UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	10-CV-457 (GLS/DRH)
-against-	:	
McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC, McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC, TIMOTHY M. McGINN, DAVID L. SMITH, LYNN A. SMITH, GEOFFREY L. SMITH, 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.	:	

DAVID M. WOJESKI'S MEMORANDUM OF LAW IN OPPOSITION TO PLAINTIFF'S MOTION FOR SANCTIONS

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PRELIMINARY STATEMENT

David M. Wojeski ("Wojeski") respectfully submits this memorandum of law in opposition to Plaintiff Securities and Exchange Commission's (the "SEC") Motion for Sanctions, dated January 31, 2011 ("Motion for Sanctions").

This action was originally commenced against the defendants in 2009 in connection with allegations of securities fraud by defendant McGinn Smith and its founders. In an effort to freeze the assets of McGinn Smith founder David L. Smith ("Smith") pending the litigation, the SEC moved for a temporary restraining order against a family trust created for the benefit of Smith's two children in 2004. After a temporary restraining order was issued by this Court, Wojeski was asked to step in as trustee for the family trust, just in time to testify at the Court's three-day preliminary injunction hearing to determine whether Smith retained any residual benefit from the family trust. In furtherance of his duties as successor trustee of the family trust, Wojeski reviewed a document that purported to be the trust's only agreement in preparation for testifying at the preliminary injunction hearing. Approximately six weeks after testifying at the preliminary injunction hearing and after the Court denied the SEC's request for a preliminary injunction, Wojeski became aware of a possible annuity agreement related to the trust that was not previously disclosed to Wojeski when he assumed the role of trustee. Wojeski promptly turned this evidence over to his attorney and, within days, the SEC revealed that there was, in fact, an annuity agreement that provided an annual benefit to Smith starting in 2015.

The SEC now moves the Court for sanctions against Wojeski based on allegations that Wojeski actively concealed the existence of the annuity agreement from the Court. However, the SEC's theory is entirely unsubstantiated and the evidence clearly demonstrates that Wojeski did not learn of the annuity agreement until after he testified at the Court's preliminary injunction

hearing and after the Court denied the SEC's motion for a preliminary injunction. The evidence further demonstrates that Wojeski took immediate steps to notify his attorney when he learned of a possible annuity agreement. Nonetheless, the SEC now seeks to find Wojeski jointly and severally liable along with Smith's wife (beneficiary of the annuity agreement), the former trustee (signatory to the annuity agreement) and the family trust's former attorney for the concealment of the annuity agreement that he had no knowledge of until late July 2010. Wojeski, trustee of the family trust for less than nine months, took no steps to conceal the existence of the annuity agreement, was never asked to testify regarding when he learned of the existence of the annuity agreement, and, as a non-party to this action who resigned as trustee as of January 2011, should not be sanctioned in the absence of clear evidence of willfulness (of which there is none).

STATEMENT OF FACTS

A. Wojeski is Appointed as Trustee in May 2010

In or around April 2010, Jill A. Dunn ("Dunn") approached Wojeski about becoming the trustee of the David A. and Lynn A, Smith Irrevocable Trust U/A dated August 4, 2004 (the "Trust"). Affidavit of David M. Wojeski, dated March 18, 2011 ("Wojeski Aff.) at ¶ 3). Wojeski was a Certified Public Accountant and principal of Wojeski and Co., Certified Public Accountants, and had served as a trustee for several trusts. (Wojeski Aff. at ¶ 2). Prior to accepting the engagement, Wojeski sought basic information regarding the Trust's features and the powers granted to the trustee to ensure that it would not be an engagement that required extensive work or contained a risk of significant litigation. (Wojeski Aff. at ¶ 3). Specifically, Wojeski requested a copy of the Trust's agreement and any documents that related to the Trust's agreement. Id. In response to this request, Wojeski received and reviewed the Declaration of Trust, dated August 4, 2004 ("Declaration of Trust"), which was provided to him by Dunn.

(Wojeski Aff. at ¶ 4). Upon review of the Declaration of Trust, Wojeski learned that the Trust was established by David and Lynn Smith as a simple, irrevocable trust for the benefit of their two children, Geoffrey and Lauren Smith. Id.

Shortly thereafter, Wojeski met with the Trust's accountant, John D'Aleo ("D'Aleo") and Dunn, to review the Trust's activity since its inception. (Wojeski Aff. at ¶ 5). D'Aleo showed Wojeski a "roll forward" that he prepared for the Trust to demonstrate how the Trust was initially funded and how each deposit and withdrawal from the Trust was allocated. Id. Wojeski and D'Aleo also reviewed the Trust's tax returns to confirm that the Trust's tax liabilities were satisfied and were consistent with the Trust's "roll forward." Id. At the conclusion of this meeting, Wojeski requested copies of the documentation to support D'Aleo's "roll forward," which he understood to be the Trust's tax returns from 2004 to 2008 and copies of the Trust's brokerage account statements from September 2004 to April 2010. Id. After agreeing certain numbers from the Trust's tax returns and the Trust's brokerage statements to the "roll forward," Wojeski agreed to accept the appointment as trustee of the Trust. (Wojeski Aff. at ¶ 6).

By Trust Appointment, dated May 14, 2010, Wojeski was duly appointed as successor trustee of the Trust, effective as of May 22, 2010, following Urbelis' resignation. (Wojeski Aff. at ¶ 7).

B. As Successor Trustee, Wojeski Files a Motion to Intervene and Lift the Temporary Restraining Order on the Trust's Assets

At the time that Wojeski was appointed trustee of the Trust, he was aware that the SEC had frozen the Trust's sole asset, its NFS/Fidelity brokerage account, as part of pending litigation against several parties, including the Trust's donors David and Lynn Smith (the "Action"), by temporary restraining order, dated April 20, 2010. (Wojeski Aff. at ¶ 8). Wojeski understood the basis for the temporary restraining order was an allegation that David Smith was a beneficial

owner of the Trust. Id. As such, in furtherance of his fiduciary responsibilities as trustee and upon advice from Dunn, Wojeski filed a motion on May 26, 2010, requesting that the Court issue an order permitting Wojeski to intervene in the Action for the limited purpose of asking the court to lift the temporary restraining order and asset freeze on the Trust's NFS/Fidelity brokerage account and to oppose the SEC's request for a preliminary injunction with regard to the same account ("Motion to Intervene"). (Wojeski Aff. at ¶ 9).

As set forth in his Motion to Intervene, based on his review of the Declaration of Trust, the Trust's brokerage account statements and the Trust's tax returns and his experience as a Certified Public Accountant for over twenty years, Wojeski opined that the Declaration of Trust was a planning devise and a textbook example of an irrevocable trust formed under an agreement between David and Lynn Smith and the initial trustee on August 4, 2004. (Wojeski Aff. at ¶ 10). Wojeski's review of the Trust's documents, as provided to him by Dunn, demonstrated that the Trust had been funded at its inception with 100,000 shares of Charter One Financial Corporation ("Charter One") stock, which was further evidenced by the Trust's brokerage account statement from September 2004, which showed the receipt of 100,000 shares of Charter One stock on September 1, 2004 and the subsequent sale of the stock for $4,450,000. Id.

Wojeski further opined that by the terms of the Declaration of Trust, neither David Smith nor Lynn Smith maintain any control over the Trust or its assets, other than the power to appoint a successor trustee. (Wojeski Aff. at ¶ 11). In addition, Wojeski opined that neither David Smith nor Lynn Smith have any interest, whether present, future or reversionary, in the trust, its income or its assets, as it is irrevocable by its own terms and pursuant to provisions of the New York Estates, Powers & Trusts Law. Id.

By Order, dated May 28, 2010, the Court granted Wojeski's Motion to Intervene. (Wojeski Aff. at ¶ 12).

C. Wojeski Opposes the SEC's Motion for a Preliminary Injunction

On June 11, 2010, Wojeski provided testimony to the Court in connection with the SEC's pending motion for a preliminary injunction, which would have effectively continued the Court's restraint of the Trust's brokerage account. (Wojeski Aff. at ¶ 13). The testimony Wojeski provided to the Court on June 11, 2010 was consistent with the statements he made in connection with his Motion to Intervene. (Wojeski Aff. at ¶ 14). Once again, based on his review of the Declaration of Trust, the Trust's tax returns and Trust's brokerage account statements, Wojeski testified that the Trust was an irrevocable trust and that neither David Smith nor Lynn Smith had any interest, whether present, future or reversionary, in the trust, its income or its assets. Id.

By Order, dated July 7, 2010, the Court lifted the temporary restraining order as to the Trust's brokerage account, concluding that the SEC has failed to demonstrate either that the Trust was created with or the repository of ill-gotten funds or that David L. Smith was an equitable or joint owner of the Trust ("July 7, 2010 Order"). (Wojeski Aff. at ¶ 15).

D. The Acts Taken in Further Administration of the Trust in July 2010

Once the restraint on the Trust's brokerage account was lifted, Wojeski took several actions in his role as trustee in July 2010 to further the administration of the Trust. Specifically, Wojeski used the Trust's assets to pay attorney, consultant and trustee fees, to make limited distributions to the Trust beneficiaries as requested in fulfillment of his fiduciary obligations as trustee of the Trust and in the exercise of his professional judgment. (Wojeski Aff. at ¶ 16-17).

E. Wojeski Receives Evidence of the Trust's "Private Annuity Contract"

On July 20, 2010, Wojeski received a facsimile from David Smith enclosing a five-page document that purported to be the policy delivery receipt from a "Private Annuity Contract," executed on October 19, 2004, between David L. Smith & Lynn A. Smith, as transferors and The David L. & Lynn A. Smith Irrevocable Trust U/A Dated August 31, 2003, transfer together with an illustration of the "Private Annuity Contract." (Wojeski Aff. at ¶ 18). The next day, Wojeski e-mailed the facsimile to Dunn. (Wojeski Aff. at ¶ 19). Several days later, Dunn informed Wojeski that the SEC was in possession of a private annuity agreement ("Annuity Agreement") that related to the Trust. (Wojeski Aff. at ¶ 20).

