UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	**10 Civ. 475 (GLS)**
McGINN, SMITH & CO., INC., et al.	:	

PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO THE MOTION OF DEFENDANT DAVID L. SMITH TO DECLARE THE FINAL JUDGMENT ENTERED AGAINST HIM ON JUNE 25, 2015 VOID UNDER FEDERAL RULE OF CIVIL PROCEDURE 60(b)(4)

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June 25, 2021

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

Plaintiff Securities and Exchange Commission ("SEC") respectfully submits this memorandum of law in opposition to the motion of Defendant David L. Smith ("Smith") to declare the disgorgement and prejudgment interest portions of the Final Judgment entered against him on June 25, 2015 (DE[1] 835) (the "Final Judgment") void under Federal Rule of Civil Procedure 60(b)(4). For the reasons set forth below, the Court should deny Smith's motion.

PRELIMINARY STATEMENT

The Final Judgment, which this Court entered six years ago, held Smith liable on a joint-and-several basis with Defendant Timothy McGinn ("McGinn") for disgorgement of more than $87 million in profits from their massive Ponzi scheme, plus prejudgment interest.[2] Smith now asks this Court for sweeping and unprecedented relief that would not only reverse the disgorgement ordered in the Final Judgment but would result in returning over $4 million of fraudulent proceeds to Smith. Smith also futilely asks the Court to order the Receiver—who has already completed the distribution of receivership funds to Smith's victims—"to refrain from disbursing funds until after this motion is decided." Def. Br. at 2.[3] The Court should deny Smith's motion, which seeks an inequitable and unwarranted result.

The primary arguments that Smith now raises were rejected or deemed waived in his prior unsuccessful appeal, *SEC v. Smith*, 646 F. App'x. 42 (2d Cir. 2016). Yet under the auspices of a Rule 60(b)(4) motion, Smith now asks the Court to find that the Final Judgment is "void" in light of the Supreme Court's decision in *Liu v. SEC,* 140 S. Ct. 1936 (2020), and

[1] "DE" refers to the ECF docket entry for this case.

[2] The Court also entered the Final Judgment as to Timothy M. McGinn on June 25, 2015 (DE 836). McGinn has not joined in Smith's motion.

[3] "Def. Br." refers to David L. Smith's Memorandum of Law in Support of Rule 60(b) Motion, filed on June 3, 2021 (DE 1195-1).

Congress's amendments earlier this year to Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act"). A subsequent change in law, however, is not one of the narrow reasons a judgment may be rendered void under Rule 60(b)(4). Furthermore, the Exchange Act amendments, which codified certain aspects of *Liu* and apply to "pending" cases, does not apply to this case. The SEC's case against Smith is *not* pending, given that the Final Judgment was entered in July 2015 and Smith's appeal rights have been exhausted.

Even if *Liu* and the Exchange Act amendments did apply, the Final Judgment is consistent with the equitable principles the Supreme Court set forth in *Liu* for disgorgement, which the statutory amendments did not disturb. *Liu* permits joint-and-several liability for disgorgement and prejudgment interest, as the district court in *Liu* indeed recently imposed on remand. Furthermore, the calculation of Smith's disgorgement comports with *Liu*—this Court appropriately ordered Smith to disgorge investor proceeds (jointly and severally with McGinn) over which Smith and McGinn had full ownership and control and which they used not just for personal benefit but also to conceal and further their fraudulent scheme. Smith's attempt to limit his disgorgement in this case to the restitution ordered in the narrower criminal case should similarly be rejected.

Smith's victims have recovered less than 25% of the amounts they lost in Smith and McGinn's fraudulent scheme, and the Receiver's distribution is essentially complete. Yet Smith's Rule 60(b)(4) motion now seeks to void a six-year-old judgment that was appropriate then and would still be appropriate if rendered now. The Court should deny Smith's motion.

PROCEDURAL HISTORY

I. The SEC's Action

The SEC filed its Complaint on April 20, 2010, alleging that Smith and McGinn orchestrated a massive scheme to defraud investors from at least 2003 through April 2010. DE 1. Also named as defendants were certain entities, including the issuers and a registered broker-dealer, that were owned and controlled by Smith and McGinn and used to further the fraud. The SEC also moved for an asset freeze and the appointment of a Receiver over the various McGinn Smith entities. DE 4.

On the same day the Complaint was filed, the Court entered an Order appointing William J. Brown, Esq., as Receiver, and temporarily freezing the assets of the Defendants and others. DE 5. On July 7, 2020, the Magistrate Judge preliminarily granted the SEC's motion for an asset freeze. DE 86; *see also* DE 194 (Order dated Nov. 22, 2010 freezing additional assets).

On August 8, 2010, the SEC filed an Amended Complaint, DE 100, and on June 8, 2011, a Second Amended Complaint, DE 334.

II. The Criminal Case

On January 26, 2012, Smith and McGinn were indicted on various counts of mail, wire and securities fraud; conspiracy; aiding and abetting; and filing false tax returns. *United States v. McGinn and Smith*, 12-CR-028 (DNH) (N.D.N.Y.). Criminal DE 1.[4] A superseding Indictment was filed on October 11, 2012, which charged McGinn and Smith with making material misrepresentations and omissions during 2006-2009 in connection with the offerings. Criminal DE 25.

[4] "Criminal DE" means the ECF document entry number in the Criminal Case.

On February 6, 2013, after a jury trial, Smith and McGinn were convicted of conspiracy to commit mail and wire fraud, mail fraud, wire fraud, securities fraud, and filing false tax returns. *See* Criminal DE 104, 108.

