 U.S. at 850-51; *Nguyen v. United States*, 539 U.S. 69, 80-81 (2003) ("[T]o ignore the violation of the designation statute in these cases would incorrectly suggest that some action (or inaction) on petitioners' part could create authority Congress has quite carefully withheld. Even if the parties had *expressly* stipulated to [the disputed issue], such a stipulation would not have cured the plain defect in the composition of the panel.").

* * * *

The disgorgement order here bears little resemblance to the equitable relief contemplated and permitted by statute, as analyzed in *Liu v. SEC* and codified in amendments to Section 21 of the Exchange Act. Accordingly, the judgment was void under Rule 60(b)(4), and the Court should grant David Smith relief to stop the enforcement of unauthorized penalties against him, as well as to return money collected from him and his family as an unlawful penalty.

CONCLUSION

For the foregoing reasons, the Court should declare the disgorgement order void under Federal Rule of Civil Procedure 60(b)(4) and order the return by the Receiver of $4,372,508 to David Smith and his family—the difference between the amount collected by the Receiver from the Smiths and the amount David Smith received as proceeds of fraud.

Dated: June 3, 2021
New York, New York

Respectfully submitted,

/s/

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Attorneys for David L. Smith

Gmail **Geoffrey Smith <gsmith2307@gmail.com>**

Turned over and frozen Smith accounts

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gsmith2307@gmail.com <gsmith2307@gmail.com> Tue, Apr 14, 2020 at 7:01 AM
To: "William J. Brown" <WBrown@phillipslytle.com>

Thank you Bill. I did not see my accounts in the list.

Also, do you know what years you paid taxes for Lynn?

Best,

Geoff

Geoffrey Smith, CFA
917-623-8235

Sent from my iPhone

> On Apr 14, 2020, at 6:53 AM, William J. Brown <WBrown@phillipslytle.com> wrote:
>
> Geoff,
>
> Attached is a list with the information you requested. I have also provided a copy to the SEC given the purpose stated in your e-mail.
>
> Bill
>
> ---
>
> **From:** Geoffrey Smith <gsmith2307@gmail.com>
> **Sent:** Friday, April 10, 2020 4:34 PM
> **To:** William J. Brown <WBrown@phillipslytle.com>
> **Subject:** Turned over and frozen Smith accounts
>
> **External Email:** Use Caution.
>
> [Quoted text hidden]
>
> **William J. Brown**
> Partner
>
> Phillips Lytle LLP

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Download vCard

<Smith Accounting-C.pdf>

WJ Brown - Reciever
Amount Received from
David, Lynn & Geoffrey Smith

		Amount
SMITH TRUST:		
	Pine Street	654,513.34
	Community Bank - MMK	1,556,389.88
	Community Bank - Checking	36,126
	Bank Transfer	100,000
	Camp Sale	545,204.16
	Camp Expenses	-70,453.52
	Investment Account Proceeds	606,700.85
	Investment Account Proceeds	1,384.18
	Taxes Paid 13,14,15. 16	-56,475.97
	Sub Total Smith Trust:	3,373,388.92
LYNN SMITH:		
	Pine Street	2,244,607.38
	Saratoga Home	67,511.36
	Vero Beach Home Sale	102,310.94
	Vero Beach Home Expenses	-17,472.88
	Investment Account	173,951.91
	Investment Account #2	23.2
	Taxes Paid for Lynn Smith	-17,808.55
	Sub Total Lynn Smith:	2,553,123.36
DAVID SMITH:		
	JohnHancock 401k	144,489.52
	IRA	34,453.02
	Restitution	3,053.92
	Sub Total David Smith	181,996.46
	Grand Total	6,108,508.74