F. SEC's Motion for Reconsideration

By motion, dated August 3, 2010, the SEC filed a motion for reconsideration of the July 7, 2010 Order alleging that the Annuity Agreement had not previously been disclosed by any party and the Annuity Agreement demonstrated that David and Lynn Smith were beneficial owners of the Trust and that a preliminary injunction freezing the assets of the Trust was warranted. (Wojeski Aff. at ¶ 21). In opposition to the SEC's motion for reconsideration, Dunn prepared an affidavit on Wojeski's behalf stating that he had no prior knowledge of the Annuity Agreement when he provided testimony at the preliminary injunction hearing on June 11, 2010 or at any time leading up to and following the Court's July 7, 2010 Order ("October Affidavit"). (Wojeski Aff. at ¶ 22). Specifically, the October 7, 2010 Affidavit stated that "the first I learned of the existence of the Annuity Agreement was in late July, when my attorney informed me that the former trustee had just produced the agreement simultaneously to her and to the SEC's counsel." Id.

When Wojeski signed the October Affidavit, he believed that he was stipulating to the fact that he learned of the existence of the Annuity Agreement in late July, which in his mind was referring to the July 20th date that he received the fax of the annuity illustration. At the time, he did not realize that the "late July" reference had a different meaning to Dunn, who drafted the affidavit on his behalf. (Wojeski Aff. at ¶ 23). Although he did not see any problem with the October Affidavit at the time, in hindsight, he acknowledged that it would have been clearer had the exact date of July 20th been used. Id. As such, upon advice from counsel, he submitted a clarifying affidavit, dated November 17, 2010 ("November Affidavit"), stating that "the first I learned of the possible existence of an annuity was in late July, when I received documents faxed to me by David Smith" to clarify his prior statement about when he first learned of the existence of the Annuity Agreement. Id. The Court ultimately granted the SEC's Motion for Reconsideration, finding that at least Lynn Smith and Urbelis had actively concealed the existence of the Annuity Agreement and finding that Dunn's version of the facts was not credible. The Court made no substantive finding regarding Wojeski's participation in the alleged scheme to conceal the Annuity Agreement.

G. Geoffrey Smith is Substituted as Trustee

Wojeski submitted his resignation as trustee of the Trust on December 9, 2010 which, per the Trust agreement, became effective on January 8, 2011. (Wojeski Aff. at ¶ 28). On February 14, 2010, the Court ordered the substitution of Geoffrey Smith as trustee of the Trust. Id. As such, Wojeski's duties as trustee have ceased and he is no longer a party to the Action. Id.

ARGUMENT

SANCTIONS AGAINST WOJESKI ARE PATENTLY UNWARRANTED ABSENT A FINDING OF BAD FAITH

A. Sanctions Against Non-Parties Are Not Favored and Must be Based on Clear Evidence of Bad Faith or Evidence of Harassment, Delay or Improper Purpose Only

The SEC seeks an award of sanctions against Wojeski based on the Court's inherent authority to award sanctions against parties and non-parties upon a finding of bad faith. The SEC cites the United States Supreme Court opinion in Chambers v. NASCO, Inc. with vigor as support for the Court's inherent authority to impose such sanctions in the ordinary course of managing its own affairs "so as to achieve the orderly and expeditious disposition of cases. Chambers v. NASCO, Inc., 501 U.S. 32, 43 (1991). The SEC argues that sanctions against Wojeski are warranted based on his alleged false and misleading testimony regarding the nature of the Trust and his allegedly false affidavits regarding how and when he learned of the Annuity Agreement. However, despite a plethora of baseless assertions and conclusory accusations, the SEC lacks the evidence necessary to even suggest, let alone conclusively demonstrate, that Wojeski actively concealed the existence of the Annuity Agreement and lacks any support for the allegation that Wojeski's version of the facts is anything but the truth.

Although the SEC correctly cites Chambers v. NASCO, Inc. for the proposition that this Court has the power to impose sanctions against a non-party, such as Wojeski,[1] upon a finding of bath faith, the SEC conveniently omits the important warning contained in the Chambers opinion, which states:

[1] The SEC incorrectly refers to Wojeski as a party to this action. Wojeski voluntarily intervened in the Action in his role as trustee for the Trust in May 2010, but by the time that the instant motion was filed, Wojeski had resigned as trustee and the Court eventually ordered the substitution of Geoffrey Smith as trustee for the Trust.

> "A court must, of course, exercise caution in invoking its inherent power, and it must comply with the mandates of due process, both in determining that the requisite bad faith exists and in assessing fees."

Chambers v. NASCO, Inc., 501 U.S. 32, 50 (U.S. 1991). In heed of this warning, the Second Circuit has required that a finding of bad faith must be shown by (1) clear evidence or (2) evidence of harassment, delay or other improper purposes. DLC Mgmt. Corp. v. Town of Hyde Park, 163 F.3d 124, 136; See United States v. International Brotherhood of Teamsters, 948 F.2d 1338, 1345 (2d Cir. 1991)("Because of the potency of the court's inherent power, courts must take pains to exercise restraining and discretion when wielding it. Accordingly, this court has required a finding of bad faith for the imposition of sanctions under the inherent power doctrine."); LaGrande v. Adecco, 233 F.R.D. 253, 258 (N.D.N.Y 2005)(Before the Court exercises of its enormous power to sanction, it should do so with restraint and should be reserved for when a party acts in bad faith, vexatiously, wantonly or for oppressive reasons); Leiching v. Conrail, 1997 U.S. Dist. LEXIS 3561, 5-6 (N.D.N.Y Mar. 22, 1997)(upholding the Second Circuit requirement that there be clear evidence that the opposing party's actions were taken to harass, delay the proceedings, or for otherwise inappropriate reasons.).

B. The Court Lacks Any Evidence that Wojeski Acted in Bad Faith or Acted to Further Any Improper Purpose

Here, the SEC has unfairly grouped Wojeski, a practical newcomer, together with Lynn Smith, Dunn, Urbelis and possible Featherstonhaugh, all of whom were either involved with the Trust since its inception and/or who clearly had access to more information than was made available to Wojeski when he became the successor trustee of the Trust. The SEC points to fifteen findings of fact made by the Court in support of its Motion for Sanctions, all of which the SEC argues suggest clear evidence of misconduct and an active concealment of the Annuity Agreement, including findings that (1) Lynn Smith and Urbelis' failure to disclose the Annuity

Agreement satisfies the requirements for fraud, misrepresentations and misconduct, (2) Lynn Smith's assertion that she had forgotten about the Annuity Agreement was implausible, (3) both Lynn Smith and Urbelis provided testimony to the Court in which they failed to disclose the Annuity Agreement despite being asked questions which should have elicited disclosure of the Annuity Agreement, and (4) Dunn's testimony regarding the discovery of the Annuity Agreement has been inconsistent and contradictory and undermines her credibility. Notably, only one of the fifteen findings of fact refers to Wojeski and only notes that Wojeski "had a fiduciary duty of at least ordinary care to the Trust and its beneficiaries to identify any obligations of the Trust, such as the Annuity Agreement."[2] This finding does not suggest that Wojeski ever mislead the SEC or this Court, but rather concludes that Wojeski, as successor trustee of the Truth, had a duty to identify any obligations under the Trust. Notably, this finding does not question Wojeski's denial that he was aware of the Annuity Agreement prior to July 20, 2010, nor does it judge the truthfulness of Wojeski's story or raise doubt as to his credibility. Wojeski was never asked to testify regarding when he learned of the Annuity Agreement and the SEC's entire set of evidence against Wojeski is based on circumstantial theories of wrongdoing, which the facts simply do not support.

The case law cited by the SEC in support of this Court's ability to sanction non-parties for willful misconduct are entirely inapposite and, as a contrast, further highlights the lack of clear evidence against Wojeski. In Manez v. Bridgestone Firestone N. Am. Tire, LLC, 533 F.3d 578 (7th Cir. 2008), the court sanctioned an attorney for perpetuating fraud on the court by using his family connections to convince a Mexican court to issue an order in bad faith incorrectly concluding that Mexico did not have jurisdiction over the claims in order to have the case heard by an Indiana court. In In re Intel Corp. Microprocessor Antitrust Litig., 562 F. Supp. 2d 606 (D.

[2] The Court's Memorandum-Decision and Order, dated November 22, 2010, Dkt. 194 at 19.

Del. 2008) and Matter of Holloway, 884 F.2d 476 (9th Cir. 1989), the respective courts sanctioned non-parties for their repeated failures to comply with court-imposed discovery orders. Lastly, in Chambers v. Nasco, supra, the court sanctioned several individuals[3] in connection with clear evidence that they had "emasculated and frustrated the purposes" of the court's rules by fraudulently transferring ownership of a property under sale moments before the intended buyers were able to file a claim for specific performance. These four cases each present scenarios of woeful disregard and/or manipulation of the court system that prejudiced the innocent parties and created unnecessary delay in the litigation of these matters. The SEC has utterly failed to demonstrate that Wojeski's conduct meets this high standard for sanctioning a non-party or even that Wojeski's conduct was wrong in any way.

Most importantly, in the absence of clear evidence that Wojeski actively concealed the Annuity Agreement, the SEC asks this Court to ignore the possibility that Wojeski was simply not made aware of the Annuity Agreement until after the Court denied the SEC's motion for a preliminary injunction, and instead jump to the conclusion that Wojeski provided false testimony to this Court. Statements to this effect are conclusory and have no basis in fact. Moreover, the SEC has no evidence to suggest that Wojeski's credibility is anything but reliable. The SEC unfairly harps on an inadvertent slight of words contained in Wojeski's October Affidavit as the only circumstantial evidence that Wojeski had any intention to mislead the Court. However, whether Wojeski learned of the Annuity Agreement on July 20, 2010 or July 27, 2010 is irrelevant since the principle fact remains the same: Wojeski had no knowledge of the Annuity Agreement at the time he provided testimony to this Court at the June 11, 2010 preliminary hearing injunction and at the time the Court issued its order denying the SEC's request for a

[3] Notably, though the SEC cites Chambers, in part, to demonstrate the court's ability to sanction a non-party, the court in Chambers only sanctioned the non-party trustee, who helped facilitate the fraudulent transfer of ownership, with a reprimand.

preliminary injunction on July 7, 2010. (Wojeski Aff. at ¶ 24-27). Moreover, the evidence clearly demonstrates that as soon as Wojeski learned that the Annuity Agreement might exist when he received the illustration by e-mail on July 20, 2010, he immediately forwarded it to his attorney. (Wojeski Aff. at ¶ 19). The SEC has not offered a shred of evidence to suggest that Wojeski ever lied to this Court or actively concealed the existence of the Annuity Agreement. Notably, this Court has never held a hearing to obtain testimony from Wojeski about when he learned of the Annuity Agreement and never concluded that Wojeski willfully concealed the existence of the Annuity Agreement.

