UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	
vs.	:	
	:	
McGINN, SMITH & CO., INC.,	:	Case No. 1:10-CV-457
McGINN, SMITH ADVISORS, LLC,	:	(GLS/CFH)
McGINN, SMITH CAPITAL HOLDINGS CORP.,	:	
FIRST ADVISORY INCOME NOTES, LLC,	:	
FIRST EXCELSIOR INCOME NOTES, LLC,	:	
FIRST INDEPENDENT INCOME NOTES, LLC,	:	
TIMOTHY M. McGINN, AND	:	
DAVID L. SMITH, GEOFFREY R. SMITH,	:	
Individually and as Trustee of the David L. and	:	
Lynn A. Smith Irrevocable Trust U/A 8/04/04,	:	
LAUREN T. SMITH, and NANCY McGINN,	:	
	:	
Defendants,	:	
	:	
LYNN A. SMITH and	:	
NANCY McGINN,	:	
Relief Defendants,	:	
	:	
-and-	:	
	:	
GEOFFREY R. SMITH, Trustee of the	:	
David L. and Lynn A. Smith Irrevocable	:	
Trust U/A 8/04/04,	:	
	:	
Intervenor.	:	

STEPHEN FOWLER'S MOTION TO FILE SUR-REPLY

1. Investor Stephen Fowler hereby files this Motion for Leave to File a Sur-Reply in Opposition to the Receiver's Motion for an Order Approving Plan of Distribution of Estate Assets (Dkt. No. 847). This Motion is necessary to respond to a number of cases that the Receiver cites for the first time in his Reply in Support of the Plan (Dkt. No. 883).

2. The Receiver's Reply cites a number of new cases (including unpublished orders) for the proposition that the Offset Provision in the Plan is proper and commonly-utilized. (Reply at 6.) ***None of these cases*** permitted a dollar-for-dollar offset from claimant's ***distribution amount*** like the Receiver seeks to impose in this case. Rather, the vast majority of these cases only reduced the victim's ***claim amount***. *See In re Equity Funding Corp. Of Am. Sec. Lit.*, 603 F.2d 1353, 1354 (9th Cir. 1979) (reducing the *claim* amount, *i.e.* the "net adjusted loss," based on recoveries made in a related reorganization proceeding); *S.E.C. v. Wang*, 944 F.2d 80, 87 (2d Cir. 1991) (offsetting option traders' *claims* based on gains made on related call options purchased during the same time period); *C.F.T.C. v. Cook*, 09-3332 (D. Minn.), Dkt. No. 494 at 10 (stating that the receiver will "deduct from each victim's *claim*..." (emphasis added)); *S.E.C. v. Med. Cap. Holdings, Inc.* 09-0818 (C.D. Ca.), Dkt. No. 1108 at 2 ("the [plan] provides that the MIMO *claim* amount will be reduced by amounts received..." (emphasis added)). [1]

3. This is a significant distinction. Under these cases, if Mr. Fowler's original claim was $3 million and he recovered $300,000 from a third-party, it would reduce Mr. Fowler's claim to $2.7 million.[2] If the Receivership Estate paid 18% of claims, Mr. Fowler would still be entitled to a distribution of $486,000 ($2.7 million * 18%). The cases do not support offsetting Mr. Fowler's ***distribution amount***, which would leave Mr. Fowler with a distribution of only $240,000 from the Receivership estate using the same claims rate ($3 million * 18% = $540,000 - $300,000 = $240,000). This would be a difference of $246,000 ($486,000 - $240,000).

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[1] Mr. Fowler previously cited *Parish* and *Capital Consultants* in his Objection to the Plan (Dkt. 865, p. 9). As stated therein, *Parish* also offset the *claim* amount, while *Capital Consultants* provided only a 50% reduction in the distribution amount – not a dollar-for-dollar reduction. *Id.*

[2] These amounts were simplified for this example. As stated in Mr. Fowler's objection, Mr. Fowler's actual claim was $3,020,749.29 and the collateral recovery at issue was $382,000.

4. The only case cited by the Receiver where a receiver attempted a dollar-for-dollar offset of the distribution amount was *S.E.C. v. Stanford Int'l Bank*, 09-0298 (N.D. Tex.). In that case, the receiver proposed a provision identical to the Offset Provision, but the court ***adopted a different procedure*** in its order approving the plan. (*Id.*, Dkt. No. 1766, pp. 11-12.) Under the court's unpublished order, the receiver was permitted to reduce payments to the claimants based on collateral recoveries, but claimants were provided an opportunity to file an objection to such reductions with the court. (*Id.*, Dkt. No. 1877, p 7.) Further, the court held that claimants still had a right to pursue claims against third-parties after receiving their distribution. (*Id.* at pp. 9-10.) Thus, even the plan in *Stanford* did not provide the receiver with the authority to make a dollar-for-dollar offset of claimants' distributions in all cases.

