

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

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

LYNN A. SMITH,

Defendant.

APPEARANCES:

DAVID STOELTING, ESQ.
Attorney for Plaintiff
Room 400
3 World Financial Center
New York, New York 10281

FEATHERSTONHAUGH, WILEY &
CLYNE, LLP
Attorney for Defendant
Suite 207
99 Pine Street
Albany, New York 12207

**DAVID R. HOMER
U.S. MAGISTRATE JUDGE**

OF COUNSEL:

ANDREW CALAMARI, ESQ.
KEVIN McGRATH, ESQ.
LARA SHALOV MEHRABAN, ESQ.

JAMES D. FEATHERSTONHAUGH, ESQ.

MEMORANDUM-DECISION AND ORDER

Presently pending is the motion of plaintiff Securities and Exchange Commission (“SEC”) for an order amending the preliminary injunction to permit the sale of a Florida property titled to defendant Lynn A. Smith. Dkt. Nos. 222, 228. Lynn Smith opposes the motion. Dkt. No. 247.¹ For the reasons which follow, the motion is granted.

¹David L. Smith, Lynn Smith’s husband, is also a defendant in this case but filed no opposition to the motion.

I. Background

The SEC commenced this action on April 20, 2010 with the filing of a complaint alleging that David Smith and Timothy M. McGinn operated an Albany-based financial services company and related entities through which they defrauded investors of over \$80 million in violation of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 under the 1934 act, 17 C.F.R. § 240.10b-5; and related provisions. Compl. (Dkt. No. 1) at ¶¶ 7-12. To preserve defendants' assets for the benefit of investors in the event it prevails here, the SEC simultaneously sought and received a temporary restraining order (TRO) appointing a receiver to take possession of defendants' assets, freezing defendants' assets pending the outcome of this action including those in the name of Lynn Smith, and ordering verified accountings, and related relief. Dkt. Nos. 4, 5. A receiver was appointed and the assets of the defendants and Lynn Smith were frozen pending a hearing. TRO at 7. In a Memorandum-Decision and Order filed July 7, 2010, the SEC's motion for a preliminary injunction was granted in principal part freezing the assets of the defendants. Dkt. No. 86 ("MDO").² Familiarity with that decision is assumed. The preliminary injunction froze the assets of the defendants, including Lynn Smith,³ for the benefit of investors pending the outcome of this action. Dkt. No. 96.

Among the assets frozen by the preliminary injunction was a property located at 906

²Lynn Smith was named only as a relief defendant in the original complaint. Dkt. No. 1. In an amended complaint filed on August 2, 2010, Lynn Smith was named as a defendant. Dkt. No. 100.

³Excluded from the asset freeze was a vacation property on Great Sacandaga Lake, New York owned by Lynn Smith. MDO at 8 & n.1, 42.

Orchid Point Way, Vero Beach, Florida (“Florida Property”). MDO at 8, 42; L. Smith Decl. (Dkt. No. 247-1) at ¶ 2. The Smiths jointly purchased this property as a second vacation home⁴ on July 2, 2001 for approximately \$1.4 million. L. Smith Decl. at ¶¶ 3, 4. In 2009, title to the Florida Property was transferred in to Lynn Smith’s name alone. MDO at 8. In August 2008, the property had an estimated market value of \$2.4 million. *Id.* at n.12.

Both the SEC and Lynn Smith now estimate the market value of the property at approximately \$1.7-\$1.9 million. McGrath Decl. (Dkt. No. 222-2) at ¶ 7; L. Smith Decl. at ¶ 16. The total amount of the mortgage on the property is approximately \$900,000. MDO at 8 n.12.