In the absence of clear evidence that Wojeski acted in bad faith to conceal the existence of the Annuity Agreement, the SEC's motion to impose sanctions on Wojeski must be denied. Ferron v. Echoster Satellite, 658 F. Supp. 2d 859 (S.D. Ohio 2009)(denying motion for sanctions based on lack of evidence suggesting bad faith on the part of a non-party); Feldman v. Davidson, 2009 U.S. Dist. LEXIS 36921 (S.D. Fla. April 13, 2009)(denying motion for sanctions against non-party based only on circumstantial evidence); Kant v. Seton Hall University, 2009 U.S. Dist. LEXIS 116451 (D. N.J. December 14, 2009)(declining to impose sanctions against non-party absence any indication of bad faith).

Finally, in the absence of clear evidence that Wojeski acted in bad faith to conceal the existence of the Annuity Agreement, there is no basis for the Court to disgorge the payments he received from the Trust in July 2010. According to the SEC's calculations, Wojeski only received $13,874.00, which included $5,775.50 reimbursement for fees paid to a title company and only $8,098.50 for his own trustee fees for work performed for the Trust. As set forth above, there is absolutely no evidence that Wojeski was unjustly enriched by the receipt of these payments, nor is there any clear evidence that Wojeski engaged in any willful misconduct or

securities fraud, a necessary requirement for disgorgement. This is not a case where Wojeski has been found liable for securities fraud. Wojeski, as successor trustee of the Trust, performed a considerable amount of work in furtherance of the Trust's administration and was entitled to receive payments for the services he rendered. The SEC has not offered any grounds that these funds were obtained by ill-gotten means or resulted in unjust enrichment. These payments were received in exchange for services rendered and are entirely just. As such, the SEC's request for disgorgement of the payments Wojeski received in July 2010 should also be denied. Cf. SEC v. Pallais, 2010 U.S. Dist. LEXIS 137586 (S.D.N.Y. Dec. 23, 2010)(disgorgement of ill-gotten gains found to be an proper remedy used against individuals found to be involved in a securities fraud); See also SEC v. Colonial Inv. Mgmt. LLC, 659 F. Supp. 2d 467 (S.D.N.Y. 2009)(holding that it would be inequitable to hold all defendants jointly and severally liable for the full amount of disgorgement when defendants have differing levels of culpability, especially when there is at least one innocent defendant).

Wojeski clearly stands apart from the other defendants against whom the SEC now seeks sanctions. Wojeski is an innocent party who was not provided with all of the documents necessary to adequately identify all of the Trust's obligations in furtherance of his duties as successor trustee, despite duly requesting them. Wojeski had no reason to believe he wasn't provided with all of the information related to the Trust's agreement when he assumed the role of trustee and was caught by surprise by the existence of the Annuity Agreement at the same time as the SEC. Wojeski could not have participated in any scheme to conceal the existence of the Annuity Agreement since he had no knowledge of its potential existence until July 20, 2010. In fact, the evidence demonstrates that Wojeski took immediate steps to reveal the existence of a possible annuity agreement as soon as he received evidence that one existed. That is not the

action of an individual attempting to conceal the existence of that very annuity agreement. At all times, Wojeski provided truthful testimony to this Court and there is no evidence to suggest otherwise. As such, the SEC has simply failed to meet its burden of providing any clear evidence demonstrating that Wojeski acted in bad faith or with any improper purpose and has offered nothing to this Court other than conjecture and baseless allegations.

CONCLUSION

Based on the foregoing, the SEC's motion for sanctions against David M. Wojeski and request for disgorgement should be denied in its entirety.

Dated: White Plains, New York
March 21, 2011

Respectfully submitted,

WILSON, ELSER, MOSKOWITZ, EDELMAN & DICKER LLP

By: /s Fred N. Knopf

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CERTIFICATE OF SERVICE

I hereby certify that on March 21, 2011 a copy of the foregoing Opposition to SEC's Motion for Sanctions was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by e-mail to all parties by operation of the Court's electronic filing system or by mail to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF System.

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	10-CV-457 (GLS/DRH)
-against-	:	
McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC, McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC, TIMOTHY M. McGINN, DAVID L. SMITH, LYNN A. SMITH, GEOFFREY L. SMITH, 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.	:	

APPENDIX OF LEXIS CASES CITED IN MEMORANDUM OF LAW

LEXSEE 2009 U.S. DIST. LEXIS 36921

CARL FELDMAN, et al., Plaintiffs, vs. Major General (Ret.) MICHAEL W. DAVIDSON, et al., Defendants.

CASE NO. 05-61760-CIV-COHN/SNOW

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

2009 U.S. Dist. LEXIS 36921

April 13, 2009, Decided
April 13, 2009, Entered

COUNSEL: [*1] For Carl Feldman, Lois Feldman, Herb Shackleton, Steven Mills, Gilda Capadanno, Arnold Pusar, Steven Mills, Plaintiffs: Michael Laurence Feinstein, LEAD ATTORNEY, Michael L. Feinstein, Fort Lauderdale, FL.

For Robert Yaw, II, Defendant: Jose R. Riguera, LEAD ATTORNEY, Berman Kean & Riguera, Fort Lauderdale, FL; Robert Bruce McCausland, LEAD ATTORNEY, McKenna & McCausland PA, Fort Lauderdale, FL; Orion G. Callison, III, Boies Schiller & Flexner, Miami, FL.

JUDGES: JAMES I. COHN, United States District Judge.

OPINION BY: JAMES I. COHN

OPINION

ORDER DENYING MOTION FOR SANCTIONS

THIS CAUSE is before the Court upon Defendants Major General (Ret.) Bruce M. Lawlor and Centuria Corporation's ("Centuria Defendants") Motion to Reopen March 14, 2007 Final Order of Dismissal, For Sanctions Against Anthony Fareri for Committing Fraud Upon the Court and For Entry of an Order to Show Cause directed to Jan Douglas Atlas, Esq. and Adorno and Yoss [171] ("Motion for Sanctions"). [1] The Court has carefully considered the Motion for Sanctions, non-party Anthony Fareri's ("Fareri") Response [DE 186], and the Centuria Defendants' Reply [DE 188]. The Court has also considered Defendants' prior Motions for Sanctions Pursuant to the Private [*2] Securities Litigation Reform Act [DEs 90, 96, 97] (collectively referred to as the "PSLRA Motions"); Plaintiffs' Response to the PSLRA Motions [DE 104]; Defendants' Replies [DEs 108, 112]; the Centuria Defendants' Supplemental Brief [DE 125]; the PSLRA Motions, Responses and Replies concerning Plaintiff's Motion for Reconsideration [DEs 113, 114 [2], 116, 117]; oral argument heard by the undersigned on November 14, 2006; and is otherwise fully advised in the premises.

1 Defendant Major General (Ret.) Michael W. Davidson ("Davidson") joined in the Motion for Sanctions [DE 176].

2 DE 114 and DE 115 appear to be identical. Therefore the Court refers only to DE 114.

I. BACKGROUND

To the extent possible, the Court refrains from restating the past activities in this case and focuses solely on the various motions for sanctions. The PSLRA Motions were filed after the Court granted Defendants' Motion to Dismiss [DE 86]. However, Plaintiffs filed a Response to Order to Show Cause, Motion for Reconsideration, and Motion for Leave to Amend Complaint [DE 88] ("Motion for Reconsideration"). A second round of sanctions motions were filed pertaining to the Motion for Reconsideration [DEs 113, 114,116,117]. [*3] Oral argument was heard on all of the motions for sanctions on November 14, 2006. Thereafter, the Court granted in part the Motion for Reconsideration and allowed Plaintiffs to amend certain causes of action. (Order Granting In Part Motion for Reconsideration and Motion for Leave to Amend, DE 127.) Therefore, there was no final adjudica-

tion and the Court denied the PSLRA Motions as premature. (Order Denying PSLRA Motions, DE 128.) The Court stated that "Defendants need not renew the Motions upon final adjudication of the above-captioned matter. However, all parties will have ten days from the date of final adjudication to supplement the information already before this Court regarding sanctions." (Id. at p. 3.)

On January 7, 2007, it came to the Court's attention that Plaintiffs were not receiving notice of the Court's Orders and the Court extended deadlines and informed Plaintiffs that:

> If Plaintiffs elect not to file an amended Complaint, they must notify the Court, in writing, if they intend to proceed with the remaining counts in this action as set forth in the initial Complaint and with a trial as to damages owed by Defendant Secure Solutions Holding, Inc. Plaintiffs failure to file [*4] an amended Complaint or otherwise inform the Court of their intent to proceed, shall result in the dismissal of all remaining counts without prejudice and the closing of this case.

(Order Resetting Response Deadlines, Order Vacating Order of Dismissal, DE 136.) After Plaintiffs failed to notify the Court or file an Amended Complaint, on March 14, 2007, the Court entered a Final Order of Dismissal [DE 154] dismissing the remaining claims without prejudice. (Final Order of Dismissal, DE 154.) The Court provided all parties until March 28, 2007 to supplement the PSLRA Motions. (Id. at p. 2.) The parties failed to supplement the PSLRA Motions by the deadline and as a result, the Court did not make Rule 11 findings pursuant to the Private Securities Litigation Reform Act ("PSLRA") codified at *15 U.S.C. §§ 78z-1* and *78u-4*.

On December 4, 2007 the present Motion for Sanctions was filed. [3] The Motion for Sanctions seeks to supplement the prior PSLRA Motions and provide additional grounds for sanctioning Fareri, Attorney Atlas and Adorno & Yoss. [4] (Motion for Sanctions, DE 171, p. 20 - 26.)

> 3 The Motion for Sanctions requested that the Court reopen this action. The Court granted the Motion for [*5] Sanctions to the extent that the Court directed Fareri to file a Response. (Order Granting in Part, DE 177.)
>
> 4 The Court previously stated that "[i]n light of the Court's Order Granting in Part Motions to Dismiss and for Sanctions in Pafumi, et al. v. Davidson, et al, Case No. 05-61679, DE 266, Jan Douglas Atlas, Esq. and Adorno & Yoss are not required to file a response to the Motion for Sanctions." (Order Granting in Part, DE 177.) The Court adopts the findings of the Pafumi Order [DE 266] regarding Attorney Atlas and Adorno & Yoss and addresses the allegations in the Motion for Sanctions only as a supplement.