5. Notwithstanding these cases, the Receiver fails to provide any compelling reason to reduce even Mr. Fowler's ***claim amount*** where Mr. Fowler is nowhere close to recovering 100% of his losses. The Receiver does not offer any reasonable basis for distinguishing *Ivanhoe*, 295 U.S. 243, 247 (1935) or *In re Del Biaggio*, 496 B.R. 600, 602 (Bankr. N.D. Cal. 2012), which hold that a court should not deduct a collateral recovery ***at all*** where a claimant is not close to recovering 100% of his losses. The Receiver's sole argument, that these cases were decided under the federal bankruptcy code (Reply at 7), is not persuasive since the Receiver invokes the application of the same bankruptcy code for his own benefit elsewhere in his Reply (*e.g.*, *id.* at 6 ("The Bankruptcy Code, a codified equitable proceeding, likewise promotes equality of recovery among creditors by application of the preference recovery rules...") and 11-12 (arguing that the body of case law regarding deadline to object to claims under the bankruptcy code "is instructive" because of the limited case law in the receivership context)).

6. The Receiver's reliance on *CFTC v. Walsh*, 712 F.3d 735, 754 (2d Cir. 2013) and *In re Reserve Fund Sec. & Derivative Litig.*, 673 F. Supp. 2d 182, 196 (S.D.N.Y. 2009) also is not compelling because any difference in treatment between investors is not arbitrary or based solely on mere chance. (Reply at 5.) After the fraud was discovered, Mr. Fowler affirmatively took action to mitigate his losses by pursuing alternative recoveries. This was not arbitrary or chance, but was Mr. Fowler's own decision. This action should be rewarded. Further, the cases cited by the Receiver are distinguishable because they were trying to control for differences in how victims' investments were handled ***before*** the fraud was discovered. They did not seek to equalize losses based on what the victims chose to do ***after*** the fraud was discovered.

7. The Receiver's argument that other investors are worse off without the offset because "every dollar attributable to a collateral recovery that is not deducted from an investor's distribution is one less dollar that is available to be distributed among all investors," fails because the other investors were ***never entitled*** to Mr. Fowler's collateral recovery. (Reply at 6.) This is like saying that other investors are worse off if the Receiver does not confiscate another victim's car; the other investors never had a right to that car so they are not worse off without it. Nothing was taken out of the Receivership estate and the Receivership estate is not smaller based on Mr. Fowler pursuing and receiving his collateral recovery. If Mr. Fowler had not pursued such claims, the Receivership estate would have exactly the same amount of money that it has now.

8. Finally, the Receiver's argument that it is not mandating the assignment or ownership of Mr. Fowler's claims because it allowed Mr. Fowler to pursue those claims and secure the collateral recovery would be laughable if it was not so unfair to Mr. Fowler. (Reply at 8.) The Receiver is effectively seeking assignment of Mr. Fowler's claims by confiscating the entire recovery that Mr. Fowler made from those same claims. The Receiver seeks to confiscate

Mr. Fowler's recovery, even though he admits that Mr. Fowler did all of the work, took all of the risk, and that the Receivership estate never had a right to bring the claim. (*Id.* at 5, 8.) The Receiver also never warned Mr. Fowler that he would offset all of the money that Mr. Fowler recovered from the claims. Had the Receiver disclosed the Offset Provision, Mr. Fowler never would have undertaken the effort and risk to pursue the collateral claims. Indeed, if the Offset Provision is approved, ***no victim*** will ever pursue a collateral recovery because, if they win, they will not realize any material benefit and, if they lose, they may be responsible for the legal fees and costs. Avoiding this chilling effect, which would reduce the total recovery for an indefinite number of future Ponzi victims, is much more compelling than any benefit from giving a slightly higher distribution to 750 victims in this case – especially when the distribution is only increased by money that these other victims had no right to recover in the first place.

9. WHEREFORE, Investor Stephen Fowler requests that the Court grant his Motion for Leave to File a Sur-Reply and (i) that the Court hold that Mr. Fowler's recovery identified in Mr. Fowler's Opposition to the Receiver's proposed Plan should be excluded from the Offset Provision or, in the alternative, (ii) that the Court reject the Plan and/or the Offset Provision.

Dated: March 14, 2016

Respectfully submitted,

/s/ Bryan M. Westhoff

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CERTIFICATE OF SERVICE

I, Bryan M. Westhoff, an attorney, hereby certify that on March 14, 2016, a true and correct copy of **STEPHEN FOWLER'S MOTION TO FILE SUR-REPLY** was served by electronic notice through the CM/ECF system of the United States District Court for the Northern District of New York, thereby serving the following parties of record:

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/s/ Bryan M. Westhoff
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