The Smiths remained current on their monthly mortgage payments of \$6,188 until their assets were frozen in April 2010, but no payments have been made since. McGrath Decl. at ¶ 3; L. Smith Decl. at ¶ 4. Other recurring services and costs associated with the maintenance of the property have also gone unpaid or have not been performed. These include “landscaping (\$475/month), pest control (\$100/month), pool cleaning (\$86/month), utilities (\$530/month), . . . insurance (\$796/month) . . . , taxes [of] \$1,875/month . . . , monthly . . . dues of \$1,375[,] and various additional annual assessments totaling \$1,060. . . .” L. Smith Decl. at ¶¶ 8-9. Including mortgage payments, the recurring monthly costs total over \$13,000.

⁴The Smiths primary residence was in Saratoga Springs, New York and Lynn Smith then owned a vacation property on Great Sacandaga Lake. See note 2 supra.

II. Discussion

A. Jurisdiction

Lynn Smith challenges all aspects of the SEC's motion beginning with the jurisdiction of the Court to grant the requested relief. Courts have routinely granted relief from preliminary injunctions freezing assets pending the outcome of an action to, for example, permit a bank to foreclose on real property where the owner has defaulted on the mortgage. See, e.g., S.E.C. v. Haligiannis, 608 F. Supp. 2d 444, 448 (S.D.N.Y. 2009); United States v. Lauer, No. 3-06-CV-1724 (JCH), 2008 WL 905924, at *2 (D. Conn. Mar. 28, 2008). The jurisdiction of a court to freeze assets and to modify such orders to permit sales arise from the same authority. See MDO at 12-15. That authority authorizes a court in cases such as this to exercise "broad equitable discretion." S.E.C. v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997); see also S.E.C. v. Unifund Sal, 910 F.2d 1028, 1035 (2d Cir. 1990) ("When Congress grants district courts jurisdiction to enjoin those violating or about to violate federal statutes, it is authorizing the exercise of equity practice with a background of several hundred years of history.") (internal quotation marks and citations omitted); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1103 (2d Cir. 1972) (explaining the equitable powers granted to the district court and holding that when there is "a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy.").

The preliminary injunction here mandates that the assets be maintained without dissipation of their value. Dkt. No. 96 at 5. Therefore, if the value of an asset is at risk of dissipation so that funds available to investors could be diminished in the event the SEC

obtains a judgment here, the Court may act to prevent such dissipation. Id.; see S.E.C. v. Unifund, SAL, 910 F.2d 1028, 1041-42 (2d Cir. 1990) (asset freeze was warranted in amount sufficient to satisfy potential judgment for penalties in insider trading case); S.E.C. v. Infinity Group Co., 212 F.3d 180, 197 (3d Cir. 2000) (the purpose of an asset freeze is "to preserve the status quo by preventing dissipation and diversion of assets") (citation omitted); S.E.C. v. Am. Bd. of Trade, Inc., 830 F.2d 431, 436 (2d Cir. 1987) (same). In addition, the Court also has the power to enter the proposed Order under § 21(d)(5) of the Securities Exchange Act of 1934, which provides that in SEC actions, "the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors." See also S.E.C. v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980) ("federal courts have inherent equitable authority to issue a variety of 'ancillary relief' measures in actions brought by the SEC to enforce the federal securities laws") (citations omitted).

Accordingly, this Court possesses the jurisdiction to grant the relief requested by the SEC in this motion.

B. Due Process

Lynn Smith broadly complains that her right to due process of law will be violated if the SEC is granted leave to sell the Florida Property before a final determination of the SEC's claims in this action by a jury. First, however, such interim equitable relief as sought here is authorized by statute and case law as discussed above in subsection A. Second, while a final determination has not been rendered, Lynn Smith ignores the fact that a hearing was held on the SEC's motion for a preliminary injunction, all defendants and relief

defendants were afforded the opportunity to challenge the evidence proffered by the SEC in support of its claims and to offer evidence in their own behalf, David Smith stipulated that the evidence demonstrated a substantial likelihood that the SEC would prevail on the merits, and Lynn Smith's contentions as to the Florida Property were rejected. MDO. Therefore, Lynn Smith's complaints here provide no basis to deny the relief requested by the SEC.

