UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

No. 10-CV-457 (GLS/DRH)

TIMOTHY M. McGINN; DAVID L. SMITH; and LYNN A. SMITH,

Defendants.

DAVID R. HOMER
U.S. MAGISTRATE JUDGE

ORDER

A preliminary injunction was previously entered upon the consent of plaintiff Securities and Exchange Commission ("SEC"), defendants Timothy M. McGinn ("McGinn"), and David L. Smith and over the opposition of defendant Lynn A. Smith. Dkt. Nos. 54, 86, 96, 194. Presently pending is the SEC's motion (1) to amend the preliminary injunction order to prohibit McGinn, David Smith, and Lynn Smith from using credit cards during the pendency of this action, and (2) requiring periodic accountings from those defendants. Dkt. No.143. The defendants oppose the motion. Dkt. Nos 145, 146. Also pending is Lynn Smith's cross-motion to lift the asset freeze in the preliminary injunction order to pay attorney's fees and living expenses. Dkt. No. 146. The SEC opposes Lynn Smith's cross-motion. Dkt. No. 151. For the reasons which follow, both the SEC's motion and Lynn Smith's cross-motion are denied.

As to the SEC's motion, the preliminary injunction order states in pertinent part that McGinn, David Smith, and Lynn Smith shall "hold and retain within their control, and otherwise prevent, any withdrawal, transfer, pledge, encumbrance, assignment,

dissipation, concealment or other disposal of any assets, funds, or other property . . . of, held by, or under the direct or indirect control of" McGinn, David Smith, and Lynn Smith. Dkt. No. 96 at § VI; see also Dkt. No. 58 at VI. There appears no dispute that all three defendants have incurred credit card debt since the entry of that order. These motions followed.

The language of the preliminary injunction order does not explicitly prohibit the defendants from incurring credit card debt. It prohibits the defendants from encumbering their assets, from which the SEC suggests that since credit card companies would become additional creditors of the defendants if the credit card debt is not paid, the additional claims to the assets of the defendants may encumber and diminish those assets in violation of the preliminary injunction order. A reading of the plain language of the preliminary injunction order does not support a contention that the order now prohibits credit card debt. Moreover, since the order was the result of negotiations between the SEC, McGinn, and David Smith, the absence of explicit language prohibiting such debt further supports a strict reading of the order's terms as does the fact that inclusion of a strict prohibition could easily have been accomplished if the parties had so desired. Thus, the preliminary injunction does not presently prohibit the defendants from incurring credit card debt.

The question then becomes whether the preliminary injunction order should be amended to provide such an explicit prohibition. That order was entered with the consent of McGinn and David Smith after negotiation of its terms among the parties. An amendment which, as here, would materially and adversely alter its terms requires the consent of McGinn and David Smith. They deny such consent and assert that they will

withdraw their consent to the order if an amendment is granted prohibiting their use of credit cards. In the event of such a material alteration of the terms to which they consented, McGinn and David Smith are entitled to withdraw their consent and to a hearing on all matters related to the SEC's motion for a preliminary injunction. See Shared Servs., Inc. v. Shared Tech., Inc., No. 90-C-753, 1990 WL 72098, at *2-3 (N.D. Ill. May 14, 1990).

Therefore, unless the SEC's motion to amend the order is futile, a hearing must be held to determine if the SEC satisfies its burden of demonstrating the elements necessary to obtain a preliminary injunction. Cf. Ricciuti v. N.Y.C. Transit Auth., 941 F.2d 119, 123 (2d Cir.1991) (holding that motion to amend a complaint should be denied if futile). Here, the premise of the SEC's proposed amendment is that if these defendants incur additional credit card debt and are unable to repay it, the credit card companies will become additional creditors in future proceedings to collect against the defendants' assets and thereby threaten the availability of those assets to satisfy the claims of investors in this case in the event of a judgment against the defendants. First, however, the threat, if any, to the availability of assets to investors is contingent both on the defendants failing to pay the debt and on a determination that a judgment on such debt would take precedence over the claims of investors. Neither contingency is reasonably certain. Second, the amount of credit card debt which these defendants are likely to incur is not unreasonable in these circumstances. It appears from the SEC's motion, for example, that the three defendants incurred a total of approximately $21,000 in credit card debt through July 2010. Dkt. No. 143-3-5. Finally, where the defendants' assets have been frozen, incurring debt through loans from friends, family, and other available sources affords one of the few ways

presently available to these defendants to pay living and legal expenses. To foreclose such sources of financial support from these defendants would work an undue hardship on them in these circumstances, particularly where the potential harm to investors from such debt remains speculative. Accordingly, the SEC's motion to amend the preliminary injunction order to add a prohibition against incurring credit card debt is denied.

As to the SEC's motion to compel these defendants to provide periodic accountings of their financial conditions, that motion rests on the contention that all known assets of these defendants have been frozen in the preliminary injunction order, the defendants had not sought any relief from the stay to pay for legal and living expenses, the defendants must, therefore, be paying their current expenses from sources unknown which could be subject to the preliminary injunction order, and an accounting should be required to address this possibility. The facts underlying this motion may give rise to suspicions, but mere suspicion and speculation alone will not suffice to require accounting. The SEC has previously received statements from these defendants regarding their assets and, in addition, Lynn Smith has testified under oath regarding the same subject. The SEC has also subpoenaed financial records of the defendants and received the cooperation of law enforcement authorities who conducted numerous searches of premises associated with these defendants for, inter alia, financial records. In these circumstances, then, absent a showing beyond suspicion and speculation, periodic accountings by these defendants will not be required.

As to Lynn Smith's cross-motion, she seeks to lift the asset freeze in the preliminary injunction order to permit her to pay various legal and living expenses. As a threshold matter, this motion fails because Lynn Smith has failed to demonstrate the financial need

required to obtain this relief. On the SEC's motion for the preliminary injunction, a vacation home on Great Sacandaga Lake which Lynn Smith had inherited from her father was released from the asset freeze back to her control. Dkt. No. 86 at 37. Lynn Smith then sold the unencumbered property in July 2010 to a family trust for which she received at least $440,000. Dkt. No. 142-2 at 4. These funds should allow payment of all reasonable legal and living expenses of Lynn Smith for the foreseeable future without the necessity of lifting the asset freeze for her in any respect. Expenditure of these funds for excessive and unreasonable legal and living expenses does not and will not provide a basis to lift the asset freeze. Accordingly, Lynn Smith's cross-motion is denied.

WHEREFORE, for the reasons stated above, it is hereby

ORDERED that:

1. The motion of the SEC for an order to amend the preliminary injunction order to prohibit McGinn, David Smith, and Lynn Smith from incurring additional credit card debt and to require them to provide periodic accountings of their assets (Dkt. No. 143) is **DENIED**; and

2. The cross-motion of Lynn Smith to lift the preliminary injunction order to permit her to use assets to pay certain legal and living expenses (Dkt. No. 146) is **DENIED**.

IT IS SO ORDERED.

DATED: December 2, 2010

David R. Homer
U.S. Magistrate Judge