II. ANALYSIS

A. Sanctions Pursuant to the Court's Inherent Powers

The Court has the discretion to fashion appropriate sanctions for conduct which abuses the judicial process. *Chambers v. NASCO, Inc., 501 U.S. 32, 44-45, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991)*. In fashioning appropriate sanctions, the Court has the inherent power to impose sanctions on parties, lawyers or both. *In re Sunshine Jr. Stores, Inc., 456 F.3d 1291, 1304 (11th Cir. 2006)*. Attorneys' fees and costs may be assessed against the client or the attorney, or both "when either has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." [*6] *Byrne v. Nezhat, 261 F.3d 1075, 1106 (11th Cir. 2001)*.

The court's inherent power to sanction includes sanctioning non-parties for bad faith conduct. See generally, *Chambers, 501 U.S. at 41*. However, additional safeguards may be warranted when a non-party is being sanctioned. For example, a non-party must "(1) have a substantial interest in the outcome of the litigation and (2) substantially participate in the proceedings in which he interfered." *Helmac Products Corp v. Roth (Plastics) Corp., 150 F.R.D. 563, 568 (E.D. Mich. 1993)*.

1. Sanctions Against Non-Party Anthony Fareri

Defendants seek to sanction Fareri, a non-party, because he "as the attorney-in-fact for the Plaintiffs pursuant to powers of attorney, together with Douglas Zemsky ("Zemsky"), Paul Harary ("Harary"), Jan Atlas ("Atlas") and Adorno & Yoss perpetrated a fraud on this Court. . . ." (Reply, DE 188, p. 1.) Defendants allege that Fareri should be sanctioned for his purported involvement in the Harary/Zemsky fraudulent scheme that formed the basis of the Securities and Exchange Corporation ("SEC") enforcement action and the criminal indictments against Zemsky and Harary. (Motion for Sanctions, DE 171, p. 9-17.) While the [*7] Court has found that Zemsky and Harary participated in a fraud upon the Court, the extent of Fareri's involvement and his knowledge of the fraud are gleaned only circumstantially at this time. Much depends on the credibility of Harary and Zemsky. (See Order Granting in Part Motions to Dismiss and for Sanctions, Case No. 05-61679, Pafumi, et al. v. Davidson, et al, DE 266.) Even though Fareri is not named in

the SEC Enforcement action, the action refers to a Florida stockbroker and the initials "AF" are used in the criminal actions against Harary and Zemsky. As far as the Court is aware, Fareri has not been criminally indicted. Defendants argue that the Court can determine, based upon circumstantial evidence, that Fareri participated in the fraud because without Fareri the Harary/Zemsky conspiracy falls apart. (Reply, DE 188, p. 3.) This may be true, however, the Court is concerned that the evidence against Fareri is not fully developed. At this time, the Court lacks sufficient evidence to support a finding of sanctionable conduct on the part of Fareri.

2. The Law Firms

The Court finds that Attorney Atlas and Adorno & Yoss ("Adorno") did not knowingly or recklessly pursue a frivolous [*8] claim or engage in litigation tactics that needlessly obstructed the litigation of non-frivolous claims. Nor did they act in bad faith, vexatiously, wantonly, or for oppressive reasons.

Here, even if Fareri were involved in the Harary/Zemsky conspiracy, the criminal actions against Harary and Zemsky were not made public until September 24, 2007. (Motion for Sanctions, DE 171, p. 11.) It was on September 24, 2007, that the SEC announced its settlement of the enforcement action against Harary and Zemsky. (Id. at 9.) Almost a year earlier, on November 14, 2006, the Court had granted Adorno's Motion to Withdraw. (Civil Minutes, DE 124.) There is no evidence that the attorneys for Plaintiffs had knowledge of any of the alleged fraudulent activities before September 24, 2007 or at any time participated in any sanctionable conduct.

B. Sanctions Pursuant to the PSLRA

The central purpose of the PSLRA is to prevent "frivolous lawsuits initiated to intimidate defendants and force them into a quick settlement." *Smith v. Smith, 184 F.R.D. 420, 423 (S.D. Fla. 1998)*; see also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006)*. The PSLRA requires courts, upon final adjudication [*9] of a private securities action, to evaluate all complaints, responsive pleadings and dispositive motions to determine whether they violate *Rule 11(b)*. It does not alter the standards for finding a Rule 11 violation, but functions solely to require courts to conduct a Rule 11 evaluation after entering final judgment in a claim for securities fraud and to impose sanctions when a violation is found. *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc., 186 F.3d 157, 166 (2d Cir. 1999)*. Regardless, "sanctions are to be imposed sparingly, as they can have significant impact beyond the merits of the individual case and can affect the reputation and creativity of counsel." *Hartmarx Corp. v. Abboud, 326 F.3d 862, 867 (7th Cir. 2003)* (internal citations omitted).

Rule 11(b) provides:

> By presenting to the court a pleading, written motion, or other paper--whether by signing, filing, submitting, or later advocating it--an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances:
>
> (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, [*10] or needlessly increase the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law;
>
> (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

As the 1993 Advisory Committee Note to *Rule 11(b)(2)* explains, the rule "'establishes an objective standard, intended to eliminate any 'empty-head pure-heart' justification for patently frivolous arguments.'" See *Simon DeBartolo, 186 F.3d at 166* (quoting Advisory Committee Notes). While frivolous claims should be sanctioned, claims alleging innovative interpretations of the law do not warrant sanctions. *Id.* In making this determination, "'the extent to which a litigant has researched the issues and found some support for its theories even in minority opinions, in law review articles, or through [*11] consultation with other attorneys should certainly be taken into account in determining whether paragraph (2) has been violated.'" *Simon DeBartolo, 186 F.3d at 166* (quoting Advisory Committee Notes). Arguments for a change of law, even if not specifically identified, should be viewed with tolerance. *Id.*

If a court determines that *Rule 11(b)* has been violated, the PSLRA requires the district court to impose appropriate sanctions. Id. It is presumed that where a

responsive pleading or dispositive motion fails to comply with the requirements of *Rule 11(b)*, the appropriate sanctions to be imposed depend upon the severity of the violation. *Adams v. IntraLinks, Inc., Case No. 03 Civ 5384, 2005 U.S. Dist. LEXIS 15970, 2005 WL 1863829, at *3 (S.D.N.Y. Aug. 5, 2005)*. If the violation is "substantial," the court should award attorneys' fees and costs incurred by the opposing party in the entire action. *15 U.S.C. § 78u-4(c)(3)(A)(ii)*.

The party upon whom sanctions are to be imposed can rebut the presumption regarding payment of fees and costs by showing either that: 1) the award of fees would be unjust or impose an unreasonable burden on the party and failure to award sanctions would not impose an even greater burden on the [*12] opposing party; or 2) the Rule 11 violation was *de minimis*. If it is determined that a party violated *Rule 11(b)(2)* and that sanctions should be imposed, monetary sanctions should be awarded against counsel and not the represented party because "'monetary responsibility for such violations is more properly placed solely on the party's attorneys.'" *Simon DeBartolo, 186 F.3d at 166* (quoting Advisory Committee Notes). Unlike a R. 11(b)(2) violation, a violation of *11(b)(1)* for bringing a complaint for an improper purpose would warrant the imposition of sanctions on counsel and the party. *Simon DeBartolo, 186 F.3d at 176 - 177*.

After a hearing on the matter, the Court previously denied the PSLRA Motions as premature. The Court now considers the original PSLRA Motions and the supplemental information provided in the Motion for Sanctions.

1. The Law Firms

The original PSLRA Motions allege that Attorney Atlas, Adorno, ignored well-settled procedural and substantive law resulting in the filing of a patently frivolous lawsuit. Defendants argue that they were required to expend unnecessary time and money defending an action that fell woefully short of stating a valid claim. Defendants also moved [*13] for sanctions pursuant to *Federal Rule of Civil Procedure 11* for the Motion for Reconsideration.

"Sanctions should only be imposed where it is patently clear that a claim has absolutely no chance of success." *Adams, 2005 U.S. Dist. LEXIS 15970, 2005 WL 1863829, at *3* (internal quotation omitted). Here, the Complaint and Motion for Reconsideration did succeed in part. Indeed, the arguments made in the Motion for Reconsideration and during the hearing led the Court to grant in part Plaintiffs' Motion for Reconsideration. Additionally, counsel's arguments regarding standing and the application of *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006)* added credence to Plaintiffs' contention that the instant action raised non- frivolous arguments for an extension or modification of securities law. The law is often subject to differing interpretations and Plaintiffs' counsel should not be sanctioned merely because this Court did not choose to adopt their proffered interpretation of securities law. The Complaint and Motion for Reconsideration were not presented for any improper purpose and the legal contentions were warranted by a non-frivolous argument for extending the law. See *Fed.R.Civ.P. 11(b)*.

There [*14] is no evidence that Adorno or Attorney Atlas intentionally overlooked the stringent pleading requirements in the filing of the Complaint or the Motion for Reconsideration. Furthermore, the implications of the criminal actions and the SEC Enforcement Action did not become public until September 24, 2007, long after Adorno withdrew as counsel. For the foregoing reasons, and in light of the arguable claims for relief, the Court finds that the imposition of sanctions against Adorno and Attorney Atlas as requested in the original PSLRA Motions and the present Motion for Sanctions are not warranted.

2. Plaintiffs and Non-Party Anthony Fareri

Defendants do not seek sanctions against Plaintiffs, but rather, Fareri. (Centuria Defendants' PSLRA Motion, DE 96, p. 2.) However, Defendants provide no case law for sanctioning a non-party pursuant to the PSLRA, nor has the Court found any. Indeed, as the Centuria Defendants pointed out, "*Federal Rule of Civil Procedure 11* provides that the court's authority to impose sanctions is limited only to attorneys, parties, and signators who violate *Rule 11*." (Supplemental Brief, DE 125, p. 2.) Therefore, the Court declines to sanction Fareri pursuant to the [*15] PSLRA.