C. Florida Homestead Exclusion

The Florida constitution permits a homeowner to exempt from forced sale an individual's residence. Fla. Const. art. X, § 4; L. Smith Mem. of Law (Dkt. No. 247) at 7-8. Although Lynn Smith has always and continues to reside in New York, she contends that the SEC may not force the sale of the Florida Property because she may at some point make that property her primary residence in which case the property would be exempt from such a sale. L. Smith Decl. at ¶ 11. First, Lynn Smith remains a New York resident with a primary residence in that state making the Florida homestead exemption unavailable to her. The mere speculation that she might one day move to the Florida Property is insufficient at this stage to bar the relief sought by the SEC. Second, it is far from clear in these circumstances whether the exemption would be available to Lynn Smith in any event. See, e.g., United States v. Rodgers, 461 U.S. 677, 701 (1983) (noting that the Supremacy Clause "provides the underpinning for the Federal Government's right to sweep aside state-created [homestead] exemptions" under § 7403). Third, Lynn Smith's self-serving assertion that she is considering a move to Florida lacks credibility and affords no basis to deny sale of the Florida Property. See Dkt. No. 194 at 20 n.17; MDO at 9 n.13.

Accordingly, Lynn Smith's argument on this ground is rejected.

**D. Lifting Asset Freeze to Permit Lynn Smith
to Pay Costs of Maintenance**

Lynn Smith proposes as an alternative to the sale of the Florida Property that the asset freeze be "relaxed" to free sufficient of her assets to permit maintenance of the property without a sale pending the outcome of this action. Lynn Smith's previous motion for the same relief was denied. Dkt. No. 211 at 4-5. No changed circumstances have been presented which would merit reconsideration of that order. Moreover, for the reasons discussed below in subsection E, expending additional funds to maintain the Florida Property as its value decreases or, at best, remains the same, serves the best interests of neither Lynn Smith nor the investors. Accordingly, Lynn Smith's argument on this ground is also rejected.

E. Balancing of Interests

To exercise the equitable jurisdiction invoked by this motion, countervailing interests in maintaining or selling the Florida Property must be assessed. It appears in the best interests of both the investors and Lynn Smith that if the property can be maintained for the foreseeable future without sale such that the equity interest in the property will not be diminished, the property should be maintained and its sale denied. However, if the property will significantly diminish in value over the foreseeable duration of this action, its sale should be authorized forthwith to avoid further diminishment of the equity.

In 2008, the estimated market value of the property was approximately \$2.4 million

with an outstanding balance due on the mortgage of approximately \$900,000 leaving an equity in the property of approximately \$1.5 million. MDO at 8 n.12. With the downward turn of the country's economy and the Florida real estate market, the property's present market value has diminished to approximately \$1.7-\$1.9 million. McGrath Decl. (Dkt. No. 222-2) at ¶ 7; L. Smith Decl. at ¶ 16. With a mortgage balance due of approximately \$900,000, the equity in the property has already shrunk by approximately \$500,000-\$700,000. No evidence has been offered to indicate that there exists any reasonable expectation that the market for the property will improve in the foreseeable future.

Moreover, it is likely that the current equity in the property will continue to diminish during the pendency of this action. The monthly mortgage payments of over \$6,000 are not being paid and the mortgage holder may well seek an order permitting foreclosure and a sale of the property under less favorable circumstances. Those services necessary for the upkeep of the property either have been canceled or are incurring additional debts against the property. In either instance, the equity in the property will be further reduced by the costs of repairs from deterioration and additional liens against the property for unpaid services. Incurring these additional expenses at a rate of over \$13,000 per month might make sense if there existed any reasonable likelihood that the value of the property would appreciate sufficiently in the foreseeable future to compensate for the expenses. No such likelihood appears.

Thus, in the circumstances presented here, the balance of considerations weighs overwhelmingly in favor of selling the property forthwith to halt the diminishment of its value and to realize the greatest possible return.

