13-3164-cr(L),
13-3202-cr(CON), 13-3477-cr(XAP), 13-3544-cr(XAP)

United States Court of Appeals
for the
Second Circuit

UNITED STATES OF AMERICA,

Plaintiff-Appellee-Cross-Appellant,

– v. –

TIMOTHY M. MCGINN, DAVID L. SMITH,

Defendants-Appellants-Cross-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF NEW YORK

BRIEF AND SPECIAL APPENDIX FOR DEFENDANT-APPELLANT-CROSS-APPELLEE DAVID L. SMITH

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PRELIMINARY STATEMENT

David L. Smith did not conspire to, or himself commit, any fraud, nor is he guilty of filing false tax returns. The government introduced weeks of testimony and hundreds of exhibits, but failed to demonstrate that Smith had any fraudulent intent. Instead, the trial evidence told the story of a complicated but legitimate business structure, an accounting function that was in shambles, and losses by investors in the midst of the financial crisis.

For Smith in particular, the evidence showed that he was not involved in the failures to account for transactions properly or in money movements that had been conducted incorrectly—skipping interim steps that would have made them clearly appropriate. When Smith learned of these incorrect accounting entries and money movements, the evidence showed that he responded by immediately consulting a lawyer and directing re-characterizations and corrections of the accounting. This cannot support a finding of intent to defraud.

As to the charges of filing a false tax return, the evidence was insufficient to show knowledge or willfulness, and the District Court committed plain instructional error by failing to properly instruct on *Cheek* willfulness and expressly stating that the defense of good faith is "not applicable" to the tax charges. Finally, the evidence on which Count Ten was predicated was insufficient

because it could not have supported a finding that there was any attempt to deprive investors of any money or property.

The convictions should be reversed.

JURISDICTION

The District Court had jurisdiction under 18 U.S.C. § 3231. Smith's sentence was imposed on August 7, 2013, and the judgment was entered on August 13, 2013. His timely Notice of Appeal was filed on August 16, 2013. This Court has jurisdiction under 28 U.S.C. § 1291.

ISSUES PRESENTED FOR REVIEW

1. Whether Smith is entitled to acquittals on the conspiracy count and the mail, wire, and securities fraud counts for insufficient evidence of specific intent where the evidence showed that Smith's involvement was not in connection with the underlying transactions but in attempting to fix accounting errors.
2. Whether Smith's convictions should be reversed because the government constructively amended the indictment and committed a prejudicial variance by claiming a 1999 letter describing 1999 conduct was part of the charged 2006-2010 conspiracy and inviting the jury to convict based on that letter.
3. Whether Smith is entitled to acquittal on the tax charges because the government failed to prove knowledge or willfulness and because the

District Court committed plain instructional error by misstating the willfulness standard and improperly precluding a good faith defense.

4. Whether Smith's conviction for mail fraud on Count Ten must be reversed because the evidence on which the Count is based could not have deprived investors of money or property.

5. Whether restitution and forfeiture should be reversed because the District Court adopted a loss figure that included $600,000 that was directly attributable to conduct as to which Smith was acquitted.

STATEMENT OF THE CASE

The superseding indictment charged David L. Smith with one count of conspiracy, 18 U.S.C. § 1349; nine counts of mail fraud, 18 U.S.C. § 1341; ten counts of wire fraud, 18 U.S.C. § 1343; six counts of securities fraud, 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. § 240.10b-5; and three counts of filing a false return, 26 U.S.C. § 7206(1). On February 6, 2013, before United States District Judge David N. Hurd, the jury returned guilty verdicts against Smith on the conspiracy count, three counts of mail fraud, two counts of wire fraud, six counts of securities fraud and three counts of filing a false return, and acquitted him of six counts of mail fraud and eight counts of wire fraud. (SPA-1). Smith was sentenced to concurrent terms of 120 months' imprisonment on the fraud counts and thirty-six months on the tax counts, to be followed by concurrent terms of three years of

supervised release on the fraud counts and one year on the tax counts. The District Court rejected as unproven the government's request for more than $30 million in loss amount, restitution, and forfeiture, and imposed the sentence, restitution, and forfeiture based on a loss amount of approximately $6 million. (SPA-5-6). Smith is currently incarcerated.

STATEMENT OF FACTS

All of the charges in this case related to the conduct of the various entities that formed McGinn Smith's investment business. The investment operation fell into two halves. One half, which consisted of four investment funds with broad investment mandates, was referred to in the business and at trial as the "four funds" and had over 1,000 investors. (Smith Presentence Investigation Report ("PSR") ¶¶ 115, 169). The other half consisted of a number of investment entities that raised funds from investors in debt offerings that would be repaid out of cash flows generated by underlying investments. The underlying investments primarily consisted of recurring contract payments, such as monthly home alarm monitoring fees, monthly cable television fees, and monthly telephone and internet fees. This half of the business was referred to in the business and at trial as the "trusts." The two leaders of the business (and the major or sole owners of many of the various entities) were Smith and Timothy McGinn. Smith primarily focused on the four

funds side of the business, and McGinn primarily focused on the trust side of the business.

A. The Structure of the Fund Business

The four funds and their operations played only a small role in the trial. The funds were organized to "acquire various public and/or private investments, which may include, without limitation, debt securities, collateralized debt obligations, bonds, equity securities, trust preferreds, collateralized stock, convertible stock, bridge loans, leases, mortgages, equipment leases, securitized cash flow instruments, and any other investments that may add value to our portfolio." (*See* A-752, A-757, A-760, A-763). Each fund was structured as a limited liability company, and offered participation in the form of debt investments (i.e. notes) to accredited investors. The funds were permitted to invest in "affiliated" companies. (A-752, A-757, A-760, A-763).

B. The Structure of the Trust Business

The structure of the trust business, which was different from the four funds and more complex, was as follows. At the core of this business were a number of operating companies, formed as limited liability companies, or "LLCs." These operating companies included TDM Cable Funding LLC, McGinn Smith Funding LLC, NEI Capital LLC and TDMM Cable Funding LLC. These operating companies engaged in financing transactions that permitted, for example, home

alarm system providers to monetize the recurring monthly payments they were owed by customers. The operating companies did this either by purchasing the contracts from the providers outright, or by making loans to the providers secured by the underlying monthly contracts. These investments typically yielded a high rate of return, often well in excess of 20%.

After the financing had been arranged by McGinn on behalf of the operating company, typically using bridge loans from other McGinn Smith entities, McGinn then essentially sold participation in that financing transaction to accredited investors. To accomplish this, McGinn used a trust structure. That is, for each underlying investment, McGinn, together with Joseph Carr, the general counsel, created one or more trusts and prepared a private placement memorandum for each trust. McGinn Smith brokers then sold debt-like investments in the trust to accredited investors. The private placement memoranda clearly described the amount of money to be raised by the offering and the rate of return to be paid to investors on that amount. (*See*, *e.g.*, A-498, A-503, A-519, A-522, A-538, A-543, A-550, A-554, A-579, A-582, A-610, A-614, A-633, A-637, A-679, A-684). The private placement memoranda also disclosed specifics of the underlying assets that would generate cash flow, either specifying the size of the underlying investment, detailed cash flow tables, or both. (*See*, *e.g.*, A-528, A-535, A-541, A-566, A-577, A-593, A-596, A-608, A-625, A-631-32, A-648, A-654-55, A-661, A-666, A-674,

A-682, A-693). The trust investments typically carried fixed rates of return near 10%. (*See*, *e.g.*, A-501, A-521, A-541, A-554, A-582, A-605, A-614, A-637, A-659, A-666, A-675, A-683, A-694).

Take, for example, TDM Cable Trust 06. The private placement memorandum explained that the trust offered to accredited investors up to $3,550,000 in contract certificates carrying returns of either 7.75% (for a two-year maturity) or 9.25% (for a four-year maturity). (A-498). The memorandum then explained that the proceeds of this raise would be used "to purchase the Preferred Return cash flow stream arising out of the sale of cable TV, broadband internet, and fiber optic telephone services to the Homeowners Association of Cutler Cay and Keys Cove as well as certain preferred payments received in connection with the purchase of the ADT Note." (A-502). Those cash flow streams, the memorandum explained, had already been acquired by TDM Cable Funding LLC, one of the McGinn Smith operating companies. The private placement memorandum, together with its attachments, explained that to acquire these cash flow streams from TDM Cable Funding would require initial investments of $364,695 for Keys Cove and $629,839 for Cutler Cay. (A-508, A-512). The attachments also described the amount of additional investments required as the homeowners association added service for more houses, and the $500,000 investment to purchase a portion of the ADT note. (A-509, A-513-15).

Although the private placement memorandum, which was written for sophisticated investors, described a sophisticated set of transactions, at its most basic level it explained that by investing approximately $1.5 million, TDM Cable Funding LLC had acquired monthly cash flow streams from Cutler Cay and Keys Cove between $25,100 and $28,400 (which was a return of approximately 30%). (A-496; *see also* A-317-18; Tr. 2475-76[1]), which would be sufficient to pay the cash flows out to investors of 8.68% (based on a blend of the 7.75% and 9.25% rates). (A-308, A-317-18; Tr. 2410, 2475-76). In other words, because the rate of return expected by TDM Cable Funding LLC was far in excess of the rate of return expected by investors in the TDM Cable Trust 06, the interest payments and return of principal to investors investing more than $3 million could be covered by utilizing less than $2 million of that capital to purchase underlying cash flow streams.

This difference, or spread, was implicit in the private placement memorandum's detailed description of the types and amounts of the underlying investments, as well as the terms of those investments. If the underlying investments went as planned, this spread would remain in the operating LLC (TDM Cable Funding LLC) after investors in TDM Cable Trust 06 were paid their high-yield interest payments and principal over the term of their investment. (A-

[1] Testimony at the trial is cited herein with parallel cites both to the excerpted page included in the appendix and to the page of the full transcript.

383-84; Tr. 2810-11). At the end of the transaction, this spread would constitute profit to TDM Cable Funding LLC, the members of which were McGinn, Smith, and Matthew Rogers. (A-383; Tr. 2810). Thus, the trust half of the business was designed to create a spread of substantial surplus capital at the outset that was anticipated to become profit to the partners at the end of the transaction. (A-384; Tr. 2811).