III. CONCLUSION

Based upon the forgoing it is **ORDERED AND ADJUDGED** as follows:

1. Bruce M. Lawlor and Centuria Corporation's Motion to Reopen March 14, 2007 Final Order of Dismissal, For Sanctions Against Anthony Fareri for Committing Fraud Upon the Court and For Entry of an Order to Show Cause directed to Jan Douglas Atlas, Esq. and Adorno and Yoss [171] is **GRANTED IN PART AND DENIED IN PART.** The Motion is granted to the extent that the Court considered the Motion as a supplement to the prior PSLRA Motions and required a response by Anthony Fareri. The Motion is denied on its merits and no sanctions are imposed.

DONE AND ORDERED in Chambers at Fort Lauderdale, Broward County, Florida, this 13TH day of April, 2009.

/s/ James I. Cohn

JAMES I. COHN

United States District Court

LEXSEE 2009 U.S. DIST. LEXIS 116451

CHANDER KANT, Plaintiff, v. SETON HALL UNIVERSITY, Defendant.

Civil Action No. 00-CV-5204 (DMC)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

2009 U.S. Dist. LEXIS 116451

December 14, 2009, Decided
December 14, 2009, Filed

NOTICE: NOT FOR PUBLICATION

SUBSEQUENT HISTORY: Reconsideration denied by, Motion granted by *Kant v. Seton Hall Univ., 2010 U.S. Dist. LEXIS 30437 (D.N.J., Mar. 30, 2010)*

PRIOR HISTORY: *Kant v. Seton Hall Univ., 2009 U.S. Dist. LEXIS 105721 (D.N.J., Nov. 12, 2009)*

COUNSEL: [*1] For **KOUSOULAS & ASSOCIATES P.C, Movant: EUGENIE F. TEMMLER,** *LEAD ATTORNEY,* RABNER, ALLCORN, BAUMGART & BEN-ASHER, PC, UPPER MONTCLAIR, NJ.

CHANDER KANT, Plaintiff, Pro se, SHORT HILLS, NJ.

For **CHANDER KANT, Plaintiff: ANTONIA KOUSOULAS,** *LEAD ATTORNEY,* KOUSOULAS & ASSOCIATES, NEW YORK, NY.

For **KOUSOULAS & ASSOCIATES P.C, Petitioner: ELLIOTT ABRUTYN,** *LEAD ATTORNEY,* MORGAN, MELHUISH & ABRUTYN, ESQS., LIVINGSTON, NJ; **EUGENIE F. TEMMLER,** *LEAD ATTORNEY,* RABNER, ALLCORN, BAUMGART & BEN-ASHER, PC, UPPER MONTCLAIR, NJ.

For **SETON HALL UNIVERSITY, Defendant: JOHN JAMES PEIRANO , JR.,** *LEAD ATTORNEY,* **JAMES P. LIDON,** MCELROY, DEUTSCH, MULVANEY & CARPENTER, LLP, MORRISTOWN, NJ.

For **Kousoulas & Associates P.C., Intervenor: ANTONIA KOUSOULAS,** *LEAD ATTORNEY,* KOUSOULAS & ASSOCIATES, NEW YORK, NY.

JUDGES: Hon. Dennis M. Cavanaugh, United States District Judge.

OPINION BY: Dennis M. Cavanaugh

OPINION

DENNIS M. CAVANAUGH, U.S.D.J.:

This matter comes before the Court upon motion by Chander Kant ("Plaintiff") to hold a non-party witness, George Tzannetakis ("Mr. Tzannetakis"), in contempt. After carefully considering Plaintiff's submission, and for the reasons discussed below, Plaintiff's motion is **denied.**

I. BACKGROUND

This case arises out of [*2] Antonia Kousoulas's ("Kousoulas"), representation of Plaintiff in an employment discrimination suit against Seton Hall University ("Seton Hall"). The Kant v. Seton Hall trial concluded with a verdict of $ 80,000 in favor of Plaintiff on April 11, 2006. Thereafter, Kousoulas filed an application for fees and costs. On July 18, 2006, the Court issued an Opinion and Order awarding counsel fees in the amount of $ 124,834.95 and costs in the amount of $ 2,595.41.

To collect the legal fees, Kousoulas filed a petition to enforce her attorney's fees lien. Plaintiff filed an Answer and Counterclaim alleging legal malpractice, in an effort to contest payment of the fees to his trial counsel. Kousoulas moved for summary judgment on her attorney's fees petition, and moved to dismiss Plaintiff's mal-

practice counterclaim. The Court granted both motions on September 9, 2009.

During the course of the post-trial dispute over the payment of attorney's fees, Plaintiff, through the Clerk's office, subpoenaed Mr. Tzannetakis for deposition and document production pertaining to any and all matters relating to Antonia Kousoulas. Mr. Tzannetakis contacted the Clerk's office to explain that he had a disability [*3] that prevented him from driving. [1] His correspondence with the Clerk's office was dated August 23-a day before the scheduled deposition. Mr. Tzannetakis subsequently mailed a letter memorializing his correspondence with the supervising clerk to Plaintiff. Unfortunately, Plaintiff did not learn of Mr. Tzannetakis' difficulty in getting to the deposition until after the appearance date. Plaintiff waited for the witness and paid a court reporter appearance fee. On May 1, 2009, Plaintiff filed this motion to hold Mr. Tzannetakis in contempt of court.

1 The subpoena contained a check for travel expenses. See Plaintiff's Brief, at 2. The cost of a car service, however, was significantly more than the value of the travel expense check. Id.

II. APPLICABLE LAW

Federal Rule of Civil Procedure 45(e) provides for the imposition of sanctions against a witness for failure to comply with a subpoena duces tecum when a witness "having been served, fails without adequate excuse to obey the subpoena." Before sanctions can be imposed under *Fed. Rule Civ. P. 45(e)*, there must be a court order compelling discovery. *Cruz v. Meachum, 159 F.R.D. 366, 368 (D. Conn. 1994)*; see also, *Brittingham v. City of Camden, 2008 U.S. Dist. LEXIS 51285 (D.N.J. July 2, 2008)*; [*4] *Pennwalt Corp. v. Durand-Wayland, Inc., 708 F.2d 492, 494 (9th Cir. 1983)*. A subpoena obtainable from the Clerk of the Court, or issued by an attorney without any court involvement, is not of the same order as one issued by a judicial officer in the resolution of a specific dispute. *Waste Conversion, Inc. v. Rollins Envtl. Servs. (N.J.), Inc., 893 F.2d 605, 608 (3d Cir. 1990)* (en banc). Where there is no involvement of a court (e.g., an order to compel), sanctions are not available under *Rule 45(e)*. See *Pennwalt Corp., 708 F.2d at 494* (discussing *subsection (f)*, which is now contained in *subsection (e)*); *Cruz, 159 F.R.D. at 368*; WRIGHT & MILLER, FEDERAL PRACTICE & PROCEDURE: CIVIL 3D § 2465.

While a district court may impose sanctions on a non-party pursuant to its "inherent powers" when an order has been violated, such a drastic remedy is only proper upon a showing of bad faith. *Pennwalt Corp., 708 F.2d at 494*; *Cruz, 159 F.R.D. at 368*; see also *Roadway Express, Inc. v. Piper, 447 U.S. 752, 766, 100 S. Ct. 2455, 65 L. Ed. 2d 488 (1980)*. The Court's sanction power is discretionary and should be exercised with caution; where there is ground to doubt the wrongfulness of the individual's conduct, he should not be held subject [*5] to sanction. See *Littlejohn v. Bic Corp., 851 F.2d 673, 686 (3d Cir. 1988)*; *Quinter v. Volkswagen of America, 676 F.2d 969, 974 (3d Cir. 1982)*.

III. DISCUSSION

The subpoena duces tecum served upon Mr. Tzannetakis (a non-party witness) was not issued by a judicial officer in the resolution of a specific dispute, but rather filed by the Plaintiff in the Clerk's office. Therefore, as Plaintiff did not file a motion with the Court to order compliance, sanctions under *Rule 45(e)* are inappropriate. See *Brittingham, 2008 U.S. Dist. LEXIS 51285, at *3-4*; *Pennwalt, 708 F.2d at 494 (9th Cir. 1983)*; *Cruz, 159 F.R.D. at 368 (D. Conn. 1994)*.

Moreover, while the Court may exercise its inherent power to impose sanctions on a non-party in a case where a court order has been violated, it is not proper to do so in the absence of a finding of bad faith. *Cruz v. Meachum, 159 F.R.D. 366 at 368*; see *Littlejohn, 851 F.2d at 686*; *Quinter, 676 F. 2d at 974*. There is no indication of bad faith on the part of Mr. Tzannetakis.

Although the subpoena did not contain contact information for the issuing clerk, Mr. Tzannetakis nonetheless took the initiative to notify the office of the Clerk of Court that he could not [*6] attend. Specifically, he had a disability which prevented him from driving. Mr. Tzannetakis also inquired into the cost of hiring a car service to provide transportation. The cost of the car service was significantly more than the transportation expenses check provided by Plaintiff. Plaintiff argues that Mr. Tzannetakis' communications regarding his inability to attend the deposition were not provided in a timely manner. Perhaps it would have been ideal for the witness to provide more notice, however, his actions certainly do not indicate bad faith. Under these circumstances, it would be inappropriate to impose sanctions on Mr. Tzannetakis.

IV. CONCLUSION

For the reasons discussed above, Plaintiff's motion to hold Mr. Tzannetakis in contempt of Court is denied. An appropriate Order accompanies this Opinion.

/s/ Dennis M. Cavanaugh

Dennis M. Cavanaugh, U.S.D.J.

Date: December 14, 2009

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LEXSEE 1997 U.S. DIST. LEXIS 3561, 5-6

COREY L. LEICHING, Plaintiff, -against- CONSOLIDATED RAIL CORPORATION, Defendant.

92-CV-1170

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF NEW YORK

1997 U.S. Dist. LEXIS 3561

March 22, 1997, Decided
March 24, 1997, FILED

CASE SUMMARY:

PROCEDURAL POSTURE: Counsel for defendant railroad and counsel for plaintiff filed objections to the report-recommendation of a magistrate judge recommending the imposition of sanctions in the amount of $ 2,500 to be assessed personally against defense counsel for conduct during discovery.