F. Responsibility for Sale

The only remaining issue is whether the sale of the property should be overseen by the receiver or by Lynn Smith. The receiver states that he would charge a fee for this service of up to \$3,000. Brown Decl. (Dkt. No. 222-3) at 4. The receiver also has substantial experience in real estate transactions of all types and nationwide. Id. at ¶ 3. Lynn Smith contends that she is better suited to oversee any sale because she is more familiar with the Vero Beach real estate market and agents there. The SEC and Lynn Smith do not dispute the approximate present market value of the property.

Lynn Smith's objections to the appointment of the receiver to oversee the sale are without merit. The receiver is well qualified, the fee to be charged is reasonable, and he is exceptionally competent and experienced. Given his nationwide experience, the fact that he lacks specific experience in the Vero Beach real estate market should offer no impediment to retaining a competent and experienced real estate agent there to market the property and obtain the maximum possible value. Moreover, there exists no question that the receiver will act to obtain the maximum possible price for the property without regard to personal gain beyond the normal fee for his services of no more than \$3,000. On the other hand, Lynn Smith is an interested party without the experience or demonstrated ability of the receiver. Accordingly, the receiver shall be responsible for overseeing the sale of the property.

III. Conclusion

For the reasons stated above, it is hereby

ORDERED that the SEC's motion for an order amending the preliminary injunction to permit the sale of a Florida property (Dkt. No. 222, 228) is **GRANTED**; and

IT IS FURTHER ORDERED that the Court-appointed Receiver, William J. Brown, Esq. (the "Receiver"), is given sole authority to take all necessary steps to effectuate a sale of the Florida Property, including the retention of a nationally known real estate agent, and the preliminary injunction is hereby modified to permit the Receiver or the Smiths to enter into a contract for the purchase and sale of the Florida Property and to conduct a sale of the Florida Property subject to the following conditions:

A. The Receiver shall provide the SEC with a copy of the contract for sale of the Florida Property (the "Contract") within three days of its execution, along with a proposed list of distributions (the "Distribution List") to be made from the proceeds of such sale. The Distribution List may include, among other things, the mortgagor of the Florida Property, and any costs of closing, including broker, attorney, and recording fees, and transfer taxes.

B. The SEC may within one week from the delivery of the Contract and the Distribution List object to the terms of the Contract, and such objections may include the sale price or the proposed distributions. The Court will resolve such objections if the Commission and the Receiver do not reach agreement on such objections. Upon request of the SEC, the Receiver shall provide at their expense an appraisal of the fair market value of the Florida Property, by an appraiser acceptable to the SEC.

C. The balance of any funds remaining after payment of the Distribution List shall be paid to the Clerk of this Court, together with a cover letter identifying the Smiths as

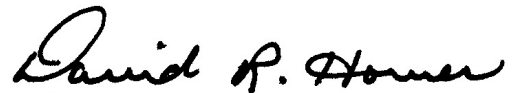
defendants in this action, setting forth the title and civil action number of this action and the name of this Court, and specifying that payment is made pursuant to this Order. The Receiver shall send a copy of the documents sent to the Clerk of the Court to David Stoelting, Senior Trial Counsel, Securities and Exchange Commission, 3 World Financial Center, Room 400, New York, New York 10281-1022. The Clerk shall deposit the funds in an interest bearing account with the Court's Registry Fund. These funds, together with any interest and income earned thereon, shall be held by the Registry Fund until further order of this Court.

D. The SEC shall provide such documents as the purchaser of the Florida Property may reasonably require to obtain title to the Florida Property.

E. The Receiver shall consult with the Smiths, and the Smiths shall cooperate with the Receiver in the listing, showing and closing of the sale of the Florida Property; and

IT IS FURTHER ORDERED that, except as modified herein, the Preliminary Injunction Order entered July 22,2010 remains in full force and effect.

DATED: February 1, 2011



David R. Homer
U.S. Magistrate Judge