Of course, there were risks to the underlying investments, and those risks could have affected the size of the spread that remained at the end of the transaction. As described in the TDM Cable Trust 06 private placement memorandum, for example, if the underlying home owners associations defaulted on their obligations to pay for cable television, internet, and telephone service for their communities, an "interruption in available cash distributable" to investors in the trust would result. (A-503). The private placement memorandum explained in detail other risks and noted that they included the possibility that investors would lose all of their investment. (*See* A-500 ("there can be no assurance that the Contracts will generate sufficient income necessary to pay the Certificates."); A-502 ("Risk Factors" include "No assurance that the Certificates will be paid"); A-505.1 ("Nevertheless, this investment involves a number of significant risks, including no assurance that the Certificates will be paid and illiquidity.")). Accordingly, although the partners drew the anticipated spread out of the operating

company at the outset, they did this as loans, rather than as realized profit, because only at the end of the transaction could it be said with certainty that this amount of profit had in fact been generated, or that some lesser (or greater) amount was generated. The government argued during the trial that when the partners drew this spread out of the transaction at the outset, the partners in fact received fees (A-486-87, A-489; Tr. 3332-34, 3339), although the government's own revenue agent witness who calculated tax loss characterized almost all of these payments not as fees, but as capital gains resulting from partnership distributions. (A-267-68; Tr. 2098-99).

C. The Trial Evidence

The witness testimony spanned fifteen trial days. During the government's case, several categories of witnesses testified. FINRA representatives testified about examinations they conducted of McGinn Smith, documents requested and received, and Smith's and McGinn's testimony and informal statements as part of those examinations. Former accounting personnel of McGinn Smith testified regarding the disarray of the accounting records, the accounting entries they made, and the changes to those entries directed by Smith. Former general counsel Carr testified about his and McGinn's preparation of private placement memoranda for the trust business, as well as the preparation and submission of documents (including promissory notes corresponding to previously disbursed loans to

partners of the anticipated profit spread from the trust business) to FINRA in connection with its examination. (A-203-16; Tr. 1836-37, 1847-58). Outside counsel from Gersten Savage testified about the urgent communications they had with Smith and McGinn after Smith learned of the state of the accounting and about certain money movements that had occurred, as well as Gersten Savage's submission of documents to FINRA. Alarm company personnel testified about the bankruptcy of an alarm company in which trust money had been invested—Firstline Security, Incorporated—and about McGinn's efforts to develop and implement a rescue plan that would result in the investors being paid. (A-181-85; Tr. 1666-67, 1673-75). McGinn Smith brokers testified about sales of Firstline trust investments they unwittingly made after Firstline declared bankruptcy. (A-142-46, A-232-33, A-298, A-318.1; Tr. 1315-16, 1325-27, 1985-86, 2376, 2532).

Rogers, the third member, together with McGinn and Smith, in the operating LLCs that were used as part of the trust business, testified that he did not intend to repay the money that was advanced to him from the anticipated spreads, and that he therefore had pleaded guilty to filing a false tax return. (A-120-24, A-136-41; Tr. 1157, 1164-67, 1236-37, 1240-43). Ronald Simons, the tax preparer and outside accountant for Smith, McGinn, and the McGinn Smith entities, testified regarding his communications with Smith about these partner distributions and the treatment of them as loans. Simons testified after having pleaded guilty to a

misdemeanor tax crime relating to the failure to report a single $57,000 advance to Smith as a fee, rather than a loan, but he stated that "I am not sure if I did anything wrong" and that at the time he delivered the tax return, he had no intent to defraud the United States government. (A-88-89; Tr. 844, 852).

The case agent testified and summarized testimony of other witnesses, offering as well her views that the partner loans taken by Smith, McGinn, and Rogers were fees and not loans. (A-280-92; Tr. 2175-87). A revenue agent testified about the additional tax she believed was due if the partner loans had instead been treated as capital gains, and if three money transfers that had gone to partners directly from trust accounts had been treated as ordinary income. (A-261-68; Tr. 2092-99). And a series of investors in both the trust side and funds side of the business testified that they had invested with McGinn Smith, had lost money, and did not know about certain transactions conducted at McGinn Smith.

The defense case lasted six days. The first defense witness was Geoffrey Smith, designated chartered financial analyst, former broker at McGinn Smith, investor in various trust investments, and the son of David Smith. Geoffrey Smith presented the results of his in-depth analysis of the bank records and private placement memoranda of the trust business and the underlying operating LLCs. He explained the structure of the trust business (namely, that it was designed to generate a capital spread that would result in profit to the members of the LLCs)

(A-299-307, A-309-16; Tr. 2385-89, 2393-96, 2426-33), and analyzed the cash flows in and cash flows out that were contemplated by the private placement memoranda and that would result in the full payment of investors from smaller, but higher yield, underlying investments. (A-299-303; Tr. 2385-89). He also traced through the bank records and established that although transactions had been improperly booked by the accounting staff, if they had been properly booked, the resulting characterizations of the transactions reconciled with the ending bank balances of each trust entity. (A-323-24; Tr. 2692-93).

McGinn similarly testified regarding the structure of the trust business including the capital spreads. (A-338-49; Tr. 2719-30). McGinn testified that the spread was drawn by the partners as loans so that, if the investments did not perform as expected (and the expected spread was not in fact realized), that money could be returned to the operating company to protect the investors. (A-385-86, A-389-93; Tr. 2813-14, 2863-67). McGinn described his preparation, together with Carr, of the private placement memoranda for the trusts. (A-350-63; Tr. 2739-52). McGinn also testified regarding his efforts to rescue the Firstline investment. (A-367-80; Tr. 2775-88). He explained that post-bankruptcy sales of the Firstline trust should not have been made, and testified that he had not realized that brokers continued to sell investments in the Firstline trust after Firstline declared bankruptcy. (A-368-71; Tr. 2776-79). McGinn testified that he at no time had any

intent to defraud investors. (A-374-75, A-387, A-388-89, A-394; Tr. 2782-83, 2827, 2850, 2863, 2871).

Smith also testified. He testified that when he learned of the disastrous state of the accounting, and of money transfers that had been directed by McGinn from the wrong entities, he worked urgently to correct the accounting and re-characterize the transactions. (A-425-26; Tr. 3081-82). Smith testified that he had no knowledge of the Firstline bankruptcy filing until 2009 (well after all Firstline trust investments had been sold). (A-450; Tr. 3122-23). Smith also explained his understanding of the trust side of the business—that is, that it was designed to result in excess capital that would become profit at the end of the deal, and that the partners drew that excess capital at the start of the deal as a loan. (A-449, 476-81; Tr. 3116, 3244-49). Smith, however, during the relevant time period, was focused on the funds and the difficulties they faced as a result of the nation's financial crisis rather than the trust transactions and their corresponding accounting entries. (A-451-54; Tr. 3134-37). Finally, Smith was confronted with a letter he wrote in 1999, regarding a different business structure that McGinn Smith had used then, in which he expressed his view that the structure gave the appearance that they were engaged in a fraud. (A-464-72; Tr. 3154-62). Smith explained that his predictions were incorrect (the businesses he complained about ultimately had a successful public offering that resulted in all investors recovering all payments they had been

promised) (A-334-35, A-478-79; Tr. 2710-11, 3246-47), and that the structure used during the time period of the indictment was critically different—in the earlier time period, any spread that was anticipated to result from the investments was distributed at the outset as profit to the partners, whereas in the later period it was distributed as a loan so that if the spread was not realized, it would be due from the partners. (A-342-44, A-347-48, A-364-66; Tr. 2723-25, 2728-29, 2762-64).

D. The Evidence of Accounting Disarray

The government called three members of the accounting staff at McGinn Smith—Brian Cooper, David Rees and Brian Shea. Shea took over from Rees as chief financial officer in April 2009, and described the total disarray of the accounting records. For example, he testified:

> My predecessor had entered a lot of items, but he didn't research what they were. So they had unusual notations like unknown or research or check on this, question mark, not sure, booked to expense accounts, such as charity. So those would be some of the clues that I said, okay, I have got to sit down and figure out where all this went.

(A-44; Tr. 482). Similarly, Cooper's testimony incorporated the following quotes from his grand jury testimony:

> Q: How did you communicate with him [Rees] about the transfers?
>
> A: When the transfers would happen, and I didn't know what it was for, I would have to go to him and try to find out what the transfer was for because we didn't get enough information from Tim McGinn where he was getting the money and what it was and for. It seemed like talking to Dave Rees, I don't know if he was scared or didn't know how to confront Tim McGinn on these transfers.

(A-119; Tr. 1106).

> We didn't know how to—I didn't know how to record these transfers in the books. I didn't know what was an asset or a loan, what the money was coming from and going into the books. So the majority of the time, the funds would get recorded based off the bank statements. It would sit out there as a loan due to/due from.

(A-117; Tr. 1072).

Cooper also admitted that he commingled funds between a trust and an operating LLC:

> Q: [And] instead of splitting it out and clarifying the books, you began to throw transactions—again, no disrespect, you began to throw transactions from the operating company into the trust, correct?
> A: Yes.
> Q: That's because you really didn't know the difference, fair to say?
> A: I think the books were messed up when I took them over and I was trying to reconcile them, and I may have done those transactions, but at a later point, I was correcting those books.

(A-118; Tr. 1088). Rees made clear that he often made up his accounting entries based on no further information than a wire transfer confirmation and his own assumptions. (A-94, A-100-01, A-105; Tr. 924, 941, 944, 953).

E. The Evidence Regarding Smith's Activities

Although the indictment charged a conspiracy spanning the period September 2006 through April 2010, the evidence of Smith's activities was much more limited, and in fact, with the exception of his correction of a mis-booking by

Rees of distributions to him, almost exclusively related to a period of time in the fall of 2009.

1. Smith's Communications Relating to the Tax Treatment of LLC Distributions

In relation to the tax counts, the evidence showed that between late 2006 and late 2007, Smith had communications regarding his distributions from TDM Cable Funding LLC, ultimately correcting Rees's characterization of them and making clear that these were loans. (A-441-46; Tr. 3103-08). Rees had booked these distributions as fees based on assumptions and guess-work. (A-94; Tr. 924).

2. Smith's Conduct Relating to the Trusts and Transfers Through McGinn, Smith, Transaction Funding

In relation to the other counts, the evidence showed that Smith had no involvement in: the preparation of private placement memoranda for the trusts; the operation of the trusts; the operation of the trusts' associated operating company LLCs; or the underlying investments by those operating LLCs. Thus, among other things, the evidence showed that Smith was not involved in payments to what the government dubbed "preferred investors"—that is, payments from McGinn Smith Transaction Funding LLC ("MSTF") to investors in other entities. (A-45-47; Tr. 487-88, 491). Although the evidence was equivocal, taken in the light most favorable to the government, there was some indication that, in November 2008 and April 2009, Smith was involved in money transfers from some of the four

funds to MSTF that were used to fund the payroll of McGinn Smith & Co., Inc., the broker/dealer operated by the defendants.[2]

Rather, Smith's involvement in the various transactions that had occurred on the trust side of the business began in the latter part of 2009, when Smith undertook to correct and re-characterize the accounting of those transactions. First, according to the testimony of Shea, Shea informed Smith in the summer of 2009 that MSTF had been funding payments to certain investors in other McGinn Smith entities. Shea described Smith's reaction and statements as follows:

> He was very upset. David Smith is a person that generally stays very calm. He was very upset. He was concerned that these payments had gone out of MSTF to non-MSTF investors. He knew it wasn't allowed by the private placement.
>
> . . . .
>
> And then he also said, you know, I knew that Tim was paying these people. I am not sure from where, and what the [expletive] was he thinking.