On August 13, 2013, Smith was sentenced to ten years' imprisonment and ordered to pay a $50,000 fine, and McGinn was sentenced to fifteen years' imprisonment and ordered to pay a $100,000 fine. Smith and McGinn were also held jointly and severally liable for a restitution payment of $5,748,722 relating to the victims of their fraud. Criminal DE 231, 232.

On May 22, 2015, the Second Circuit denied Smith and McGinn's appeals. *United States v. Timothy McGinn and David Smith,* 787 F.3d 116 (2d Cir. 2015). The Second Circuit, however, remanded for the limited purpose of correcting the judgments "to make clear that funds should be credited against restitution only when they are distributed to victims[.]" *Id.* at 130. On September 8, 2015, the District Court entered amended judgments (Criminal DE 274, 275).

III. This Court's Summary Judgment and Disgorgement Decisions

On February 17, 2015, the Court granted in part the SEC's motion for summary judgment, finding Smith and McGinn liable for numerous violations of the federal securities laws. DE 807. The Court, among other things, held that disgorgement was appropriate and directed the SEC to provide a reasonable approximation of the profits. *Id.* at 54-57.[5]

On March 30, 2015, the Court ordered Smith and McGinn, among other things, to disgorge $87,433,218. *SEC v. McGinn, Smith & Co., Inc.,* 98 F. Supp.3d 506 (N.D.N.Y. 2015). Applying established law, the Court determined the disgorgement amount by subtracting the amount returned to investors ($29,172,312) from the total amount raised through the fraudulent

[5] The Court also rejected Smith's argument that the Court was collaterally estopped from ordering disgorgement because of the $5.7 million restitution order in the criminal case. *Id.* at 44.

offerings ($126,932,000). *Id*. at 519-20. Smith argued at the time that the Court's methodology was overbroad because it included the proceeds of the pre-2006 "Four Funds" offerings, which were not part of the criminal case. *Id*. at 520. The Court rejected this argument because its "independent liability finding is enough to warrant inclusion of Four Funds' profits in a disgorgement order, rendering Smith's argument academic." *Id.* The Court also found that Smith's argument, which relied entirely on the evidence from the much narrower criminal case, "totally ignores the proof the SEC has submitted" in the civil case. *Id*.

The Court also imposed $11,668,132 in prejudgment interest, noting that Smith "has not objected to either the SEC's request for prejudgment interest, or the amount of prejudgment interest that the SEC seeks," and granted the SEC's request that the disgorged funds be returned to the defrauded investors. *Id.* The Second Circuit affirmed the Final Judgment and noted that, by not raising the argument below, Smith had waived his argument that this Court should have deducted expenses from the disgorgement amount. *SEC v. Smith*, 646 F. App'x. 42, 44 (2d Cir. 2016). Smith did not appeal the imposition of joint and several liability or prejudgment interest.

IV. The Receiver's Distributions to Investors

On October 31, 2016, the Court entered an Order approving the Receiver's proposed Distribution Plan. DE 904. There are 861 investors with allowed claims of $110,467,889. The Receiver has made three distributions, totaling approximately $21,738,980, to over 800 investors. Distributions to investors are now substantially complete. DE 1196-1 ¶¶ 5- 7 (Decl. of Receiver William J. Brown dated June 24, 2021 ("Receiver Decl.")).

These distributions represent less than 25% of the investors' losses. Many of the investors are elderly and lost significant amounts of money due to the Defendants' fraud. *Id.* ¶ 10. The Receiver estimates that, once all investor distribution checks clear, approximately

$225,000 will remain in the Receivership accounts to pay administrative costs to complete the wind-up of the Receivership. *Id.* ¶ 9.

As the Receiver's Declaration states, retrieving the distributed funds at this stage would be virtually impossible. *Id.* at ¶ 12. Most investors, some of whom are now deceased, have received relatively small amounts, and attempting to retrieve distributed sums would be onerous and costly for the Receivership. *Id.* Most importantly, innocent investors would be forced to return the relatively small proportion of their funds they have recovered. *Id.*

ARGUMENT

"Properly applied, Rule 60(b) strikes a balance between serving the ends of justice and preserving the finality of judgments." *Nemaizer v. Baker*, 793 F.2d 58, 61 (2d Cir. 1986). For that reason, motions for relief from judgments under Rule 60(b) are generally "disfavored" in the Second Circuit. *See, e.g., Empresa Cubana Del Tabaco v. General Cigar Co. Inc.*, 385 F. App'x. 29, 31 (2d Cir. 2010).

Smith does not meet the requirements for relief under Rule 60(b)(4) because, even if the Final Judgment were somehow inconsistent with *Liu* and the statutory amendments, that would not render the judgment void under Rule 60(b)(4). Furthermore, the statutory amendments cannot render the judgment void, because they do not apply to this case, which is not "pending" within the meaning of the statute. Even if the amendments did apply, the judgment still is not void because it is consistent with *Liu* and the statutory amendments. In any event, Smith has waived his arguments that the Court should have subtracted the expenses from the operation of his fraudulent scheme from the disgorgement amount, and that it should not have imposed joint and several liability and prejudgment interest, and those waivers should further weigh against granting his motion. For all these reasons, the Court should deny Smith's motion.

I. Even If the Final Judgment Were Not Consistent with Current Law, the Judgment Would Not Be Void Under Rule 60(b)(4).

Smith argues that the Final Judgment is void under Rule 60(b)(4) because this Court "had no power to impose" it. Def. Br. at 16. Smith, however, does not rely on any of the permitted, "extraordinary" bases for granting Rule 60(b)(4) motions—specifically, that the court that entered the judgment lacked subject matter or personal jurisdiction or that due process was denied, as described below. Instead, Smith claims that the disgorgement ordered in the 2015 Final Judgment is void because of changes in the law *years after* the Final Judgment was entered and the Second Circuit affirmed. None of the cases he cites supports such exceptional relief.