OVERVIEW: Defense counsel claimed that they should not be sanctioned at all, and plaintiff's counsel claimed that defense counsel had not been sanctioned severely enough. The judge based the recommendation for the imposition of sanctions against defense counsel on the record of discovery abuses and tactics in the case that spanned several years and numerous conferences, threats of sanctions, and a profusion of motion practice relating to discovery. The court adopted the report-recommendation. The court held that the record in the case was replete with conduct justifying the imposition of sanctions. Defense counsel were expressly advised by the magistrate judge against the interposing of what had been determined by the court to be baseless and patently frivolous objections during depositions. Yet, the conduct continued. Further, the excessive objections without a valid legal basis, and the constant delays and refusals to produce documents, amounted to nothing less than a bad faith effort by defense counsel to harass, delay, and burden plaintiff.

OUTCOME: The court adopted the report-recommendation of the magistrate judge and ordered that defense counsel personally pay to plaintiff's counsel within 30 days of receipt of the decision and order the total sum of $ 2,500, a sum representing the cost to plaintiff for the dilatory conduct of defense counsel during pre-trial discovery.

COUNSEL: [*1] Appearances:

For plaintiff: CHRISTOPHER N. LUHN, ESQ., IANNIELLO, ANDERSON, REILY & LUHN, Clifton Park, NY. For plaintiff: RUSS M. HERMAN, ESQ., MAURY A. HERMAN, ESQ., LEONARD A. DAVIS, ESQ., HERMAN, HERMAN, KATZ & COTLAR, L.L.P., New Orleans, Louisiana.

For defendant: LAWRENCE R. BAILEY, Jr., ESQ., WALKER & BAILEY, New York, NY.

JUDGES: Thomas J. McAvoy, Chief U.S. District Judge

OPINION BY: Thomas J. McAvoy

OPINION

MEMORANDUM-DECISION & ORDER

I. BACKGROUND

This matter comes before the Court on the objections of the defendant's and plaintiff's counsel to the Report-Recommendation of Magistrate Judge Smith, dated October 24, 1996, recommending the imposition of sanctions in the amount of $ 2,500.00 to be assessed person-

ally against defense counsel Bailey and Muraidekh for conduct during discovery. The Magistrate Judge found such conduct to be "improper," "petty," "abusive," "vexatious," "unreasonable," "intransigent," and lacking in "good faith" and "civility." Defense counsel vigorously object to the grounds on which the Magistrate Judge based his findings and recommendation, and challenge the legal propriety of the imposition of sanctions against them. Plaintiff's counsel [*2] objects to the Magistrate Judge's Report-Recommendation as well, and with all the intensity that has come to characterize the communications between each side and the papers filed on their behalf. Distilled to its essence, defense counsel claim that they should not be sanctioned at all, and plaintiff's counsel claims that defense counsel have not been sanctioned severely enough. [1]

1 The Court is tempted to uphold the Magistrate Judge's Report-Recommendation on the sole ground that any decision that is unacceptable to both sides probably has found the appropriate middle ground between two extremes.

Magistrate Judge Smith based the recommendation for the imposition of sanctions against defense counsel on the record of discovery abuses and tactics in this case that span several years and numerous conferences, threats of sanctions, and a profusion of motion practice relating to discovery.

Defense counsel, Bailey and Muraidekh, claim that their actions were justified, within the boundaries of the law, and ethical. [*3] Moreover, they claim that sanctions were imposed without being given notice and an opportunity to argue their side. Finally, defense counsel contend that the case was terminated before the subject sanction was recommended by the Magistrate Judge, and thus, neither the Magistrate Judge nor the undersigned has the power to sanction them.

The plaintiff's counsel, Mr. Luhn, submits that not only are the sanctions appropriate, but given the egregiousness of defense counsel's conduct, this Court should "enlarge substantially" the sanction amount recommended by the Magistrate Judge. The Court now considers the objections raised.

II. DISCUSSION

A. Standard of Review of Magistrate Judge's Report-Recommendation

Before Magistrate Judge Smith, Jr., was a letter motion, dated on or about April 7, 1995, by the plaintiff seeking various forms of relief. The Magistrate Judge issued a Report and Recommendation on October 24, 1996, and objections have been filed. Accordingly, pursuant to *Fed. R. Civ. P. 72* this Court must "make a *de novo* determination upon the record" of the motions before the Court. *Fed. R. Civ. P. 72(b)*. After making a *de novo* determination, this Court may "accept, [*4] reject, or modify the recommended decision receive further evidence, or recommit the matter to the [Magistrate Judge] with instructions." Id. For the following reasons, the Court adopts the Report-Recommendation of the Magistrate Judge.

B. Lack of Notice and Opportunity to be Heard

The Magistrate Judge recommended sanctions against defense counsel pursuant to *28 U.S.C. § 1927* and the inherent power of the Court. *28 U.S.C. § 1927* states, in relevant part

Any attorney ... who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

Decisions in this Circuit have "emphasized the requirement that an attorney's acts be vexatious in order to be sanctionable" under *§ 1927*. *Keller v. Mobil Corp., 55 F.3d 94, 99 (2d Cir. 1995)*. The purpose of *§ 1927* is to deter unnecessary delays in litigation. *U.S. v. Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen and Helpers of America, AFL-CIO, 948 F.2d 1338, 1345 (2d Cir. 1991)*. The Supreme Court has explained that *§ 1927* "is concerned only with limiting the abuse of [*5] court processes," especially the abuses connected with pre-trial discovery. *Roadway Express, Inc. v. Piper, 447 U.S. 752, 762 & 757 n. 4, 65 L. Ed. 2d 488, 100 S. Ct. 2455 (1980)*. Thus, an award under this statute is appropriate "when an attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay." Id. Stated another way, the Court must determine if defense counsel acted in bad faith. Id. Bad faith conduct may include pursuing "frivolous contentions," *Dow Chemical Pacific Ltd. v. Rascator Maritime S.A., 782 F.2d 329, 345 (2d Cir. 1986)* (citations omitted), "frivolous motions," *Browning Debenture Holders' Committee v. DASA Corp., 560 F.2d 1078, 1088 (2d Cir. 1977)*, or "intentionally dilatory" conduct, *Nemeroff v. Abelson, 620 F.2d 339, 350 (2d Cir. 1980)*. The Court notes that "the Second Circuit requires that there be "clear evidence" that the opposing party's actions were taken to harass, delay the proceedings, or for otherwise inappropriate reasons." *Center Cadillac, Inc. v. Bank Leumi Trust Co. of New York, 878 F. Supp. 626, 628 (S.D.N.Y. 1995), citing* [*6] *Dow Chemical Pacific Ltd. v. Rascator Maritime S.A., 782 F.2d 329, 344 (2d Cir. 1986)*.

Furthermore, the Court has the inherent power to sanction bad-faith conduct of attorneys or their clients

apart from any of the statutory or rules provisions. *Chambers v. NASCO, 501 U.S. 32, 115 L. Ed. 2d 27, 111 S. Ct. 2123 (1991)*. The exercise of this power is appropriate where there is clear evidence that the attorney's actions are taken for reasons of harassment or delay, or for other improper purposes. *Oliveri v. Thompson, 803 F.2d 1265, 1272 (2d Cir. 1986)*.

Regardless of the basis for the imposition of sanctions, the Circuit clearly requires that such penalties "'certainly should not be assessed lightly or without fair notice and an opportunity for a hearing on the record.'" *Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926, 935 (2d Cir. 1992), quoting Roadway Express, Inc. v. Piper, 447 U.S. 752, 767, 65 L. Ed. 2d 488, 100 S. Ct. 2455 (1980)*. The Court now considers the record before it.

1. Sanctionable Conduct

The record in this case is replete with conduct justifying the imposition of sanctions. Defense counsel were repeatedly warned by the Court against [*7] failing to produce documents, yet this dilatory conduct continued. The result was motion practice and letter requests for intervention by the Court, and ultimately threats of sanctions by the Court. See Orders dated October 24, 1994, February 3, 1995, and March 6, 1995. In addition, defense counsel were expressly advised by the Magistrate Judge against the interposing of what had been determined by the Court to be baseless and patently frivolous objections during depositions. Yet, the conduct continued. For example, the Court has reviewed the deposition transcript of William Barringer. The Court has found what it considers to be improper or baseless objections on nearly every page of the deposition. In addition, the Court reviewed the deposition of John R. Judge, wherein defense counsel directed the deponent not to answer questions even after noting his objections to questions. In the deposition of Michael Mitchell, defense counsel engaged in the same dilatory conduct. In the view of the Court, such actions serve no purpose other than to delay the progress of a case, increase the expense to the other side, or effectuate a vexatious or bad faith intent.

Defense counsel have attempted, [*8] through correspondence with the Magistrate Judge and in a lengthy and detailed objection to the Magistrate Judge's Report-Recommendation, to justify their actions. The crux of defense counsel's arguments are (1) that the plaintiff was dilatory as well; and (2) that defense counsel acted within the confines of the law. As to the first argument, the Court does not doubt that the plaintiff's actions caused some measure of delay in this case. However, the determination that the Court has made with respect to defendant's counsel is that not only has their conduct caused delay, but that their conduct had no good faith basis in law or fact. As to the second, the Court finds that, at best, defense counsel conduct themselves on the very fringes of legal and ethical conduct. When attorneys flirt too often and too closely with the edge of ethical conduct and practices, as in this case, the lines of what is ethical and legally justifiable become blurred, and often that line of demarcation is overstepped. In this case, the excessive objections without a valid legal basis, and the constant delays and refusals to produce documents, including directing a witness not to bring with him documents expressly [*9] ordered to be produced by the Court, amount to nothing less than a bad faith effort by defense counsel to harass, delay, and burden the plaintiff. It must be noted that the same result was inflicted on the Court.

For the reasons stated above, and for innumerable reasons apparent in the record of this case, the Court finds that sanctions are appropriate against defense counsel pursuant to *28 U.S.C. § 1927* and the inherent power of the Court.

2. Notice and Opportunity to be Heard

Clearly, defense counsel is entitled to some due process prior to the imposition of sanctions pursuant to *28 U.S.C. § 1927*. See *Schoenberg, 971 F.2d at 935*. The issue is what process is due. In this case, there is no issue of notice. The parties have corresponded in numerous letters regarding the alleged discovery abuses and delays. In addition, the Court has threatened defense counsel with sanctions as a result of their actions. Moreover, the Magistrate Judge has now recommended a specific sanction for specific conduct.