(A-49; Tr. 497).

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[2] Some of the testimony was quite conclusory, and without any indication of its foundation. For example, the government's questioning of Shea was as follows:

> Q: Was there anything in the Four Funds' PPMs that allowed money to be used for payroll at the broker-dealer?
> A: No. The answer is no.
> Q: Was Mr. Smith aware of these transactions?
> A: Yes.

(A-50; Tr. 500). The government made no attempt to clarify the time period during which Smith was purportedly aware of these transactions. As noted above, Shea started work in April 2009, well after the transfers were made.

Not long thereafter, as a result of a FINRA request for documents and information, Smith gained a fuller understanding of the dire state of the accounting records. Prior to September 2009, FINRA had been conducting regular reviews of the McGinn, Smith & Company broker dealer and later the four funds as well. On September 30, 2009, however, FINRA sent a written request for an expanded set of documents. (A-768-69). The request asked for Quicken data files for a series of entities from both the four funds and the trust sides of the business; the names and titles of people responsible for entering information into that software; documentation related to loans from the listed entities to Smith, Lynn Smith, McGinn, Rogers, and Mario Bustamonte; and for the listed entities, a copy of offering documentation. (A-769). Furthermore, the written request asked for additional information "[i]f the aforementioned files [i.e. the Quicken data files] [we]re not up to date." (A-768). In other words, by the plain terms of the letter, if the Quicken files produced were "up to date," no additional information about them was requested.

After receiving this document request from FINRA, Smith identified transactions that had been conducted through MSTF that should not have been, and immediately consulted with the firm's attorney, Jay Kaplowitz, at the law firm of Gersten Savage. (A-423-32; Tr. 3079-88). Kaplowitz testified that he met with Smith and McGinn, who described the transactions and sought a solution to correct

them. (A-74.1-75; Tr. 726, 728; *see also* A-412, A-422-33, A-437-40; Tr. 2965, 3071, 3079-93).[3] Smith also sent a detailed letter to Kaplowitz explaining the transactions of which he had recently become aware, and proposing ways to re-characterize the transactions so that they would run through entities that were permitted to conduct them and would be accounted for properly. (A-704-715). As explained in the letter,

> why we booked fees [on the books of MSTF] that are clearly owed by the funds to MSCH and MSA and then ran them through the books of MSTF is absolutely inexplicable and incredibly stupid. Our solution is simply to book them as advances which are due from MSCH and MSA, supported by the fees owed us.

(A-709). Smith's letter concluded, "Having discovered this mistake and realizing the appearance of impropriety or worse, I seek a solution that calls for immediate restitution with some reasonable explanation for our behavior. That will probably call for creativity beyond anyone's ability." (A-710). Kaplowitz claimed that he "told them that they couldn't alter the records to reflect another way of accounting for the advances that they took out."[4] (A-78-79; Tr. 740-41; *see also* A-429;

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[3] The government also elicited from Kaplowitz his opinion that what they had done was "wrong." (A-75-76; Tr. 728-29).

[4] The government also elicited the following opinions about Smith's letter—which Kaplowitz admitted he only partially read:

> Q: And was there anything unusual about the letter?
>
> A: Well, I have never received a twelve page handwritten letter from a client. I have never received a letter from a client admitting to a crime,

Tr. 3085 (Smith: "[Kaplowitz] was cautioning me, he said, look, you just—not that I needed to be cautioned, but nonetheless that was his role as an attorney, that, you know, whatever you do, make sure it is transparent, make sure that it doesn't look like you are trying to in effect cover up the books and records.")).

After consulting with Kaplowitz, Smith directed the accounting staff to execute his proposed re-booking of the transactions. (A-433, A-438-40; Tr. 3089, 3091-93). Shea testified that the second time he spoke to Smith regarding these MSTF transactions was at a follow-up meeting in the fall of 2009. (A-51; Tr. 501). At the meeting, "Mr. Smith presented a plan to offset all these items under one account due from McGinn, Smith Advisors, McGinn, Smith Capital Holdings, and basically instructed me to create certain accounting transactions . . . ." (A-51; Tr. 501).[5] Shea then

> created a new balance sheet account on McGinn, Smith Transaction Funding that said due from McGinn, Smith Advisors and McGinn, Smith Capital Holdings. And then in that account [he] moved these payments that were made, these loans from the Four Funds, the payments that went to McGinn, Smith & Company [the broker-

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> to what I felt was a crime at least. So, yes, I found it unusual in that respect.

(A-77.1; Tr. 739). There is no indication in the record that the government alerted the defense or the District Court about the answer anticipated to the question in advance of asking it, or explained the relevance of Kaplowitz's personal views of the aspects of the letter that he found "unusual."

[5] Shea finished this answer by offering his opinion about Smith's intent in directing this plan—"that would disguise the nature of all these payments." (A-51; Tr. 501).

> dealer], and then the payments that were those three buckets, which [they] talked about [i.e. payments to investors in other entities], all into this account.

(A-52; Tr. 502).

Smith's written plan for changing the accounting of these transactions (some of which had been booked by Rees with notations such as "charity" or "?" or "investigate" (A-44.1-45; Tr. 485-87; *see also* A-733-35) was admitted in evidence. (A-736-49). Smith stated in that document that the loans that had been advanced by some of the four funds to MSTF, and then used to pay other investors, should not be characterized as loans. Instead, Smith directed that these payments should be characterized as fees that should have been accrued over time as due from the four funds to McGinn, Smith Advisors and McGinn, Smith Capital Holdings. (A-53.1; Tr. 522; A-736-49). Each witness who testified about this confirmed that although these fees had not been recorded in the books as accruing, they in fact were payable to these entities. (A-54; Tr. 528 (Shea); A-108; Tr. 956 (Rees: "Q: Did you know that Tim McGinn and David Smith did not take fees they were entitled to from these transactions? A: Yes."); A-116; Tr. 1062 (Cooper); Tr. 1919-20 (Carr, stating that he had heard this fact); A-419; Tr. 3059 (Smith)). All monies advanced by MSTF were ultimately properly booked and repaid with 8% interest by fee income due to MS Advisors and McGinn Smith Capital Holdings. (A-387.1-87.2, A-413.1; Tr. 2842-43, 3029).

F. The Acquittals

The jury acquitted Smith on Counts Two through Seven, Eleven through Thirteen, Fifteen, Sixteen and Eighteen through Twenty. Counts Seven and Sixteen both related to an alleged fraud with respect to two related trust investments, Integrated Excellence Sr. Trust 08 and Integrated Excellence Jr. Trust 08. Counts Eighteen through Twenty related to wire transfers to McGinn. The remaining Counts related to transactions connected with Firstline Trust 07 Series B. The jury thus rejected the government's contention that Smith must have known about, and must have had the intent to defraud with respect to, the post-bankruptcy Firstline transactions. The jury acquitted both Smith and McGinn on Counts Two and Three, which involved the private placement memorandum as well as a check to purchase contract certificates from Firstline prior to the bankruptcy, respectively. These acquittals demonstrated that the jury rejected the government's argument that the Firstline private placement memorandum—which was not substantively different from the other private placement memoranda presented to investors—was false.

SUMMARY OF ARGUMENT

First, all of Smith's non-tax convictions should be reversed because there was insufficient evidence to prove his intent to defraud. The government's evidence only proved that the partners drew anticipated profits out of the trust

business as loans and that Smith intended to try to fix errors in the books and records once it became clear to him that transactions had been booked improperly. The evidence did not prove that Smith had intent to defraud.

Second, Smith's convictions should be reversed because the superseding indictment was constructively amended. The prosecution improperly relied upon a 1999 letter during cross-examination of both defendants as well as during summation, inviting the jury to convict based on uncharged conduct and mens rea in 1999. The District Court failed to give proper limiting instructions with respect to the letter that might have prevented the jury from convicting for uncharged 1999 conduct.

Third, Smith's tax convictions should be reversed because the government did not present sufficient evidence to prove knowledge or willfulness and because the District Court plainly erred by instructing the jury in a manner that eviscerated willfulness and precluded Smith's valid defense of good faith.

Fourth, Count Ten should be reversed because the letter and memorandum on which that count is predicated could not have deprived investors of any money or property and are, therefore, insufficient to sustain a mail fraud conviction.

Fifth, the restitution and forfeiture orders were plainly erroneous in including losses directly relating to counts of which Smith was acquitted and as to which no additional facts were presented or findings made.

ARGUMENT

I. NO RATIONAL JURY COULD FIND THAT SMITH HAD THE INTENT TO DEFRAUD BASED ON THE EVIDENCE PRESENTED

All of the non-tax charges in the indictment required the government to prove that Smith had the intent to defraud. The evidence presented fell well short of this, showing instead only that partners drew as loans the anticipated profits of the trust deals, and that when Smith learned of certain other money movements and of their improper, guess-based accounting, he undertook to correct the accounting errors by re-characterizing the transactions as they should have been conducted and booked originally. Because this evidence amounted to nothing more than carelessness followed by a perhaps overzealous, but good faith, reaction to the problem and effort to fix it, these convictions should be reversed for insufficiency.

A. Applicable Law

Whether the evidence was sufficient is reviewed *de novo*. *United States v. Cassese*, 428 F.3d 92, 97-98 (2d Cir. 2005). A conviction must be reversed for insufficient evidence where no rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt, viewing the evidence in the light most favorable to the government. *United States v. Chavez*, 549 F.3d 119, 124 (2d Cir. 2008). "[I]f the evidence viewed in the light most favorable to the prosecution gives equal or nearly equal circumstantial support to a theory of guilt and a theory

of innocence, then a reasonable jury must necessarily entertain a reasonable doubt." *United States v. Coplan*, 703 F.3d 46, 69 (2d Cir. 2012).

The conspiracy and mail and wire fraud counts each required proof beyond a reasonable doubt of intent to defraud. Essential to mail or wire fraud is "proof of a scheme or artifice to defraud"—a "conscious knowing intent to defraud." *United States v. D'Amato*, 39 F.3d 1249, 1256-57 (2d Cir. 1994) (internal quotation marks and citations omitted) (mail fraud); *United States v. Guadagna*, 183 F.3d 122, 129 (2d Cir. 1999) (internal quotation marks and citations omitted) (wire fraud). "[M]isrepresentations amounting only to a deceit are insufficient to maintain a mail or wire fraud prosecution. Instead, the deceit must be coupled with a contemplated harm to the victim." *United States v. Starr*, 816 F.2d 94, 98 (2d Cir. 1987).