Rule 60(b)(4) provides that "on motion and just terms, the court may relieve a party… from a final judgment [or] order…[if] the judgment is void." A judgment is not void under Rule 60(b)(4), however, "simply because it is or may have been erroneous," but is void only where it is "so affected by a fundamental infirmity that the infirmity may be raised even after the judgment becomes final." *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 270 (2010) ("[t]he list of such infirmities is exceedingly short"). This occurs "only in the rare instance where a judgment is premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard." *Id.* at 271; *see also City of New York v. Mickalis Pawn Shop, LLC,* 645 F.3d 114, 138 (2d Cir. 2011) (a judgment is void only if the court "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); 11 Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 2862 (3d ed.). "[F]inal judgments should not be lightly reopened," and Rule 60(b) relief from judgments is "extraordinary" and appropriate only in "exceptional circumstances." *Central Vt. Pub. Serv. Corp. v. Herbert,* 341 F.3d 186, 190 (2d Cir. 2003); *see*

also Espinosa, 559 U.S. at 270 (emphasizing the importance of finality in this context). Indeed, in an analogous case, Second Circuit has summarily affirmed the denial of a Rule 60(b)(4) motion where the defendants argued that the judgment was void in light of a change in law based on *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). *SEC v. Boock*, 750 F. App'x. 61 (2d. Cir. 2019) (summary order).

Smith does not attempt to argue that the Final Judgment was void for lack of subject matter or personal jurisdiction or for a violation of due process. Instead, Smith argues that the Final Judgment is void under Rule 60(b)(4) because this Court was "powerless" to enter it based on a change in law. *See, e.g.,* Def. Br. at 15. Specifically, Smith does not claim that the Court was powerless in 2015 when the Final Judgment was entered; instead, Smith argues, the powerlessness arose years later when the law regarding disgorgement in SEC cases—not jurisdictional bases for SEC cases—changed. Smith provides no authority for his novel claim that a subsequent change in law renders a judgment void under Rule 60(b)(4), and none of the cases he cites support his claim.

The cases Smith cites, Def. Br. at 15-16, involve instances where the court lacked jurisdiction *at the time the order in question was entered*. *See, e.g., Combs v. Nick Garin Trucking,* 825 F.2d 437, 448 (D.C. Cir. 1987) (voiding a default judgment where the district court lacked personal jurisdiction over the defendant who had not been properly served); *McCrae v. District of Columbia*, No. 05 Civ.2272 (RBW) (D.D.C. Mar. 19, 2007) (denying plaintiff's motion for reconsideration under Rule 60(b) of an order dismissing the complaint filed beyond the statute of limitations period); *Eberhardt v. Integrated Design & Constr., Inc.,* 167 F. 3d 861, 871 (4th Cir. 1999) (reversing district court's decision vacating , under Rule 60(b)(4), defendant's post-trial judgment as void and holding that a judgment is only void where "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").

None of the remaining cases Smith relies upon, Def. Br. at 12-13, involved Rule 60(b)(4) motions, and they therefore have no relevance here. *See, e.g., Whelan v. United States*, 445 U.S. 684, 690 (1980) (reversing and remanding a judgment improperly imposing consecutive sentences for murder and rape where the rape offense merged with the felony murder offense for sentencing purposes); *Welch v. United States,* 136 S. Ct. 1257, 1265 (2016) (holding that *Johnson v. United States,* 576 U.S. 591 (2015), was a substantive decision that applied to a prisoner's case on collateral review); *Louisiana Public Serv. Comm'n v. FCC,* 476 U.S. 355 (1986) (holding that the Communications Act of 1934 denied the Federal Communications Commission the power to establish certain depreciation practices and charges concerning telephone plant and equipment); *AMG Capital Mgmt., LLC v. FTC,* 141 S. Ct. 1341, 1347 (2021) (holding that the Federal Trade Commission Act did not authorize the FTC to obtain court-ordered monetary relief absent the prior issuance of a final cease-and-desist order as to such person).

Indeed, by moving under Rule 60(b)(4) rather than under the fallback provision of Rule 60(b)(6), Smith tries to sidestep established Second Circuit precedent holding that a subsequent change in law is not a basis to vacate a final judgment under Rule 60(b)(6). *Tapper v. Hearn*, 833 F.3d 166, 172 (2d Cir. 2016) ("As a general matter, a mere change in decisional law does not constitute an 'extraordinary circumstance' for the purposes of Rule 60(b)(6)…and the interest in finality outweighs the losing party's concern that justice was not done." (internal quotation marks and citations omitted)). Rule 60(b)(6) provides for relief other than on the grounds specified in Rule 60(b)(1) through (5) based on "any other reason that justifies relief," Fed. R.

Civ. P. 60(b)(6), and the Second Circuit has required "extraordinary circumstances" to relieve a party from a judgment under Rule 60(b)(6). *Tapper*, 833 F.3d at 172. Cases denying Rule 60(b) motions based on a change in the law typically arise under Rule 60(b)(6), presumably because Rule 60(b)'s other provisions, including Rule 60(b)(4), do not provide a basis to overturn a long-settled judgment based on a subsequent change of law.