By filing objections in the form of responsive letters, oral rebuttal at conferences, and a formal twenty-seven page objection to the Magistrate Judge's Report-Recommendation, it is [*10] arguable that defense counsel has been given an opportunity to respond. Certainly, a voluminous record sits before this Court that identifies the issues relating to the recommendation for sanctions and sets forth the position of the Court, plaintiff's counsel, and defendant's counsel. Accordingly, the Court can see no useful purpose that will be served by conducting a hearing at this time. In the Court's view, a hearing would be duplicative. Defense counsel was given notice that they would face sanctions if they persisted in dilatory and vexatious practices. Defense counsel responded by letter to the Magistrate Judge, and by filing a detailed objection to the Report-Recommendation. Accordingly, Messrs. Bailey and Muraidekh have been given all the process that they are due.

C. Jurisdiction

The sanctions in this case were based on a letter motion by the plaintiff filed in April 1995. A Stipulation of

Dismissal was signed by this Court and filed on September 20, 1996. The Magistrate Judge's Report-Recommendation on that letter motion is dated October 24, 1996. Simply stated, defense counsel argue that this Court was divested of jurisdiction to issue orders, even as to sanctions, as [*11] of the date that the Stipulation was filed.

In support for their position, defense counsel cite *Barr Laboratories, Inc. v. Abbott Laboratories, 867 F.2d 743, 747 (2d Cir. 1989)*. Barr states "'all jurisdiction over the action,' including the authority to impose sanctions, is lost after the plaintiff terminates a lawsuit by filing a notice of dismissal under [*Fed. R. Civ. P.] 41(a)(1)(i)*." Id., *quoting Johnson Chemical Co. v. Home Care Products, Inc., 823 F.2d 28, 31 (2d Cir. 1987)*. However, more recently, the Second Circuit has accepted the position advanced by the Supreme Court that matters such as sanctions are collateral, and thus, a Court retains jurisdiction to entertain such matters even after termination of the case. See *Valley Disposal, Inc. v. Central Vermont Solid Waste Management Dist., 71 F.3d 1053, 1060 (2d Cir. 1995)* (subsequent application for attorneys fees pursuant to *42 U.S.C. § 1988*), *citing Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 110 L. Ed. 2d 359, 110 S. Ct. 2447 (1990)* (motion for sanctions pursuant to Rule 11). Accordingly, defense counsel's argument is of no moment.

III. CONCLUSION

For the reasons stated [*12] herein, the Court hereby adopts the Report-Recommendation of the Magistrate Judge, and ORDERS that defense counsel, Bailey and Muraidekh, personally pay to plaintiff's counsel within 30 days of receipt of this Decision and Order the total sum of $ 2,500.00, a sum representing the cost to the plaintiff for the dilatory conduct of defense counsel during pre-trial discovery.

IT IS SO ORDERED.

Dated at Binghamton, New York

March 22, 1997

Thomas J. McAvoy

Chief U.S. District Judge

LEXSEE 2010 U.S. DIST. LEXIS 137586

SECURITIES AND EXCHANGE COMMISSION, Plaintiff -v- LUIS E. PALLAIS and RODEDAWG INTERNATIONAL INDUSTRIES, INC, Defendants.

08 CV 08384 (GBD)(GWG)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2010 U.S. Dist. LEXIS 137586

December 23, 2010, Decided
December 23, 2010, Filed

PRIOR HISTORY: *SEC v. Pallais, 2010 U.S. Dist. LEXIS 69594 (S.D.N.Y., July 9, 2010)*

COUNSEL: [*1] For Security and Exchange Commission, Plaintiff: Robert H. Murphy, LEAD ATTORNEY, U.S. Securities and Exchange Commission (LA), Los Angeles, CA; Sanjay Wadhwa, William Finkel, U.S. Securities and Exchange Commission (3 World Financial), New York, NY.

JUDGES: GEORGE B. DANIELS, United States District Judge.

OPINION BY: GEORGE B. DANIELS

OPINION

MEMORANDUM DECISION AND ORDER

GEORGE B. DANIELS, District Judge:

Plaintiff the Securities and Exchange Commission ("SEC") brings this suit against Rodedawg International Industries, Inc., and its CEO and Chairman Luis E. Pallais (collectively, "Defendants"), alleging violations of section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), *15 U.S.C. § 78j(b)*, and *Rule 10b-5*, *17 C.F.R. § 240.10b-5*, promulgated thereunder. On December 16, 2009, this Court entered a default judgment against Defendants and referred the matter to Magistrate Judge Gabriel W. Gorenstein for an inquest on damages and further appropriate relief.

BACKGROUND

The SEC, as detailed in its Motion for Default Judgment, seeks a judgment (1) permanently restraining and enjoining Defendants from directly or indirectly, singly or in concert, violating Section 10(b) of the Exchange Act and *Rule 10b-5* thereunder; [*2] (2) permanently barring Pallais from serving as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Exchange Act, *15 U.S.C. § 781*, or that is required to file reports pursuant to section 15(d) of the Exchange Act, *15 U.S.C. § 78o(d)*, pursuant to section 21(d)(2) of the Exchange Act, *15 U.S.C. § 78u(d)(2)*; (3) permanently barring Pallais from participating in an offering of a penny stock pursuant to section 21(d)(6) of the Exchange Act, *15 U.S.C. § 78u(d)(6)*; (4) ordering Pallais to disgorge ill-gotten gains in the amount of $7,057.20 plus prejudgment interest in the amount of $1,125.46; and (5) ordering Pallais to pay a civil monetary penalty of $130,000 pursuant to section 21 (d)(3) of the Exchange Act, *15 U.S.C. §78u(d)(3)*.

Magistrate Judge Gorenstein issued a Scheduling Order providing Defendants the opportunity to respond to the SEC's request. Pallais submitted two documents, wherein he claimed that "the SEC's claims are frivolous, he does not recall being served by the SEC, he committed no wrongdoing, this case is damaging to his shareholders, his press releases did not violate any laws, and he cannot obtain a lawyer because [*3] of financial hardship." Report and Recommendation ("Report") at 3. The Scheduling Order also notified the parties that the Court would conduct its inquest based solely on the written submissions of the parties absent a request from either side for a hearing. No party requested a hearing.

Magistrate Judge Gorenstein issued a Report and Recommendation ("Report") based solely on the written submissions of the parties. Magistrate Judge Gorenstein recommended that the SEC's request be granted in part and denied in part. In particular, Magistrate Judge Gorenstein recommended that "the SEC . . . be awarded a judgment against the defendants (1) enjoining Rodedawg and Pallais from violating section 10(b) of the Exchange Act and *Rule 10b-5*; (2) barring Pallais from serving as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Exchange Act, *15 U.S.C. § 781*, or that is required to file reports pursuant to section 15(d) of the Exchange Act, *15 U.S.C. § 78o(d)*, pursuant to section 21(d)(2) of the Exchange Act, *15 U.S.C. § 78u(d)(2)*, for ten years; and (3) ordering Pallais to pay a civil monetary penalty of $65,000 to the United States Treasury [*4] pursuant to section 21(d)(3) of the Exchange Act, *15 U.S.C. § 78u(d)(3)*." Report at 1. Magistrate Judge Gorenstein denied the SEC's requests for a penny stock bar, a civil penalty in the amount of $130,000, and disgorgement of $7,057.20 plus prejudgment interest.

In his report, Magistrate Judge Gorenstein advised the parties that failure to file timely objections to the Report would constitute a waiver of those objections. See *28 U.S.C. § 636(b)(1)*; *FED. R. CIV. P. 72(b)*. The SEC submitted a memorandum to the Court (dated July 18, 2010) indicating its objection to part of the Report issued by Magistrate Judge Gorenstein. The SEC argues that the Court should order the following remedies denied in the Report: (a) a permanent bar on Pallais from participating in an offering of penny stock because the status was uncontested and factual allegations are accepted as true upon a defendant's default; (b) a civil penalty pursuant to *15 U.S.C. § 78u(d)(3)* in the amount of $130,000 because Pallais created a significant risk of substantial losses to other persons; and (c) disgorgement because, contrary to the Report's assertion, the SEC did submit evidence to support the claim.

STANDARD OF REVIEW

The [*5] Court may accept, reject or modify, in whole or in part, the findings and recommendations set forth within the Report. *28 U.S.C. § 636(b)(1)*. When there are objections to the Report, the Court must make a de novo determination of those portions of the Report to which objections are made. Id.; see also *Rivera v. Barnhart, 423 F. Supp. 2d 271, 273 (S.D.N.Y. 2006)*. The district judge may also receive further evidence or recommit the matter to the magistrate judge with instructions. See *FED. R. CIV. P. 72(b)*; *28 U.S.C. § 636(b)(1)(C)*. It is not required, however, that the Court conduct a de novo hearing on the matter. See *United States v. Raddatz, 447 U.S. 667, 676, 100 S. Ct. 2406, 65 L. Ed. 2d 424 (1980)*. Rather, it is sufficient that the Court "arrive at its own, independent conclusions" regarding those portions to which objections were made. *Nelson v. Smith, 618 F.Supp. 1186, 1189-90 (S.D.N.Y. 1985)* (quoting *Hernandez v. Estelle, 711 F.2d 619, 620 (5th Cir. 1983)*). When no objections to a Report are made, the Court may adopt the Report if "there is no clear error on the face of the record." *Adee Motor Cars, LLC v. Amato, 388 F. Supp. 2d 250, 253 (S.D.N.Y. 2005)* (citation omitted).

RECOMMENDATIONS WITHOUT OBJECTIONS

With [*6] respect to the first two requests for relief, this Court must assess whether the SEC has provided a sufficient basis for the Court to determine damages. See *Transatl. Marine Claims Agency, Inc. v. Ace Shipping Corp., 109 F.3d 105, 111 (2d Cir. 1997)* (noting that the Court "should take the necessary steps to establish damages with reasonable certainty"). Although the Court may hold a hearing to assess damages, a hearing is not required where a sufficient basis on which to make a calculation exists. *FED. R. CIV. P. 55(b)(2)* (court may conduct hearings on damages as necessary); *Action S.A. v. Marc Rich & Co., 951 F.2d 504, 508 (2d Cir. 1991)* (*FED. R. CIV. P. 55(b)(2)* "allows but does not require . . . a hearing").