Because a defendant must have the requisite mens rea for the underlying substantive offense to be convicted of a conspiracy, in this case, the government was required to prove a specific intent to defraud to carry its burden on the conspiracy count. *See D'Amato*, 39 F.3d at 1256-57 (A defendant may only be convicted of a conspiracy if government proves beyond a reasonable doubt the requisite scienter (or fraudulent intent) on the part of the defendant); *see also United States v. Rodriguez*, 392 F.3d 539, 545 (2d Cir. 2004) (conspiracy conviction also requires proof beyond a reasonable doubt that the defendant "knew

of the existence of the scheme alleged in the indictment and knowingly joined and participated in it.") (internal quotation marks omitted).

Similarly, to establish a criminal violation of the securities laws, the government must prove that the defendant acted with intent to deceive, manipulate or defraud. *Cassese*, 428 F. 3d at 97-98.

B. The Government Failed to Prove Intent to Defraud

The government utterly failed to prove intent to defraud. Instead, a legitimate business structure was misconstrued and misclassified by the government as a massive fraud based on the mere fact of investor losses and haphazard accounting. The government made no attempt to understand these investment structures, and instead called witnesses—who neither read the private placement memoranda nor understood the transactions—to offer their opinions on the proper characterization of the transactions or the falsity of disclosures. Moreover, as to Smith in particular, the government produced no evidence that he was contemporaneously involved in these transactions or accounting entries.

There was a basic explanation for many of the challenged transactions and accounting entries. The trust-side investment structure was complicated, and was marketed to accredited investors—individuals with presumed sophistication to evaluate the structure and the risks of the investment. Those investments were designed to make money for the investors, and not surprisingly, they were also

designed to make money for the organizers and owners of the operating companies. The owners' profit was designed to come largely through the capital spread between what was taken in versus what was paid out to purchase the underlying investments. In other words, McGinn matched the incoming cash flow to the outgoing debt service rather than matching the capital needed to generate the cash flow with the capital raised from investors. Although the anticipated profit to the owners from this spread was not expressly described in the private placement memoranda, because those memoranda disclosed the size of the underlying investment or the cash flows from it or both, it was clearly implied and was not misrepresented. (A-169-71; Tr. 1509-11, 1550-51; *see*, *e.g.*, A-170-71, A-177-78, A-195-96, A-234-37, A-239-40, A-254-55, A-259-60, A-528, A-535, A-541, A-566, A-577, A-593, A-596, A-608, A-625, A-631-32, A-648, A-654-55, A-661, A-666, A-674, A-682, A-693; Tr. 1550-51, 1590-91, 1731-32, 1988-89, 2034-35, 2040-41, 2071-72, 2076-77).

Not only was the proof inadequate to show that the trust business was structured or described with intent to defraud, but as for Smith in particular, there was no evidence that he was involved in the preparation of trust private placement memoranda, the operation of the trust investments, or the various money movements challenged by the government. Both McGinn and Carr described how private placement memoranda were prepared, and there was no evidence that

Smith was involved. (A-358-59, A-203-04; Tr. 2747-48, 1836-37). Smith, of course, understood the structure of the business and what information was generally included in the private placement memoranda. (A-417-21; Tr. 3057-59, 3064-65). But he was never given a reason to question their accuracy or completeness or to believe that they were in any way misleading, and no evidence to the contrary was presented to the jury.

As a substitute for such evidence, the government used a 1999 letter that Smith wrote about private placement memoranda describing different structures and different problems. (A-774.1-.28) As set forth below, the government's use of this letter, without any limiting instructions from the District Court, constituted a constructive amendment of the indictment and invited the jury to convict Smith for his conduct and state of mind that took place in 1999. But in any event, the letter itself failed to provide sufficient evidence of intent to defraud with respect to the private placement memoranda that were part of the charges in the indictment. In the 1999 letter, Smith complained about two things. First, that the alarm contracts being purchased from a particular alarm company fell well short of their normal credit and quality standards, and therefore the default and attrition rates relating to that company should be better disclosed in the private placement memoranda. (A-474-75; Tr. 3242-43). Second, that in the 1999 time frame, their practice was to distribute anticipated profits *as profits* at the outset of the transaction, which made

no allowance for the fact that the investments might fall short of their anticipated yields. (A-478-80; Tr. 3246-48). Both of the problems were not indicative of intent to defraud and were unique to 1999. There was no evidence presented at trial that the structures used in 1999 were the same in any pertinent respect to those used in the charged period, and indeed, Judge Hurd expressly found that the investments were not the same. (A-275; Tr. 2119).

Accordingly, any connection between 1999 comments and 2006-2010 mens rea is not inference, but mere speculation. "[K]nowledge, though inferable from circumstances, must be based on evidence, not speculation." *United States v. Biaggi*, 909 F.2d 662, 681 (2d Cir. 1990); *see also United States v. Torres*, 604 F.3d 58, 67 (2d Cir. 2010) ("[W]hile we defer to a jury's assessments with respect to credibility and conflicting testimony, and to its choice between the competing inferences that can be drawn from the evidence, the jury's inferences must be reasonably based on evidence presented at trial, not on speculation[.]") (internal quotation marks and citations omitted). First, the underlying investments in the charged time period did not include those issued by sub-standard alarm companies that did not satisfy the credit-worthiness requirements. (A-482-83; Tr. 3252-53). And second, Smith and McGinn did not take anticipated profits out of the business at the outset; instead, they drew loans in the amount of the anticipated profit so that the actual amount of realized profit or shortfall realized would be determined at the

end of the transaction. (A-383-86, A-389-93; Tr. 2810-11, 2813-14, 2863-67). Thus, this 1999 letter does not provide evidence that Smith knew the charged disclosures were inadequate, let alone that he somehow participated in them with intent to defraud.

In addition to challenging the treatment of these profit spreads, the government attempted to prove fraud based on various money movements paying investors or expenses out of the wrong entity. But the evidence showed that Smith was not involved in any meaningful way in these movements, and instead showed his efforts to *correct* accounting entries once he learned of them. Thus, he corrected, for example, Rees's "assum[ption]" (A-94; Tr. 924) that a transfer from TDM Funding was a fee rather than a loan. And, in 2009, when he learned of money movements that had been conducted and accounted for incorrectly, he directed an effort to re-book the entries.

The government argued that Smith's directions to re-book transactions amounted to a falsification, and that his efforts to do so in connection with a FINRA request for documents amounted to a cover-up. But these characterizations are no substitute for evidence and were insufficient to prove intent to defraud beyond a reasonable doubt. First, the evidence did not show falsification. Rather, as set forth above, the way transactions were originally booked was haphazard, guess-based, and conducted by three individuals who had no understanding of the

trust investment business. As Cooper described it, they did not get enough information from McGinn and were afraid to ask for more. (A-114, A-119; Tr. 1021, 1106). In other words, the evidence that Smith directed that the accounting entries be changed does not support the government's claim that he knew or intended that this was "falsification" because it was clear that the original accounting entries provided no helpful information. His attempts to correct entries are insufficient to prove intent to defraud.

The government's labeling of Smith's reaction to FINRA's inquiry as a "cover-up" is no more sufficient as proof of intent to defraud. With respect to the submissions to FINRA, Smith was attempting to create a record of how transactions that had been erroneously booked should have been recorded—he did not intend to defraud FINRA. In the government's view, any change to accounting records that post-dated FINRA's request was improper and should have been disclosed to FINRA. But FINRA's letter simply does not say this—it asks for detailed information if the accounting records are not "up-to-date" (A-768 ("If the aforementioned files are not up to date, please indicate . . . a. The date in which the file was last updated; b. Description of how the omission(s) was discovered, when the omission(s) was first discovered and by whom, . . . " and so forth)), and is silent about any special disclosures required for records that are up-to-date because accounting disarray has been recently untangled and corrected. Indeed, because the

letter requested additional information about outdated records, it plainly implied that the records should be updated. In any event, even if FINRA subjectively wanted this information about updated entries,[6] the plain language of their letter and Smith's response to it are inadequate to show that Smith had the intent to defraud in giving them updated records.

The only other evidence that approaches support for the government's "cover up" rhetoric is Kaplowitz's testimony that with respect to the submission to FINRA, "I told them that they couldn't alter the records to reflect another way of accounting for the advances that they took out." (A-78-79; Tr. 740-41). This evidence falls short, for neither this one line of testimony (taken as true) nor any other evidence in the trial shows that Smith shared Kaplowitz's view that no changes should be made, especially in the face of the FINRA letter impliedly seeking up-to-date records. *See Coplan,* 703 F.3d at 69 ("[i]t would not satisfy the Constitution to have a jury determine that the defendant is probably guilty." (citations omitted)).

The government was no more successful in providing evidence to support its labeling of the promissory notes submitted to FINRA as "backdated." The government's own witness, Carr, testified that he had supervised the preparation of

[6] The government repeatedly attempted to elicit from FINRA witnesses that they would have wanted or would have expected this information to be disclosed to them, despite the plain language of the letter requesting additional detail only for records that were not up to date. (A-33-34, A-41; Tr. 392-93, 445).

the promissory notes and had not "backdated" any notes because the notes were meant to mirror what already was in the accounting records. (A-226-28; Tr. 1888-90). He also testified that neither Smith nor McGinn ever directed him, whether directly or through a third party, to backdate the promissory notes. (A-227-29; Tr. 1889-91).

In short, the government's evidence did nothing more than show that the business structure was complex, the books and records were incorrectly maintained and that Smith was attempting to fix problems. Because this is insufficient to show intent to defraud, all of the non-tax convictions must be reversed.

C. Smith Had No Involvement with the Mailings in Counts Eight and Nine or the Wire Transfer in Count Seventeen

Counts Eight, Nine, and Seventeen suffer from a further sufficiency defect—there is no evidence that Smith had anything to do with them.

As every McGinn Smith witness, including Smith and McGinn, explained at trial, McGinn and Smith managed different parts of their business, and they operated independently in many ways. The government's questioning at trial and statements in its post-trial briefing acknowledged that only McGinn was involved with the transactions that relate to Counts Eight and Nine. *See*, *e.g.*, Government's Opposition to Defendants' Mots. for Judgment of Acquittal and for a New Trial at 7, No. 12-CR-28, ECF No. 117 ("Viewing the evidence in the light most favorable to the government, *McGinn directed* that a handful of the broker-dealer's most

important clients whose investments in other products had failed should continue to be paid with MSTF money." (emphasis added)). Indeed, in cross-examining McGinn, the government repeatedly elicited that he directed these transactions and presented no evidence that Smith was involved or even knew that these transfers were coming from MSTF:

> Q: Now, you directed all of these payments on here, didn't you?
> A: Yes.
> Q: Directed every single one of them?
> A: I said yes.