In any event, the principle that a change in law does not justify relief under Rule 60(b)(6) applies even where the intervening change in law is a Supreme Court decision. *See, e.g.*, *Gonzalez v. Crosby*, 545 U.S. 524, 536–38 (2005); *Travelers Indem. Co. v. Sarkisian*, 794 F.2d 754, 757 (2d Cir. 1986). For example, after the Supreme Court's 2017 decision in *Kokesh* holding that disgorgement is subject to a five-year statute of limitations, defendants in other SEC cases attempted to vacate their judgments by arguing that courts had improperly included disgorgement for periods that predated the statute of limitations. Courts consistently declined to grant these Rule 60(b)(6) motions. *See, e.g.*, *SEC v. Amerindo Investment Advisors Inc.*, 2017 WL 3017504, at *8 (S.D.N.Y. July 14, 2017) (finding no extraordinary circumstances where disgorgement included periods outside the statute of limitations); *SEC v. Radius Capital Corp.*, No. 11-cv-116 (JES), 2017 WL 3446912, at *3 (S.D. Fla. Aug. 11, 2017) (same); *see also SEC v. Milan Capital Grp., Inc*., No. 00-cv-0108 (DLC), 2014 WL 2815590, at *7 (S.D.N.Y. June 23, 2014) (finding a post-judgment challenge to a prejudgment interest calculation, based on an intervening Second Circuit decision, presented no extraordinary circumstances).

Courts have also declined to award Rule 60(b) relief based on *Liu*. *See, e.g., SEC v. Penn,* 2021 WL 1226978 (S.D.N.Y. Mar. 31, 2021); *SEC v. Ahmed,* 2021 WL 916266 (D. Ma. Mar. 10, 2021); *SEC v. San Francisco Regional Ctr.*, 2020 WL 4569844 (N.D. Cal. Aug. 7, 2020).

Accordingly, there is no basis for the Court to void Smith's Final Judgment under Rule 60(b)(4) based on a subsequent change in law, even if the judgment was not consistent with the changed law—which it is, for the reasons described below in Section III.[6]

II. The Judgment Is Not Void Under the Statutory Amendments, Which Do Not Apply Because This Case Is Not "Pending" Within the Meaning of the Statute.

Smith argues that the new statutory provision codified at Exchange Act Section 21(d)(7) applies here and therefore renders the Final Judgment void. Def. Br. at 13-15. However, the new statutory provision applies only to "pending" cases, which does not include cases like this one, in which final judgments have been entered and all appeal rights have been exhausted. Because the statutory provision does not apply to this case, it cannot render the Final Judgment void, even if the judgment was not consistent with the new provision (which it is, for the reasons described in Section III below).

The National Defense Authorization Act ("NDAA") amended Section 21(d) to expressly permit courts "[i]n any action or proceeding brought by the Commission under any provision of the securities laws" to "order[] disgorgement." 15 U.S.C. § 78u(d)(7). The NDAA also provides that the amendments "apply with respect to any action or proceeding that is *pending on*, or commenced on or after, the date of enactment of this Act," which was January 1, 2021. NDAA § 6501(b) (emphasis added).

The Supreme Court has suggested that even an explicitly retroactive statute that applies to "pending" cases does not apply to cases that have been "finally adjudicated" and are not

[6] Voiding the judgment would be even more inequitable here where Smith seeks to raise arguments concerning the deduction of expenses in calculating disgorgement and the applicability of prejudgment interest and joint-and-several liability long after his judgment became final. Those arguments were available to him under then-existing law, and he failed to properly raise them before this Court or the Second Circuit, as noted above.

"subject to being appealed." *Plaut v. Spendthrift Farm*, 514 U.S. 211, 226-27 (1995). Under *Plaut*, "a judicial decision becomes the last word of the judicial department with regard to a particular case or controversy" and "Congress may not declare by retroactive legislation that the law applicable to that very case was something other than what the courts said it was." 514 U.S. at 227. Indeed, if Congress were to reopen settled judgments by retroactively applying a statute, that would give rise to a separation-of-powers issue such as the one Smith complains of here (addressed in Section III.D below). Relying on *Plaut*, several courts have denied Rule 60(b) motions based on a change in law. *See, e.g., Norgaard v. DePuy Orthopaedics, Inc.*, 121 F.3d 1074, 1076-77 (7th Cir. 1997) (after *Plaut*, the "door was closed" on "the possibility that 'a clear and authoritative change in governing law' would justify reopening" a case under Rule 60(b)(6)); *see also O'Hara v. LaHood*, 756 F. Supp. 2d 75, 78-81 (D.D.C. 2010) (relying on *Plaut* and *Norgaard* to deny Rule 60(b) relief in the wake of statute's retroactive amendment); *Swain v. United States*, No. 95-3325, 2000 WL 236403 (N.D. Ill. Jan. 21, 2000) (same).

Indeed, just this month, a district court in this Circuit, following *Plaut*, held that a case is "pending" for purposes of the NDAA only until "'the last court in the hierarchy [of Article III courts] rules.'" *SEC v. Ahmed*, Civil No. 3:15-cv-675 (JBA), 2021 WL 2471526, at *4 (D. Conn. June 16, 2021) (quoting *Plaut*, 514 U.S. at 227, with alteration in original).

Smith does not address the *Plaut* line of cases. Def. Br. at 9-19. Nor does he cite any statutory or legal authority for his claim that a case is "pending" years after a final judgment has been entered and the appeal has been denied simply because a court retains jurisdiction over a receiver who is returning ill-gotten gains to investors. *Id.* Because this case is not "pending" for

purposes of applying the new Exchange Act Section 21(d)(7) retroactively, the Final Judgment cannot be "void" based on the new provision.[7]

III. Even If Rule 60(b)(4) and the NDAA Were To Apply, the Judgment Is Not Void Because It Is Consistent With Both *Liu* and the Statute As Amended.