This Court accepts the Report's recommendation that the SEC's written submissions provide an adequate basis for the requested relief. After carefully reviewing the Report and Recommendation, this Court finds that the report is not facially erroneous with respect to the SEC's first two requests, and adopts the Report's Recommendation to: (1) enjoin Rodedawg and Pallais from violating section 10(b) of the Exchange Act and *Rule 10b-5*; and (2) bar Pallais from serving as an officer [*7] or director of any issuer that has a class of securities registered pursuant to section 12 of the Exchange Act, *15 U.S.C. § 781*, or that is required to file reports pursuant to section 15(d) of the Exchange Act, *15 U.S.C. § 78o(d)*, pursuant to section 21(d)(2) of the Exchange Act, *15 U.S.C. § 78u(d)(2)*, for ten years."

RECOMMENDATIONS WITH OBJECTIONS

This Court has examined Magistrate Judge Gorenstein's report in light of the SEC's objections regarding its remaining requests for relief. The SEC's objections regarding the penny stock bar and disgorgement are sustained. The SEC's objections regarding the Tier III penalty are overruled.

A. Penny Stock Bar

Magistrate Judge Gorenstein properly recited the legal standard for imposing a penny stock bar. The securities must qualify as penny stock -- that is, they must bear

"a price of less than five dollars except as provided in *17 C.F.R. § 240.3a51-1*." *United States SEC v. Universal Express, Inc., 475 F. Supp. 2d 412, 429 (S.D.N.Y. 2007)*. Also the standard for imposing an officer-or-director bar must be satisfied. See id. Here, this Court adopts the Report's recommendation to impose an officer-or-director bar.

Magistrate Judge Gorenstein properly [*8] stated that, even when a default judgment has been entered, the SEC must submit admissible evidence proving that the securities qualify as penny stock before the Court may order a bar. See *SEC v. Becker, 2010 U.S. Dist. LEXIS 52623, at * 18 (S.D.N.Y. May 28, 2010)*. A subsequent decision by United States District Judge Shira A. Scheindlin cited by the SEC did not alter the requirement for evidence. See *SEC v. Becker, 2010 U.S. Dist. LEXIS 67828, at *4-5 (S.D.N.Y. July 8, 2010)* (starting the discussion with "[t]he evidence . . . demonstrates that the imposition of a penny stock bar . . . is warranted in this case."). Rather, in that case, the SEC submitted evidence to support each of its factual assertions, and the SEC demonstrated that the issue was uncontested by identifying the defendants' admission of the penny stock status. *Id. at *5*. Thus, Judge Scheindlin found that "[t]his evidence demonstrates that [the] securities were penny stocks." Id. Magistrate Judge Gorenstein, therefore, properly denied the SEC's request for a penny stock bar because the SEC failed to submit any evidence in support of its claim.

Now, in its objection memorandum, the SEC submits sufficient evidence to establish [*9] that Rodedawg securities qualify as penny stock. The SEC provides true copies of Rodedawg International's Unaudited Balance Sheet and Income Statement for years end 2005 and 2006 to demonstrate that the company never had net tangible assets that exceed $2,000,000 or revenues of at least $6,000,0000 during an three year period. See Declaration of William Finkel, Ex. B. The SEC provides a graph generated by www.OTCMarkets.com that displays the price/volume of Rodedawg International's securities from September 1, 2005 to March 31, 2007 to demonstrate that the stock never traded at $5 per share or higher. See Finkel Declaration, Ex. A. Finally, the SEC offers a declaration in support of its assertion that "none of Rodedawg Int'l securities were ever reported securities or registered on an exchange, approved for reporting or listing, or 'NMS' securities." Finkel Declaration ¶ 10. This evidence demonstrates that Rodedawg securities were penny stock. Therefore, upon receipt of the further submitted evidence, this Court sustains the SEC's objection. A penny stock bar of ten years, the term imposed for the officer-or-director bar, is appropriate.

B. Tier III Penalty

Magistrate Judge Gorenstein [*10] properly rejected the SEC's request for a Tier III penalty in the amount of $130,000. Magistrate Judge Gorenstein properly stated the law governing the imposition of civil penalties under *15 U.S.C. § 78u(d)(3)*. A Tier II penalty is available if the violation involves "fraud, deceit, manipulation or reckless disregard of a regulatory requirement." Id. *§ 78u(d)(3)(B)(ii)*. A Tier III penalty is available if, in addition to the factors required for a Tier II penalty, the violation "resulted in substantial losses or created a significant risk of substantial losses or created a risk of substantial losses to other persons." Id. *§ 78u(d)(3)(B)(iii)(bb)*. Nevertheless, the discretion to determine the appropriate kind of penalty to impose lies with the district court. See id. *§ 78u(d)(3)(B)(I)*; accord *SEC v. Bocchino, 2002 U.S. Dist. LEXIS 22047 at *4 (S.D.N.Y. Nov. 8, 2002)*.

Magistrate Judge Gorenstein properly found that Pallais should pay a Tier II penalty. The facts demonstrate that Pallais's violation involved "fraud, deceit, manipulation or reckless disregard of a regulatory requirement." However, a second tier penalty is warranted because the SEC failed to satisfy the substantial [*11] loss requirement. Magistrate Judge Gorenstein properly found that, as illustrated by previous cases cited in the Report, the loss sustained by investors ($7,057.20) was not substantial. Additionally, Magistrate Judge Gorenstein properly determined that Pallais's fraudulent conduct did not pose a risk of substantial loss. The SEC provided no facts to demonstrate that either a large number of investors or investors with substantial funds were exposed to or could have been induced by Pallais's fraudulent press releases. The SEC failed to explain why the fluctuating price of Rodedawg shares created a substantial risk of loss. Finally, the SEC never even alleged an estimated potential loss. Therefore, this Court overrules the objection. A Tier II civil penalty of $65,000 is reasonable and appropriate.

C. Disgorgement

Magistrate Judge Gorenstein properly stated the law governing disgorgement. "Disgorgement is an equitable remedy for violations of the federal securities laws, which is aimed at 'forcing a defendant to give up the amount by which he was unjustly enriched.'" *SEC v. Anticevic, 2010 U.S. Dist. LEXIS 50207, at *19 (S.D.N.Y. May 14, 2010)* (quoting *SEC v. Tome, 833 F.2d 1086, 1096 (2d Cir. 1987)*). [*12] "[T]he Commission bears the ultimate burden of establishing that its calculated disgorgement reasonably approximates the defendant's unjust enrichment, any risk in uncertainty [in calculating disgorgement] should fall on the wrongdoer whose conduct created that uncertainty." *SEC v. Rosenfeld, 2001 U.S. Dist. LEXIS 166, at *5 (S.D.N.Y. Jan. 9, 2001)* (cit-

ing *SEC v. First City Fin., Corp., 281 U.S. App. D.C. 410, 890 F.2d 1215, 1232 (D.C. Cir. 1989)* (quoting *SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995)))* (citations and internal quotation marks omitted). "Thus, once the Commission shows the existence of a fraudulent scheme in violation of federal securities laws, the burden shifts to the defendant to 'demonstrat[e] that he received less than the full amount allegedly misappropriated and sought to be disgorged.'" *SEC v. Breed, 2004 U.S. Dist. LEXIS 7336, at *11* (quoting *SEC v. Rosenfeld, 2001 U.S. Dist. LEXIS 166, at *5-6* (citations omitted)) (internal quotation marks omitted) (bracketing in original).

Magistrate Judge Gorenstein properly stated that, absent evidence to support its claimed amount of unjust enrichment, the SEC was not entitled to equitable relief. However, Magistrate Judge [*13] Gorenstein improperly concluded that "there is no basis for ordering such relief because "the SEC . . . failed to submit any evidence, admissible or otherwise, to support its claim as to disgorgement." Report at 14. The SEC submitted with its Motion for Default Judgment Pallais' brokerage account statements for shares of Rodedawg International sold during the time of the fraudulent activity. [1] This is sufficient evidence of Pallais' profit given that, during the course of Pallais' illegal actions, "Pallais caused Rodedawg Int'l to issue millions of shares of company stock to him, and [then] Pallais sold at least 267,000 shares of Rodedawg Int'l stock for approximately $7,057.20." Complaint ¶ 19. Therefore, this Court sustains the objection. The SEC is entitled to an order disgorging Pallais of $7,057.20. The SEC is also entitled to prejudgment interest in the amount of $1,125.46. [2]

1 Statements from the Fidelity Investment Account indicate eight transactions from 03/05/07 - 03/08/07 where Pallais sold 167,500 shares for $4,132.30. See Finkel Declaration, Ex. N. Statements for the Broad Street Securities, Inc. Account indicate five transactions on 12/15/06 where Pallais sold 100,000 shares [*14] for $2,924.90. See Finkel Declaration, Ex. O.

2 The SEC, based on documentation submitted with its Motion for Default, relies on the nine percent rate of interest used by the Internal Revenue Service and provides a table detailing the annual rate, period rate, and quarter interest calculations by quarter range.

CONCLUSION

Defendants Rodedawg International Industries, Inc., and Luis E. Pallais are HEREBY ENJOINED AND RESTRAINED from violating section 10(b) of the Exchange Act and *Rule 10b-5, 17 C.F.R. § 240.10b-5*, promulgated thereunder.

Defendant Luis E. Pallais is HEREBY ENJOINED AND RESTRAINED for ten (10) years from serving as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Exchange Act, *15 U.S.C. § 781*, or that is required to file reports pursuant to section 15(d) of the Exchange Act, *15 U.S.C. § 78o(d)*, pursuant to section 21(d)(2) of the Exchange Act, *15 U.S.C. § 78u(d)(2)*, for ten years.

Defendant Luis E. Pallais is HEREBY ENJOINED AND RESTRAINED from participating in an offering of a penny stock pursuant to section 21(d)(6) of the Exchange Act, *15 U.S.C. § 78u(d)(6)*, for ten years.

Defendant Luis E. Pallais is HEREBY ORDERED [*15] to disgorge his ill-gotten gains in the amount of $7,057.20 plus prejudgment interest in the amount of $1,125.46.

Defendant Luis E. Pallais is HEREBY ORDERED to pay a civil monetary penalty of $65,000 in U.S. currency to the United States Treasury pursuant to section 21(d)(3) of the Exchange Act, *15 U.S.C. § 78u(d)(3)*.

Dated: New York, New York

December 23, 2010

SO ORDERED:

/s/ George B. Daniels

GEORGE B. DANIELS

United States District Judge