(A-409; Tr. 2950).

> Q: All right. Let's look at page five. It states: Advances from MSTF to customers of [McGinn Smith] of whom we had decided to support because of their high level of importance to the firm and to whom we were attempting to bridge the gap of their shortfall in income due to the non-performance of their investments in the Funds.
>
> . . . .
>
> Q: Mr. McGinn, that question is you were the person that directed them, correct?
> A: Yes.

(A-410-11; Tr. 2952-53; *see also* A-112-13; Tr. 1018-19 (Cooper's testimony that McGinn directed all of these payments); A-45-46; Tr. 487-88 (Shea's testimony to the same effect)).

And, as noted above, the government elicited from Shea testimony about Smith's reaction and "concern" upon learning of the transfers. (*See*, *e.g.*, A-49; Tr. at 497 ("[Smith] was very upset. He was concerned that these payments had

gone out of MSTF to non-MSTF investors. He knew it wasn't allowed by the private placement.")). The government also elicited from Shea Smith's comment that he "knew that Tim was paying these people," but he was "not sure from where[.]" (A-49; Tr. 497). Similarly, during its cross-examination of McGinn, the government confirmed that Smith was concerned about the transactions when he finally learned of them:

> Q: Now, Mr. Smith was concerned about all of these transactions out of MSTF, wasn't he? The ones—I will be a little more specific. The ones that were to the preferred customers, to Mr. Cornacchia and of payroll, ones that passed through MSTF that we just looked at?
>
> A: Mr. Smith was concerned about the optics of those payments, yes.
>
> Q: Mr. Smith was concerned; is that correct?
>
> A: That's correct.

(A-412-13; Tr. 2965-66).

In other words, the evidence showed that Smith learned of these transfers long after the fact, and thus he could not be guilty of participating in a long-since-completed crime.

With respect to Count Seventeen, the government only presented evidence that McGinn directed that money be deposited into one of Smith's bank accounts and made no effort to show that Smith was involved in any way. In fact, the government, in its cross-examination of Geoffrey Smith, even elicited the following testimony:

Q: And are you aware that Mr. McGinn directed the July 1st, 2008, transfers himself in an electronic mail message?
A: I am not.

. . . .

Q: This is an electronic mail message from Mr. McGinn to a Ms. Birnbach at Mercantile bank. If you look at the bottom, number four: Please wire from Integrated Excellence Senior Trust thirty-five thousand dollars to M&T Bank in an account in the name of Mr. Smith and thirty-five thousand dollars to M&T Bank in an account in the name of Mr. McGinn. Is that accurate?
A: Yes.
Q: So Mr. McGinn directed these transfers himself; is that correct?
A: It seems that way.

(A-320-21; Tr. 2652-53).

Even if any of the transactions could have been classified as fraudulent, the government utterly failed to present evidence that Smith had any knowledge of these transactions until after the fact, let alone that he had intent to defraud.[7] For this additional reason, Counts Eight, Nine, and Seventeen should be reversed.

D. The Evidence Was Insufficient to Prove Willfulness with Respect to the Securities Fraud Counts

For securities laws violations that do not involve insider trading, the government must prove willfulness, which this Court has defined as the defendant's awareness of the general wrongfulness of the conduct. *United States v. Kaiser*, 609 F.3d 556, 569 (2d Cir. 2010); *see also* 15 U.S.C. § 78ff(a).

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[7] There was no *Pinkerton* theory submitted to the jury, so these substantive Counts cannot be saved by the conspiracy conviction. *See Pinkerton v. United States*, 328 U.S. 640 (1946).

In order to establish that Smith's alleged misstatements constituted a "willful" violation of the securities laws for "fail[ing] to disclose that [he] planned to and did take money for [himself] in connection with two specific deals" (A-485; Tr. 3326), the government needed to prove beyond a reasonable doubt that Smith knew that the private placement memoranda for the deals at issue, TDM Verifier Trust 08 and Fortress Trust 08, did not allow for the transactions but intended to effect them anyway knowing it was wrong. (*See* A-603 (TDM Verifier Trust 08), A-656 (Fortress Trust 08)).

As discussed above, the evidence showed that Smith had no role in the drafting of any private placement memoranda, and he had no knowledge and no reason to believe that they failed to disclose any information required by law. In other words, even if the government was correct that the private placement memoranda should have expressly disclosed the anticipated profit spread structured within these deals and that the partners intended to draw those amounts as loans from the LLCs, there was no evidence that Smith (1) knew that or (2) knew that the private placement memoranda fell short.

Thus, because the evidence was insufficient to prove willfulness (or intent to defraud), the securities fraud conviction must be reversed.

II. MISUSE OF AN UNCHARGED 1999 LETTER CONSTRUCTIVELY AMENDED THE INDICTMENT OR AMOUNTED TO A VARIANCE

The 1999 letter written by Smith (A-774.1-.28) contained statements that were inflammatory, prejudicial and that easily distracted from and confused the conduct alleged in the superseding indictment. Although counsel for Smith repeatedly objected to the use of the letter during the course of the trial, and although Judge Hurd himself refused to admit the letter into evidence, the government was nevertheless permitted to read the most prejudicial parts of the letter to the jury and argued expressly that the letter proved guilt beyond a reasonable doubt. This misuse of the letter constructively amended the superseding indictment or, at the very least, amounted to a prejudicial variance.

A. Relevant Facts

During the course of the investigation, the government obtained a twenty-six-page handwritten letter that Smith had written to McGinn (but never gave to him) in 1999. This letter, which the government referenced as the "confession letter" (A-396; Tr. 2876), addressed a number of concerns Smith had about the business during the 1999 timeframe using provocative and inflammatory statements. Although the grand jury had only charged Smith for crimes beginning in 2006, the prosecution repeatedly sought and ultimately obtained permission to recite substantial portions of the 1999 letter to the jury. (*See*, *e.g.*, A-269-70; Tr. 2113-14).

Incredibly, the government itself argued that the letter was part of the charged conspiracy, even though the indictment alleged a course of conduct between 2006 and 2010—a full seven years after the letter—and even though McGinn did not even work with Smith from January 2003 to June 2006. (A-334-37; Tr. 2710-11, 2713-14). Although the government mentioned other justifications for the letter, such as rebutting anticipated expert testimony regarding materiality (which was precluded by the District Court), its core argument, repeated several times, was that the letter was "a continuation of a pattern, a course of conduct that had begun back in 1999." (A-270; Tr. 2114). The government's arguments were as follows:

> The letter shows Mr. Smith's understanding of what disclosure obligations were necessary. And that is at the heart of this case, what disclosure obligations he had to investors, what was material. It also shows what has been the topic of the proof in this case was not some isolated occurrence caused by the downturn in the economy as the defendants have repeatedly suggested, but instead a continuation of a pattern, a course of conduct that had begun back in 1999. For those reasons, the letter is highly probative, relevant evidence.
>
> . . . .
>
> And . . . [it] illuminates Mr. Smith's understanding of disclosure obligations and how their business worked . . . .
>
> . . . .
>
> I still think that it illuminates Mr. Smith's understanding, and since the—of what disclosure obligations are necessary. To the extent that the defense has suggested that they are going to call an expert witness, a securities lawyer who is going to come in here and tell the jury what is material and not—or not, that the Firstline bankruptcy was not

> material, that letter directly shows that Mr. Smith doesn't actually believe that.[8] And despite the fact that the letter was written earlier, as I said, it is part of a continuation of a pattern. And I don't think that the law requires or limits the government to offering and the Court from admitting evidence that is only in the time period charged in the conspiracy.

(A-269-71; Tr. 2113-15). Later, the government reiterated its core argument, saying "you certainly don't have to have—the evidence doesn't have to line up with the time period charged in the indictment." (A-274; Tr. 2118).

These claims were incorrect. Indeed, read in context it is clear that the letter related to a particular alarm company that was issuing shoddy contracts to default-prone customers, and expressed concerns about a structure that was used in 1999 but was not used in the charged time period. (A-774.1-.28; Tr. 3242-53). Thus, the District Court denied the government's efforts to admit the letter in its case in chief, finding that "the time matter is seven years prior to the start of the alleged conspiracy in 2006," and that the letter "*was not referring to the same investments that we are talking about in this case*." (A-274-75; Tr. 2118-19 (emphasis added)). However, the District Court stated that there are "many ways in which this letter can come in and open the door," and then enumerated several. (A-275; Tr. 2119). Prime among these was, according to the District Court, "if you persist or continue with the good faith defense." (A-275; Tr. 2119). In addition, the District Court

[8] Smith's acquittals confirm that the government utterly failed to prove that Smith even knew about the Firstline bankruptcy until long after any Firstline trust investments were sold.

stated the door might be opened if the defendants "blame" the financial crisis for the problems in their business, "claim ignorance or no knowledge of matters or if the expert testifies in accordance with some of those issues." (A-275; Tr. 2119).

After McGinn testified, the District Court, over objection, permitted the government to cross-examine him regarding portions of the letter, but did not permit the letter to be admitted in evidence. (A-403-05; Tr. 2883-85). The prosecution then proceeded to read from the letter (which was not in evidence) and ask McGinn whether the portions read were written by Smith. (A-406-08; Tr. 2934-36). And, after Smith testified, the District Court, over objection (A-456; Tr. 3146), permitted the prosecution to elicit the following statements from the letter that, unbeknownst to the jury, related to a particular alarm company that was not related to any of the charged conduct and a different structure from that used in 2006 and onward:

1. "The default of the trusts will drastically reduce revenues, cause us to lose brokers and at least their confidence in us, bring on crushing litigation and devastating publicity, and I am convinced prosecution by regulators or worse";
2. "For us not to allow for these deficits by setting up adequate reserves is, in my judgment, bordering on fraud";

3. "[W]e are not providing the prospective investor an accurate picture of his risk";
4. "We both know why we don't make that disclosure, because such disclosure would cause our salesmen to cease selling and investors to cease buying";
5. "[W]e are misleading both our own employees and customers";
6. "Most of the deficits are from poor credit risks. We now know that, and we continue to accept their contracts without adequate reserves and treat the excess discounted cash flow as certain profit to be distributed as we see fit";
7. "Hard to justify investors losing half their money while we continue to prosper at compensation levels that would seem obscene to the average citizen sitting in judgment";
8. "I would never underestimate the zeal of local or state or even SEC prosecutors to make a story out of our failure. Convictions of fat cat financiers is a great stepping stone up the career ladder";
9. "[Y]ou have previously rejected my characterization of these acts as similar to a 'Ponzi' scheme . . . because new dollars being raised are in fact buying new product and only, 'profit dollars,' . . . are being used to cover shortfalls"; and

10. "I believe that our actions could be defined otherwise. The reason for my beliefs is that we are now in possession of indisputable, empirical evidence that the new investments have no chance of being repaid in full."