In *Liu*, the Supreme Court reaffirmed a district court's authority to order disgorgement "that does not exceed a wrongdoer's net profits and is awarded for victims," 140 S. Ct. at 1940, under Exchange Act Section 21(d)(5), which authorizes district courts to impose equitable relief "that may be appropriate or necessary for the benefit of investors" in SEC actions, 15 U.S.C. § 78u(d)(5). In doing so, *Liu* cited with approval decades of precedent in which courts have recognized that the equitable remedies of disgorgement, restitution, and an "accounting" for ill-gotten profits are necessary because "it would be inequitable that [a wrongdoer] should make a profit out of his own wrong." *Liu*, 140 S. Ct. at 1943 (citation omitted).

Liu held that defendants can be held "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." *Liu*, 140 S. Ct. at 1945 (emphasis added). The Court explained that the "equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit," *id.* at 1948; that joint-and-several liability for disgorgement must comport with equitable principles, *id.* at 1949; and that disgorgement must be limited to a defendant's "net profits," excluding "legitimate expenses," *id.* at 1950. However, the Court also recognized that where the "entire profit of a business or undertaking results from the wrongdoing," the defendant may be denied "inequitable deductions such as for personal

[7] A defendant's filing of a Rule 60(b) motion to set aside a long-final judgment does not by itself render the case 'pending' under *Plaut*, and Smith cites no case to the contrary.

services." *Id.* at 1950 (citation omitted). In that circumstance, courts must determine whether expenses are "legitimate" or whether they are merely wrongful gains "under another name" when awarding disgorgement. *Id.*

In this case, consistent with *Liu* and the statutory amendments, the Court appropriately held Smith jointly and severally liable for disgorgement with McGinn, appropriately calculated disgorgement, appropriately imposed prejudgment interest, and appropriately did not limit Smith's disgorgement liability to the amount of restitution ordered in the criminal case.

A. Smith's Joint and Several Liability Would Be Appropriate Today.

Smith contends that the Court exceeded its authority under *Liu* by imposing joint and several liability on him and McGinn, Def. Br. at 7-9, while acknowledging *Liu*'s holding that courts have "some flexibility to impose collective liability" on "partners engaged in concerted wrongdoing." *Id.* at 8 (citing *Liu*, 140 S. Ct. at 1945, 1949). Yet the Court here imposed joint and several liability on Smith and McGinn on precisely this ground. The Court found: "McGinn and Smith committed pervasive and egregious securities laws violations that spanned several years and resulted in significant pecuniary gain for McGinn, Smith, and the MS Entities." DE 807 at 41. The Court further noted: "Where an individual or entity has collaborated or worked closely with another individual or entity to violate the securities laws, those individuals and/or entities may be held jointly and severally liable for any disgorgement." *Id.* at 40 (citing cases). The Court also noted that "'[g]enerally…apportionment is difficult or even impossible because [the] defendants have engaged in complex and heavily disguised transactions.'" *Id.* (citations omitted).

In doing so, the Court appropriately imposed joint-and-several liability on Smith and McGinn based on the substantial evidence that they were partners engaged in concerted wrongdoing, as *Liu* permits, 140 S. Ct. at 1949; *see also SEC v. Liu,* No. 16-cv-00974-CJC, 2021

WL 2374248, at *9 (C.D. Cal. June 7, 2021) (on remand following the Supreme Court's decision, imposing joint-and-several liability on husband-and-wife defendants where, among other things, the wife "played an integral role in the scheme" and "[d]efendants did not (and still do not) introduce evidence to suggest that [the wife] was a mere passive recipient of profits[, n]or did they (nor can they credibly) suggest that their finances were not commingled, or that [the wife] did not enjoy the fruits of the scheme"). Indeed, this Court further noted that "joint-violators bear the burden of demonstrating that their liability can be reasonably apportioned." DE 807 at 41. Both before and now, Smith has failed to even attempt to apportion liability between himself and McGinn for receipt of investor proceeds, nor could he credibly do so given his and McGinn's extensive commingling of investor funds between their various investment vehicles and the joint ownership and control they exercised over the investors funds. Indeed, this was not a case where Smith was held liable for monies he never received or never had control over; to the contrary, the evidence is clear that he received and had control over all of the funds raised through the various McGinn Smith entities. Thus, holding Smith liable for those funds is not an improper penalty.[8]

Indeed, *Liu* cited with approval, 140 S. Ct. at 1949, the case of *SEC v. Hughes*, 124 F.3d 449, 455-56 (3d Cir. 1997), where the Third Circuit affirmed a joint-and-several disgorgement award because the defendant did not contradict the "substantial evidence" offered by the SEC showing that she "benefitted substantially" from violations committed by the scheme in which she took part. *Hughes* is consistent with Supreme Court precedent endorsing the equitable

[8] Smith's argument that *Liu* dictates that a court can only impose joint-and-several liability where the facts are similar to those in *Ambler v. Whipple,* 87 U.S. 546 (1874), Def. Br. at 7-9, is groundless. *Liu* cited *Ambler* only by way of an example ("e.g.") as to how equity courts had ruled in the past, *Liu,* 136 S. Ct. at 1945, not as a current standard governing the limits of joint-and-several liability.

principle that "the wrongdoer shall bear the risk of the uncertainty which his own wrong has created." *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 265 (1946).

Smith next argues that the joint-and-several liability ordered here is impermissible because amended Exchange Act Section 21(d)(7) does not explicitly provide for it. Def. Br. at 9-10. That argument is also unavailing, even assuming Section 21(d)(7) were to apply to this case (which it does not for the reasons set forth in Section I.B above). Congress's recent NDAA amendments to the Exchange Act left intact Section 21(d)(5), the equitable relief provision under which the Supreme Court in *Liu* permitted joint-and-several liability for disgorgement as described above; and *added* Sections 21(d)(3)(A)(ii) and 21(d)(7) to codify federal courts' authority to order disgorgement "of any unjust enrichment by the person who received such unjust enrichment." 15 U.S.C. §§ 78u(d)(7); *see also SEC v. Ahmed*, No. 3:15-cv-675 (JBA), 2021 WL 2471526, at *2 (D. Conn. June 16, 2021) (describing the NDAA as "[c]odifying the SEC's disgorgement power"). While Smith argues—without any authority—that the new provisions are a limiting principle, his argument cannot explain how these added provisions limit district courts' authority to order joint-and-several disgorgement under *Liu*'s principles based at least on Exchange Act Section 21(d)(5), which Congress did not amend in the NDAA. As a result, even if the NDAA amendments were to apply to this case, they would not alter the propriety of Smith's joint-and-several liability under Exchange Act Section 21(d)(5).

B. The Disgorgement Calculation Would Be Appropriate Today.

Smith argues that the Final Judgment violated *Liu* because he was ordered to disgorge funds without subtracting "legitimate business expenses" or other investor proceeds not used for wrongdoing. *E.g.,* Def. Br. at 13 ("The amount of disgorgement awarded here [included] no effort to determine…whether those funds…resulted from wrongdoing. Nor did the disgorgement order calculate and subtract legitimate business expenses or market losses."). However, the

Court's disgorgement calculation, which held Smith and McGinn jointly and severally liable for all of the investor proceeds they raised, minus those returned to investors, was consistent with *Liu*. As described above, *Liu* recognizes that where the "entire profit of a business or undertaking results from the wrongdoing," the defendant may be denied "inequitable deductions such as for personal services." 140 S. Ct. at 1950 (citation omitted).

The Court therefore properly found 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." DE 807 at 41-42 (citing cases). The Court found ample evidence that Smith and McGinn collaborated and worked closely to perpetrate a longstanding fraud in which, among other wrongs, they used new investor monies to repay investors in their prior failed investment vehicles. The Court also found that Smith and McGinn had engaged in complex and heavily disguised transactions making it difficult or even impossible to determine what, if any, investor proceeds went to legitimate business expenses. For example, the Court found that Smith and McGinn owned or controlled the Four Funds and the various trusts through which they raised investors monies; that they improperly commingled money among those entities to conceal and further their fraudulent activities; that they improperly applied monies from these investment vehicles to support pre-2003 failing McGinn Smith investment offerings; and that they misappropriated monies from these investor funds and trusts to support their business and their lifestyles. *See, e.g., id.* at 10-16, 33-34.

Resolving any uncertainty against a wrongdoer in such circumstances is consistent with cases *Liu* cited with approval. *See, e.g., Rubber Co. v. Goodyear*, 76 U.S. 788, 803-04 (1870) (cited in *Liu*, 140 S. Ct. at 1945) (no deduction is appropriate for claimed expenses where the "manner in which the books…were kept renders such an account impossible," reasoning that the

defendants' "conduct in this respect has not been such as to commend them to a court of equity," and holding that "[u]nder the circumstances, every doubt and difficulty should be resolved against them"). Thus, the Court's calculation of disgorgement would be appropriate even under *Liu*.[9]

C. The Prejudgment Interest Award Would Be Appropriate Today.

Smith also argues that prejudgment interest is not permissible because Congress did not specifically allow for it when it added Exchange Act Section 21(d)(7) to codify district courts' disgorgement authority. Def. Br. at 11-12. This argument is also baseless.

In its summary judgment Order, the Court recognized that it has discretion to order prejudgment interest and that it is equitable to do so to prevent a defendant from obtaining the benefit of what amounts to an interest-free loan procured as a result of his illegal activity. DE 807 at 39-40 (citing *SEC v. First Jersey Sec. Inc.,* 101 F.3d 1450, 1476 (2d Cir. 1996), and *SEC v. Credit Bancorp, Ltd.,* No. 99 Civ. 11395, 2011 WL 666158, at *3 (S.D.N.Y. Feb. 14, 2011), *aff'd sub nom. SEC v. Blech,* 501 F. App'x 74 (2d Cir. 2012). And in its disgorgement order, the Court made clear that it was awarding prejudgment interest based on its equitable powers: "The district court has discretion to award prejudgment interest, a decision which is 'governed by the equities, reflecting 'considerations of fairness' rather than 'a rigid theory of compensation.'" DE 816 at 31 (quoting *SEC v. Contorinis,* 743 F.3d 296, 307-08 (2d Cir. 2014).