(A-458-70; Tr. 3148-60).

The District Court offered no guidance to the jury as to the permissible or impermissible uses of this evidence. In summation, the government placed heavy reliance on these statements, closing with the following:

> The defendants did not treat these investors fairly. They have been in the business for decades. They are capable, smart men. They knew better. They knew how to do things right. They chose not to. The letter I read to Mr. Smith yesterday tells you why. Mr. Smith wrote in a different context back in 1999.
>
> 'We both know why we don't make that disclosure. Because such disclosure would cause our salesmen to cease selling and investors to stop buying.'
>
> The evidence clearly establishes, ladies and gentlemen, that the defendants are guilty beyond a reasonable doubt of the charges in the indictment.

(A-490; Tr. 3384).

B. Applicable Law

A constructive amendment challenge is reviewed *de novo*. *United States v. Wallace*, 59 F.3d 333, 336 (2d Cir. 1995). A constructive amendment of an indictment occurs when "either the proof at trial or the trial court's jury instructions so altered an essential element of the charge that, upon review, it is

uncertain whether the defendant was convicted of conduct that was the subject of the grand jury's indictment." *United States v. Salmonese*, 352 F.3d 608, 620 (2d Cir. 2003) (citations omitted); *United States v. Patino*, 962 F.2d 263, 265 (2d Cir. 1992) ("An indictment is constructively amended when the proof at trial broadens the basis of conviction beyond that charged in the indictment."); *see also United States v. Roshko*, 969 F.2d 1, 5 (2d Cir. 1992) (where constructive amendment "affects an essential element of the offense," it "destroys the defendant's substantial right to be tried only on charges presented in an indictment returned by a grand jury" (internal quotation marks and citations omitted)).

A constructive amendment "is a per se violation of the Grand Jury Clause of the Fifth Amendment that requires reversal even without a showing of prejudice to the defendant." *United States v. Wozniak*, 126 F.3d 105, 109 (2d Cir. 1997) (internal quotation marks and citations omitted).

C. Recital of Portions of the 1999 Letter Expanded the Core of Criminality

The superseding indictment charged a conspiracy beginning "on or about September 29, 2006," mail, wire, and securities fraud charges "on or about" specified dates in 2008, and tax fraud charges "on or about" specified dates from 2007 through 2009. (*See* A-775-808). The superseding indictment nowhere charges Smith or McGinn in connection with an ongoing decade-long scheme to defraud or any criminal conduct before 2006. Nevertheless, the government expressly invited

the District Court and the jury to treat the conspiracy and scheme as one dating back to 1999, and to convict based on the 1999 letter. (A-464-72, A-490; Tr. 3154-62, 3384; *see* A-270; Tr. 2114 (arguing before the judge, but out of the presence of the jury, that the 1999 letter indicated "a continuation of a pattern, a course of conduct that had begun back in 1999")). This dramatic expansion of the core criminal conduct and mens rea charged in the indictment amounted to a constructive amendment of the indictment.

Constructive amendments to an indictment are considered prejudicial per se, but in Smith's case, the prosecution's use of the letter led to prejudice that infected the entire trial. *See United States v. Mollica*, 849 F.2d 723, 730-31 (2d Cir. 1988) (noting specifically prosecutor's remarks in summation in discussion of possibility of prejudice to defendant). Judge Hurd permitted the prosecution to read the above-quoted portions of the letter during cross-examination of both McGinn and Smith and to make the 1999 letter the culmination of its summation. The prosecution, quite literally, closed its case by suggesting that the letter itself established guilt beyond a reasonable doubt. (A-490; Tr. 3384). There is a very real likelihood that the jury convicted Smith based not on evidence of the crime charged but upon perceived intent or conduct in 1999.

On at least five separate occasions, counsel for McGinn and Smith objected to any use of the 1999 letter (*see*, *e.g.*, A-271-73, A-397-402, A-456-57; Tr. 2115-

17, 2877-82, 3146-47), and counsel for Smith specifically raised the possibility that the jury might be confused as to the mens rea element of the offenses by conflating Smith's state of mind at the time he wrote the 1999 letter with his state of mind at the time he allegedly committed the acts charged in the indictment. (A-402; Tr. 2882).

And Judge Hurd himself recognized the potential danger with respect to admitting the letter, finding that the 1999 investments were *not* the same as those charged. (A-275; Tr. 2119). Nevertheless, Judge Hurd gave no limiting instructions when the letter was read during cross-examination of McGinn, during cross-examination of Smith, or when the prosecution invited the jury to find guilt based on the 1999 letter. Nor did Judge Hurd include in his final instructions any limiting instruction on the proper use of the letter or an express statement that the defendants were not on trial for anything that happened in 1999. Thus, the District Court failed to counteract the prosecution's invitation and permitted the jury to base its convictions upon Smith's perceived intent for unrelated and uncharged conduct in 1999.[9] This expansion of the indictment's charges was a per se violation of Smith's rights under the Grand Jury clause and warrants reversal.

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[9] Indeed, the highly prejudicial letter even ultimately influenced Judge Hurd's impression of Smith during sentencing despite his clear acknowledgement (A-275; Tr. 2119) that it was unrelated to the charged conduct: "In 1999 you sent a letter to Mr. McGinn outlining all of the possible fraudulent investigations that may come to your firm. You knew what was going on. Did you stop Mr. McGinn? No. You

D. Alternatively, Presentation of Evidence from the 1999 Letter Was a Prejudicial Variance

Even if the misuse of the 1999 letter did not rise to the level of a constructive amendment of the indictment, it substantially prejudiced Smith by depriving him of a meaningful opportunity to meet the prosecution's case. Thus, Smith's conviction amounted to a prejudicial variance from the indictment, warranting reversal.

1. Applicable Law

In contrast to a constructive amendment, "[a] variance occurs when the charging terms of the indictment are left unaltered, but the evidence offered at trial proves facts materially different from those alleged in the indictment." *Salmonese*, 352 F.3d at 621 (internal quotation marks omitted). A variance warrants reversal if it results in "substantial prejudice." *United States v. Rigas*, 490 F.3d 208, 226 (2d Cir. 2007) (citations omitted); *see*, *e.g.*, *United States v. Johansen*, 56 F.3d 347, 351 (2d Cir. 1995) (reversing conviction for variance).

2. The Government's Misuse of the 1999 Letter Proved Facts Materially Different from Those Alleged in the Indictment

The superseding indictment alleged conduct and mens rea occurring from 2006 through 2009, but the government did not prove any culpable mens rea and only some conduct during that period. Instead, the government presented the 1999

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participated in the very activity that you complained about in 1999. And when the market went bad in 2008, it turned out to be a disastrous result." (A-810).

letter, placing special emphasis on it and citing it at the culmination of summation as evidence of guilt beyond a reasonable doubt. (A-490; Tr. 3384). This was materially different from the facts alleged in the indictment, and caused Smith substantial prejudice. Had Smith and his counsel known that mens rea evidence from 1999—in relation to a critically different business structure and set of circumstances—would or could be used to substitute for the intent element for conduct beginning in 2006, Smith could have opted for a different trial strategy. Indeed, defense counsel repeatedly told the Court that he was carefully structuring his questioning throughout the trial so as not to open the door to admitting any portions of the letter. (*See* A-274; Tr. 2118 ("we also talked about a door opening, and Mr. Jones and I, I think, have been scrupulous in the beginning of our examinations in the middle part of 2000 and not opening the door in any way which would allow the letter to even be considered."); A-400; Tr. 2880 ("[I] am well aware of the door opening conditions that the Court set, and I don't intend to open the door."); A-456; Tr. 3146 ("[T]he door clearly was not opened at all. We abided by the Court's agreed instructions and limited ourselves to the four corners of the indictment beginning in 2006. I think that was abundantly clear.")). Despite counsel's best, calculated efforts, extensive portions of the letter were read to the jury anyway, resulting in substantial prejudice to Smith and an inability to defend himself effectively. Thus, the convictions should be reversed.

III. THE TAX COUNTS SHOULD BE REVERSED

The convictions for filing false tax returns should be reversed because there was insufficient evidence that Smith either knew his tax returns were false or that he filed false returns willfully. Moreover, the District Court's legal instructions to the jury on these counts entirely misstated the applicable law and effectively converted the government's burden of proof into that applicable to a civil audit. The District Court then compounded this plain error by instructing the jury that the defense of good faith was "inapplicable" to the tax counts. Accordingly, even if the tax count convictions are not reversed, they must be vacated.

A. The Evidence Was Insufficient to Prove Knowledge or Willfulness

The evidence presented at trial was wholly insufficient to carry the government's burden of proving knowledge or willfulness to satisfy the tax counts. This is because the government made no attempt to establish that Smith or McGinn knew that their distributions should be reported as income under the circumstances as they understood them, and instead focused solely on the civil audit question of whether the defendants intended to repay the loans.

1. Relevant Facts

The false return counts were predicated on the government's view that the loan distributions of anticipated profits built into the structure of the trust investments should have been reported as fee income on the individual tax returns

of McGinn and Smith. The evidence the government relied on for this fee characterization was as follows.

Rees testified that he booked the transfers as fees based on nothing more than the bank records and his own guess-work:

> Q: How did you learn about these transactions?
> A: The wire confirmations showed up in our in-box, and when we were processing them, we became—I became aware of them.
>
> . . . .
>
> Q: Was this the first time that you saw an LLC paying money to Mr. Smith and Mr. McGinn directly related to a raise of investor money?
> A: I think it was.
> Q: Who booked these transactions as origination fees?
> A: I did.
> Q: Why did you do that?
> A: Because it was money going to them. I assumed that they had done some work in sourcing the deal for TDM funding, and I thought they would be due some sort of compensation, and so I booked it as a fee, which would be an expense on the TDM Funding, LLC's financial statements, but an income item to them.
>
> . . . .
>
> Q: I would like to direct your attention to the December transactions that are highlighted. Did you book those as well?
> A: Yes, I did.
> Q: Why did you book them as fees in origination fees?
> A: Because I knew that they were going to be a similar recipient and should have treated similar to the entries of October 2nd.

(A-93-95; Tr. 923-25).[10] Indeed, Rees admitted that he did not review the private placement memoranda relating to the various trust transactions. (A-102-03, A-107, A-109; Tr. 947-48, 955, 957).

Smith directed Rees to correct his entries:

Q: Why did you [change the accounting from fees to loans]?
A: I was instructed to by Mr. Smith.
Q: What did Mr. Smith say to you?
A: He asked that I—that those should be treated as loans.
Q: Did he say anything else?
A: No.

(A-96-97; Tr. 926-27).

Rees also testified that at some point in 2008, he had asked Smith "how these would ultimately get repaid since they were due to these entities," and that

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[10] Although it was clear that Rees relied only on his assumptions to book this transaction, the government nevertheless elicited from him the following opinion on an ultimate issue: "Q: At the time that you booked these entries, was there any evidence that these transactions were loans? A: No." (A-94; Tr. 924; *see* A-95, A-97; Tr. 925, 927). Similarly, the government elicited the following improper opinion testimony from Rees:

Q: What was your reaction to [Smith's] instruction to change these from fees to loans?
A: I didn't feel really good about it. It wasn't the intent of the transaction, and it was disheartening that we—that's how things were done.
Q: You said it wasn't the intent of the transaction. What do you mean by that?
A: When somebody receives income for doing services, it should be reported as income.

(A-98; Tr. 928).

Smith replied "that would be for my estate to figure out." Asked what Rees understood Smith to mean, he replied, "[t]hat there was no real intent to repay it." (A-99; Tr. 929).

Simons, the accountant who prepared the defendants' personal tax returns as well as the returns for various McGinn Smith entities, testified that near the end of December 2006, he prepared a projection for Smith of his tax-related items that included the distributions from TDM Cable Funding LLC as "other income." (A-81-82; Tr. 791-92). He attributed the information about this entry to Smith. (*See* A-83-84; Tr. 793-94 ("My recollection, that would have been a phone conversation with David Smith. Q: What did Mr. Smith Say? A: I don't recall the specific conversation . . . ."")). He testified that sometime after December 21, 2006, he received a handwritten document prepared by Smith and noting "other income" from "TDM." (A-82-84; Tr. 792-94). As of April 15, 2007, Simons no longer included these distributions in his projections of "other income" because he "would have had a phone conversation with David Smith between the 13th and 15th that would have, that would have given [him] some indication that it was not income." (A-85-86; Tr. 795-96). Simons ultimately treated these distributions as loans for Smith's, McGinn's, and the relevant entity tax returns, based on information received from "both David Smith and the comptroller [Rees]." (A-86.1; Tr. 804; *see* A-86.2-86.4, A-87; Tr. 813-15, 833).

The government also presented to the jury personal financial statements for Smith and McGinn that did not list the loans from the various operating companies relating to the trust side of the business. Smith testified that he believed a footnote disclaiming disclosures relating to Smith's holdings obviated any need to include these loans in the statements (and indeed, these statements did not include his ownership in the LLCs as assets either). (A-446.1-48; Tr. 3113-15). Simons testified that he did not recall the distributions at the time he helped prepare these financial statements. (A-90; Tr. 868). The government's own cooperator, Rogers, who pled guilty to a crime based on his purported belief that these distributions should not have been treated as loans, also did not include them as income on financial statements he prepared—"Q: So in other words, it was not disclosed as a fee or loan? A: Correct. It was neither fish nor [fowl]." (A-128; Tr. 1171; *see* A-133; Tr. 1179).

Indeed, although both Simons and Rogers pled guilty to crimes relating to the treatment of these distributions, it is not clear that either was actually guilty. When asked on cross-examination, "What did you do wrong?," Simons answered, "I am not sure if I did anything wrong . . . ." (A-88; Tr. 844). And Rogers made clear that, although he did not believe he would have to go out of pocket to repay these distributions, he intended that they be repaid from the profit spread created in the deal:

> Q: What was your understanding about whether you would have to pay the money back if the deals did not work out?
>
> A: My understanding was that I would not have to pay that money back. Sorry. My understanding was firstly that the intention was that to [the] extent the deals were that loans would be repaid through the proceeds of the equity share that he [McGinn] had granted me. But at no time did he make it clear that to the extent the deals did not work, that that those monies would be repayable to the lender vis TDM Cable Funding, LLC.

(A-123; Tr. 1166 (emphasis added)). Similarly, on cross-examination, Rogers agreed that "the loans would be repaid in the event the transactions to which they related were ultimately successful[.]" (A-135; Tr. 1220).

The government also elicited from its FINRA witnesses that in the course of one of the regular FINRA reviews conducted at McGinn Smith, and during a meeting between FINRA representatives and Smith, McGinn, and Shea, FINRA inquired about the loans that TDM Cable Funding LLC had made to its principals. (A-30; Tr. 384). A FINRA representative testified: "Initially my recollection is that Mr. Smith responded that these were fees, and then immediately Mr. McGinn jumped in and noted that these were loans." (A-31; Tr. 388; *accord* A-39-40; Tr. 442-43).

Despite this testimony, retired IRS special agent Daversa offered her opinion that these distributions were fees as follows:

> Q: Now, does this chart reflect every penny that Mr. McGinn and Mr. Smith took from the LLCs that were affiliated with the trusts?

A: No, this chart represents the monies *that took on the characteristics of fees* that we were able to match up with disbursements from the LLCs . . . ."
Q: Why did you engage in that analysis instead of just listing every penny that Mr. McGinn, Mr. Smith and Mr. Rogers had taken from the LLCs?
A: We took a conservative approach to make sure that the monies had the characteristic of fees so there was no chance that they were loans.

(A-278-79; Tr. 2171-72 (emphasis added); *see also* A-280; Tr. 2175 ("Q: Are you aware of whether there is any evidence that they were legitimate loans? [objection overruled] A: I didn't find anything other than the accounting entry to substantiate that they were bona fide loans.")). Incredibly, the retired case agent gave this testimony directly following the testimony of IRS revenue agent Dianne Adelberg, who testified that with respect to distributions from LLCs, she had converted almost all of these loans into capital gain for the purposes of re-calculating the tax. (A-267; Tr. 2098). In other words, even the government's own witnesses disagreed about how to characterize these distributions for tax purposes.

2. The Evidence Was Insufficient to Show Either Knowledge or Willfulness

The evidence presented focused solely on the question of whether McGinn and Smith had an intent to repay the money distributed to them. This question may be key in a civil audit context, but it falls well short of the mark in a criminal prosecution. As noted, the evidence was even insufficient to prove beyond a reasonable doubt that there was no intent to repay, as the evidence amounted to: a

guess entered on the books and records by Rees; a tax projection created by Smith in consultation with the tax professional who prepared not only his personal returns but the returns of the entities, which projection was later corrected; a flippant remark by Smith to Rees that his "estate" would have to figure out how to repay the loans; the financial statements submitted by McGinn and Smith that did not reflect these loans; and a statement by Smith to FINRA that these distributions were fees, which was promptly corrected by McGinn. This evidence was too equivocal even to prove that Smith did not intend to repay the loans. Indeed, even Rogers, who claimed that he had committed a tax crime by failing to report his distributions, testified that although he did not intend to repay the loans, he intended that they *would be repaid* out of the profits realized at the end of the transaction. Rogers' testimony also reflected that the financial statement evidence was equally consistent with either intent to repay or intent not to repay—on his financial statements, he neither reflected these distributions as income nor loans.

Even if it could be said that the evidence justified a finding beyond a reasonable doubt of no intent to repay, it was entirely devoid of any indication that Smith *knew* that his return was false under the circumstances, or that he filed a tax return voluntarily and in intentional violation of a known legal duty. There were no statements by him or documents indicating any awareness that his returns were false, nor was there any circumstantial evidence that he believed his returns were

false. As for the known legal duty, even the government's two IRS witnesses could not agree on whether the distributions from LLCs should be reported as fees (and therefore "other income") or as capital gain. Where even the government's IRS witnesses did not know what the legal duty was to report these funds, it is clear that the proof did not come close to showing beyond a reasonable doubt that *Smith* knew how he was required to report these funds and intentionally violated that duty. Accordingly, the evidence was insufficient, and the tax counts should be reversed.

B. The District Court's Instructions on the Tax Counts Were Plain Error

Even if the tax counts are not reversed outright for insufficient evidence, they must be vacated and remanded based on plainly erroneous jury instructions that eliminated the requirement of willfulness and precluded a defense of good faith.

1. Applicable Law

Unpreserved errors in jury instructions are reviewed for plain error. *United States v. Young*, 470 U.S. 1, 15-16 (1985). Plain error requires an appellant to demonstrate that "(1) there is an error; (2) the error is clear or obvious, rather than subject to reasonable dispute; (3) the error affected the appellant's substantial rights, which in the ordinary case means it affected the outcome of the district court proceedings; and (4) the error seriously affects the fairness, integrity or

public reputation of judicial proceedings." *United States v. Vilar*, 729 F.3d 62, 70 (2d Cir. 2013) (internal quotation marks and citations omitted). For an instructional error to have affected a defendant's substantial rights, there must have been "a reasonable probability that the error affected the outcome of the trial." *United States v. Marcus*, 560 U.S. 258, 262 (2010).

2. The District Court's Instructions Eviscerated Willfulness

Smith's defense to the tax charge was good faith—he testified that he believed the money he received from the trust business was in the form of loans. (A-445; Tr. 3107). He also testified that he intended one of two things to happen with those loans—either that they would be repaid from "sufficient equity built up in those operating companies from the transactions" or that he would repay them. (A-449; Tr. 3116). Despite the clear importance of Smith's state of mind, the District Court's mens rea instructions on the tax counts completely eviscerated the applicable standards.

A violation of Section 7206(1) of Title 26, requires the government to prove (1) that the defendant made and signed a tax return that contained false information as to a material matter; (2) that he knew that this information was false; (3) that the tax return contained a written declaration that it was being signed subject to the penalties of perjury; and (4) that he acted willfully. *See United States v. Bishop*, 412 U.S. 346, 350 (1973). It is beyond dispute that in the context of tax crimes,

willfulness means "the voluntary, intentional violation of a known legal duty." *Cheek v. United States,* 498 U.S. 192, 201 (1991). This is because "[o]ne of the most esoteric areas of the law is that of federal taxation. It is replete with full-grown intricacies, and it is rare that a simple, direct statement of the law can be made without caveat." *United States v. Regan*, 937 F.2d 823, 827 (2d Cir. 1991) (internal quotation marks and citations omitted). Evidence of good faith will defeat a charge under Section 7206(1). *United States v. Pomponio*, 429 U.S. 10, 11 (1976) (per curiam).