Nothing in *Liu* or the NDAA has changed the Court's equitable powers with respect to prejudgment interest. As Smith acknowledges, the Supreme Court did not address prejudgment

[9] The fact that Smith directed $1,736,000 of investor funds towards his personal consumption, as opposed to other funds he used in furtherance of his fraudulent schemes, does not contradict the Court's finding that Smith had initial and ultimate ownership and control over all of the investor funds raised through his Ponzi-like scheme and should be held accountable for them.

interest in *Liu*. Def. Br. at 18. Nor does Smith cite any authority to support his argument that Congress intended to eliminate courts' longstanding equitable power to order prejudgment interest through the NDAA. As described above, the NDAA did not alter courts' authority to order equitable relief under Exchange Act Section 21(d)(5), the provision that district courts have long used to award disgorgement and prejudgment interest. Indeed, numerous courts have awarded prejudgment interest since *Liu*, including the district court in the *Liu* case itself on remand. *See, e.g., Liu*, 2021 WL 2374248, at *10; *Ahmed*, No. 3:15 cv 675 (JBA), 2021 WL 2471526, at *6 (D. Conn. June 16, 2021) (collecting cases imposing prejudgment interest post-*Liu* and imposing prejudgment interest while applying the NDAA).[10]

D. Smith's Remaining Arguments to Limit Disgorgement Are Baseless.

1. No Basis Exists to Limit Disgorgement to the Criminal Restitution Amount.

Smith first argues that the disgorgement order is void because it was not limited to the amount Smith was ordered to pay as restitution in the criminal case. He contends that, "since victim losses were remedied by restitution paid, any further order of disgorgement is an unauthorized penalty." Def. Br. at 14. This argument is legally and factually flawed. First, it should be noted that Smith's criminal judgment provided an offset against his restitution obligation for any amounts the Receiver paid to investors, Criminal DE 275 at 6, ¶ G. Second, Smith has made only *de minimis* payments in satisfaction of his restitution obligation[11] But most

[10] Two other cases Smith cites—*Mehrig v. KFC Western,* 516 U.S. 479 (1996) (cited in Def. Br. at 12), and *AMG Capital Management, LLC v. FTC,* 141 S. Ct. 1341 (2021) (cited in Def. Br. at 13)—are inapposite. Those cases involved only a determination of whether Congress had authorized a particular statutory remedy. Here, as noted above, the Court imposed prejudgment interest based on its statutorily-authorized equitable powers. DE 816 at 31; 15 U.S.C. § 78u(d)(5).

[11] According to the Receiver's calculations, $181,996.46 has been collected from Smith (including $3,053.46 in restitution), $3,373,388.92 has been collected from Smith Trusts, and

importantly, the $5,748,722 in restitution, even if fully paid, falls far short of satisfying the $87,433,218 in investor losses the Court found in this case.[12]

As an initial matter, the Second Circuit has been clear for decades: disgorgement may be ordered in an SEC action against a defendant who has been ordered to pay restitution in a parallel criminal action. *See SEC v. Palmisano*, 135 F.3d 860, 864–66 (2d Cir. 1998) (rejecting defendant's double jeopardy challenge where he had been ordered to pay restitution in a parallel criminal action). To ensure that disgorgement does not operate as a penalty, courts typically credit against a defendant's disgorgement obligation the amount of his wrongful proceeds that he has *actually repaid* based on restitution or other orders in parallel criminal cases or related civil cases. *See, e.g., id.* at 863 ("[T]o the extent that Palmisano pays or has paid restitution as ordered in the criminal judgment, such payments will offset his disgorgement."); *SEC v. Opulentica, LLC*, 479 F. Supp. 2d 319 (S.D.N.Y. 2007) ("To the extent that [defendant] *pays or has paid* restitution…*such payments* will offset his disgorgement obligation.") (emphasis added); *see also Disraeli v. SEC*, 334 Fed. App'x 334, 335 (D.C. Cir. 2009) (unpublished disposition) (same). Nothing in *Liu* disturbs this precedent.

Most importantly, Smith's claim that the $5,748,722 in restitution ordered in his criminal case "remedied" the $87,433,218 in investor losses found in the civil case, and that any payment beyond the restitution amount constitutes an illegal penalty under *Liu,* is meritless. The restitution ordered in the criminal case was limited to the $5,748,722 in investor losses relating to the fraudulent offerings from 2006 through 2009. *SEC v. Smith,* 646 Fed. App'x. at 42. The

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$2,553,123.36 has been collected from other Smith family assets, for a total of $6,108,508.74. DE 195-2.

[12] Indeed, the Receiver has received allowed claims totaling $110,467,889 from 861 defrauded investors. DE 1196-1, Receiver Decl. at ¶ 6.

disgorgement ordered in the SEC derived from the $87,433,218 in investor losses stemming from all of the fraudulent offerings from 2003 through 2009, and the bulk of the funds was raised before 2006. As a matter of simple math, $5,748,722 does not come close to remedying the $87,433,218 in investor losses calculated by the Court in this case. And Smith's implication that the additional funds are not being applied for the benefit of investors is belied by the incontrovertible record of the Receiver's payments of approximately $21.7 million to investors.[13]

2. There Is No Basis for Offsetting Smith's Disgorgement Amount by the Amount of the Receiver's Expenses.

Smith's claim that the monies the Receiver has used to pay expenses in administering the Receivership constitute an additional penalty, Def. Br. at 16-17, is also meritless. The Court has ordered Smith to disgorge $87,433,218 in ill-gotten gains and pay prejudgment interest of $11,668,132 thereon. The plan of distribution approved by the Court directs the Receiver to apply the assets to first pay administrative expenses, then secured creditors, and then investors. The investors will bear the brunt of that shortfall, not Smith. Indeed, after payment of the Receiver's expenses and secured creditors, the investors have recovered only $21,744,773 of their $87,433,218 in losses. And there is little likelihood that Smith will pay any more in satisfaction of his judgment, given his age and current assets. Thus, the investors, not Smith, have borne the burden of subsidizing the Receiver's expenses, as such expense payments reduce the limited fund available for payments to them.[14]

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[13] As of May 2021, the Receiver had distributed approximately $21.7 million to defrauded investors, representing only 23.84 percent of their documented, allowed losses. This is the last expected distribution to investors from the Receiver's assets. DE 1196-1, Receiver Decl. ¶¶ 6. 10. Although the Receiver holds approximately $225,000 in cash and illiquid assets, these assets are expected to be applied to the Receiver's expenses in winding down the Receivership by the end of 2021, including potential tax liabilities of the Receivership Estate. *Id.* at 9.

[14] Smith also argues that *Liu* does not permit disgorgement of monies received by relief

The cases cited by Smith in support of this argument, Def. Br. at 16-17, are unavailing. *Mallow v. United States,* 161 Ct. Cl. 446, 448-50 (Cl. Ct. 1963), involved a claim against the government (not under Rule 60(b)(4)), for return of a fine imposed by a U.S. Army court martial subsequently found to lack personal jurisdiction over the plaintiff. *Aerolineas Argentinas v. United States,* 77 F.3d 1564, 1572-74 (Fed. Cir. 1996), involved two airlines' action in the Court of Claims to recover money the Immigration and Naturalization Service had collected to house, sustain, and guard aliens who had arrived on the airlines without entry documents and then sought asylum. Smith cites this case for the proposition that payments made to third-party vendors were deemed to be payments to the government for purposes of establishing subject matter jurisdiction. The unique facts and law at issue in that case—involving interpretation of the Tucker Act, the Court of Claims' jurisdictional statute, have no relevance to Smith's motion under Rule 60(b)(4) to void a final judgment by a court that awarded remedies based on equitable principles.

E. Smith Waived His Arguments that the Court Exceeded Its Disgorgement Authority.

As discussed above, Smith waived all three arguments regarding disgorgement he now raises in his Rule 60(b)(4) motion: he failed to object to the deduction of expenses of operating his illegal scheme in the district court; failed to object to the imposition of prejudgment interest in the district court; and failed to raise that issue, or the imposition of joint and several liability, on appeal. His failure to raise those arguments below should preclude him from obtaining relief now on those grounds under Rule 60(b). Indeed, under Rule 60(b)(6)—the fallback provision

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defendants and seeks the return of $4,372,508 to himself, his wife L. Smith, and his children. Def. Br. at 14-15. However, *Liu* does not preclude disgorgement as to relief defendants, and nor would amended Section 21(d)(7) (authorizing disgorgement of "any unjust enrichment by the person who received such unjust enrichment"; and not excluding relief defendants) if it applied.

that litigants typically use to try to attack a judgment on the grounds of changed law—courts routinely deny motions where litigants did not diligently raise the relevant issues in the district court and on appeal. *See, e.g., Gonzalez v. Crosby*, 545 U.S. 524, 537 (2005) (noting that, where movant had failed to appeal the district court's decision, the "change in the law worked by" the subsequent Supreme Court decision was "all the less extraordinary in petitioner's case, because of his lack of diligence in pursuing review of the [ ] issue"); *Medinol Ltd. v. Cordis Corp.*, 817 F. App'x 973, 977 (D.C. Cir. June 12, 2020) (unpublished disposition) (finding no abuse of discretion under Second Circuit law where the district court denied Rule 60(b)(6) motions after two Supreme Court decisions "dramatically changed the legal landscape" but the movant had not appealed and could not show "extraordinary prejudice or undue hardship").

Smith claims that he cannot waive these arguments that the Court exceeded its authority in the disgorgement order, because a waiver would violate the Constitutional separation of powers. Def. Br. at 19-21. That argument is meritless.

As an initial matter, the SEC did not lack authority to seek the disgorgement and prejudgment interest ordered here, and the Court did not lack authority to order that relief here. But a district court's decision to order too much disgorgement based on the facts of circumstances of a particular case under equitable principles is reviewable on appeal and does not create issues of "executive power." Indeed, none of the cases Smith relies upon, Def. Br. at 20, involve motions to void a judgment under Rule 60(b)(4) or waivers of issues other than jurisdiction. *See CFTC v. Schor,* 478 U.S. 833, 849-51 (1986) (on direct appeal, the Court held that respondent waived his right to a trial of certain state law counterclaims before an Article III court and that the Commodity Futures Trading Commission did not violate the separation of powers clause by entertaining those claims); *Pacemaker Diagnostic Clinic of America, Inc. v.*

Instromedix, Inc., 725 F.2d 537, 543-44 (9th Cir. 1984) (on direct appeal, the Ninth Circuit held *en banc* that, in light of the participants' consent and other provisions for the appointment and control of magistrates by Article III courts, a patent trial by the magistrate was constitutional); *Louisiana Pub. Serv. Comm'n,* 476 U.S. at 374 (holding on direct appeal that the Communications Act of 1934 denied the Federal Communications Commission the power to establish certain depreciation practices and charges concerning telephone plant and equipment); *United States v. U.S. Fidelity & Guaranty Co.,* 309 U.S. 506 (1940) (on direct appeal, the Court voided a state court bankruptcy counterclaim against the U.S. and certain Indian Nations because the state court lacked jurisdiction on such counterclaims, holding that U. S. agencies cannot waive sovereign immunity); *Nguyen v. United States,* 539 U.S. 69, 80-81 (2003) (on direct appeal, the Court held that the court that heard defendants' appeal from their criminal convictions did not lack jurisdiction because a non-Article III judge was on the panel).

CONCLUSION

For all the foregoing reasons, the Commission respectfully requests that Smith's motion to vacate the Final Judgment and for other relief be denied in its entirety.

Dated: New York, NY
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Respectfully submitted,

SECURITIES AND EXCHANGE COMMISSION

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