The District Court's instructions, however, gutted this requirement by defining the "known legal duty" as the duty to file a truthful tax return. The District Court stated:

> In short, the government must establish that the defendant under consideration acted voluntarily and intentionally with the specific intent to make a false statement on the tax return involved in the count under consideration, despite knowing that it was his legal duty to answer truthfully.

(A-495; Tr. 3535). This is too broad a standard, as is clear from this Court's decision in *United States v. Pirro*, 212 F.3d 86 (2d Cir. 2000). In *Pirro*, this Court affirmed the pretrial dismissal of a false tax return count, finding that the legal duty allegedly violated was essentially unknowable. The Court considered the requirement that "all persons owning stock" in the S corporation be reported, and

found that "[t]he tax law provided Pirro no notice that failure to report an 'ownership interest' was criminal." *Id.* at 90-91.

Thus, the duty identified by this Court in *Pirro* was the duty to report an "ownership interest," not the overbroad duty to "answer truthfully" on a tax return adopted by the District Court here. (*See* A-495; Tr. 3535). If the District Court's interpretation were correct, *Pirro* would not have needed to conduct the analysis it did. By analogy to *Pirro*, here the District Court should have instructed the jury that the government must prove that the defendants knew that they were required to report these distributions as income under the circumstances as they understood them. Under such a standard, a true distinction would have been drawn between the civil audit issue of whether these distributions should be treated as loans, fees (as the government argued and as one IRS witness testified), or capital gain (as the government's other IRS witness testified), and the criminal law issue of whether the defendants acted knowingly and willfully. Instead, the District Court's instruction effectively collapsed the willfulness element into the civil audit question of whether the defendants intended to repay the loan. This was plain error and it alone warrants vacatur of the tax counts.

3. The District Court's Instruction Precluded a Defense of Good Faith

The District Court's plainly erroneous instructions on mens rea were compounded when the District Court instructed the jury as follows: "Unlike the

mail, wire, and securities fraud counts, *the defense of good faith is not applicable to the filing false tax returns charges*." (A-494; Tr. 3532 (emphasis added)). No such instruction was requested by any party, and for good reason—good faith plainly is a defense to the tax counts, *Cheek*, 498 U.S. at 203 (holding that a good-faith belief is a defense to criminal tax violations, even if that belief is objectively unreasonable); *United States v. Pabisz*, 936 F.2d 80, 83 (2d Cir. 1991) (finding plain error and reversing conviction because "the court did not instruct the jury that defendant's beliefs need not be objectively reasonable if they were actually held in good faith"), and it was the defense presented throughout the trial. To instruct the jury that good faith "is not applicable" to the tax counts precluded the defendant's defense and directed a verdict of guilt against them. This error standing alone is plain and justifies vacatur of the tax convictions.

IV. COUNT TEN MUST BE REVERSED

Count Ten must be reversed because the letter and memorandum simply alerted investors that they would cease to receive interest payments. They did not seek to obtain any money or property from investors and did not seek to deprive investors of any money or property. Thus, the evidence was insufficient to establish the "money or property" element of the charge.

A. Relevant Facts

Several counts were predicated on the government's assertions that Smith must have known about the Firstline bankruptcy and thus participated in an effort to solicit Firstline investors after Firstline was threatened with litigation from ADT and later declared bankruptcy. The jury's verdict acquitting Smith on Counts Two through Six, Eleven through Thirteen, and Fifteen, which related to the Firstline investments, demonstrates that the jury rejected the government's arguments and instead found—as the evidence showed—that Smith was not involved with and did not know about the Firstline bankruptcy or litigation until long after the Firstline trust investments were sold. (A-450; Tr. 3122-23).

The only remaining Count that related to the Firstline investors is Count Ten, which involves the after-the-fact transmission of a letter and accompanying memorandum to Firstline investors. The government attempted to prove that the letter and memorandum contained false information and concealed the true nature of the litigation between ADT and Firstline as well as the source from which investors' payments were funded after the Firstline bankruptcy. But the government offered no evidence that any allegedly misleading statements were intended to (or even could) obtain money or property or deprive investors of control over their money or property.

B. Applicable Law

The Supreme Court has held that "the words 'to defraud' in the mail fraud statute have the 'common understanding' of 'wronging one in his property rights by dishonest methods or schemes,' and 'usually signify the deprivation of something of value by trick, deceit, chicane, or overreaching.'" *Carpenter v. United States*, 484 U.S. 19, 27 (1987) (quoting *McNally v. United States*, 483 U.S. 350, 358 (1987)).

This Court has held that "it is sufficient that a defendant's scheme was intended to deprive another of property rights, even if the defendant did not physically 'obtain' any money or property by taking it from the victim." *United States v. Males*, 459 F.3d 154, 158 (2d Cir. 2006) (citations omitted) (upholding conviction where defendant intended to freeze an account, thereby temporarily denying its owner access to its funds). The deprivation of money or property need not be permanent. *See*, *e.g.*, *id.* at 158-59; *United States v. Karro*, 257 F.3d 112, 115-16 (2d Cir. 2001); *United States v. Dinome*, 86 F.3d 277, 280, 284 (2d Cir. 1996). But essential to mail fraud is the *intended deprivation of some right to property*, and "the government must show that some actual harm or injury was contemplated by the schemer." *D'Amato*, 39 F.3d at 1257 (internal quotations and citations omitted).

C. The Letter and Memorandum Could Not Deprive Investors of any Right to Money or Property

The September 10, 2009 letter and memorandum drafted by McGinn and Carr, which informed investors that quarterly interest payments would be discontinued (A-764-67), cannot serve as the predicate for a scheme to defraud because the mailing did not seek to and could not obtain money or property and did not deprive investors of any property right.

It is undisputed that the purpose of the letter and memorandum was to alert investors that their interest payments were being suspended. At the time the documents were sent in September 2009, Firstline had been bankrupt for almost twenty months, and although McGinn caused the operating LLC to continue to make payments to Firstline investors using funds borrowed from other entities, by the date of the letter, it was decided to stop this method of funding as well. Thus, regardless of whether the notice was correct as sent or as the government argued it should have been (i.e. specifically noting that Firstline had told McGinn Smith about the ADT litigation and disclosing that McGinn Smith (as opposed to an unnamed lender) had been paying the investors through funds borrowed from various entities), there was no action the investors could have taken—their principal payments were not yet due to be repaid, they had no right to withdraw, and because there was no secondary market for the securities, there was no way they could have sold or otherwise exited the investment. The correspondence only

alerted the investors that their interest payments were being temporarily suspended because the underlying investment could no longer fund their monthly interest payments, and a plan was underway to attempt to save the investment from failure. The letter did not request additional money, seek to justify the retention of investors' money, or deny investors information that would have enabled them to make investment decisions. Accordingly, even if the letter was false, it was not designed to, and could not have obtained money or property by means of any falsity, and thus the evidence was insufficient to establish mail fraud. The conviction on Count Ten must be reversed for insufficiency.

V. RESTITUTION AND FORFEITURE SHOULD BE REVERSED

At sentencing, the District Court adopted a loss figure of approximately $6 million, rejecting as unproven the government's claim that the crime involved losses of $30 million (A-809.1). The District Court then ordered restitution of essentially the same amount. (A-809.2). However, this figure included $600,000 attributable to Firstline post-bankruptcy sales. (PSR ¶ 148). Because Smith was acquitted of the counts relating to these sales, the jury evidently agreed that Smith was unaware of the Firstline bankruptcy until long after these sales, and thus the inclusion of these amounts in restitution was plain error. The forfeiture order imposed (A-810.1) is defective for the same reason. (This amount should also not have been included in the loss amount, though correcting this would not affect the

sentencing guidelines). Thus, both the restitution and forfeiture orders should be vacated with instructions to subtract from them $600,000 in Firstline losses. *United States v. Uddin*, 551 F.3d 176, 181 (2d Cir. 2009) (unobjected-to forfeiture order reviewed for plain error); *United States v. Nucci*, 364 F.3d 419, 421 (2d Cir. 2004) (same for restitution).

CONCLUSION

For the foregoing reasons, Smith's judgment of conviction should be reversed with instructions to enter a judgment of acquittal on all Counts.

Alternatively, the case should be remanded for a new trial.

Dated: September 29, 2014
New York, New York

Respectfully submitted,

BROWN RUDNICK LLP

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Federal Rules of Appellate Procedure Form 6
Certificate of Compliance With Rule 32(a)

Certificate of Compliance With Type-Volume Limitation,
Typeface Requirements and Type Style Requirements

1. This brief does not comply with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i) because it does comply with the September 26, 2014 Motion Order (Docket No. 114) which granted Defendant-Appellant-Cross-Appellee David L. Smith leave to file an oversized brief not to exceed 16,000 words.

   This brief contains 15,988 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirement of Fed. R. App. P. 32(a)(5) and the type style required of Fed. R. App. P. 32(a)(6) because:

   This brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2010, in 14 pt. font size, Times New Roman.

/s/ Justin S. Weddle
Justin S. Weddle

Counsel for David L. Smith

Dated: September 29, 2014

SPECIAL APPENDIX

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Judgment, dated August 7, 2013, Appealed From the United States District Court, Northern District of New York (District Court Docket 232) SPA-1

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Sheet 1

UNITED STATES DISTRICT COURT

Northern District of New York

UNITED STATES OF AMERICA
V.
David Smith

JUDGMENT IN A CRIMINAL CASE

Case Number: DNYN112CR000028-002

USM Number: 19471-052

William J. Dreyer
75 Columbia Street
Albany, NY 12210
518-463-7784
Defendant's Attorney

THE DEFENDANT:

☐ pleaded guilty to count(s) ____

☐ pleaded nolo contendere to count(s) ____
which was accepted by the court.

X was found guilty on count(s) 1, 8-10, 14, 17, 21-26, and 30-32 of the Superseding Indictment on February 6, 2013
after a plea of not guilty.

The defendant is adjudicated guilty of these offenses:

Title & Section	Nature of Offense	Offense Ended	Count
18 U.S.C. §§ 1343; 1341	Conspiracy to Commit Mail and Wire Fraud	11/17/09	1
18 U.S.C. § 1341	Mail Fraud	9/10/09	8-10
18 U.S.C. § 1343	Wire Fraud	7/1/08	14, 17
15 U.S.C. §§78j(b), §78ff	Securities Fraud	11/7/08	21-26
26 U.S.C. § 7206(1)	Filing a False Tax Return	10/15/09	30-32

The defendant is sentenced as provided in pages 2 through 6 of this judgment. The sentence is imposed in accordance with 18 U.S.C. § 3553 and the Sentencing Guidelines.

X The defendant has been found not guilty on count(s) 2-7, 11-13, 15-16, and 18-20 of the Superseding Indictment on 2/6/2013.

☐ Count(s) ____ ☐ is ☐ are dismissed on the motion of the United States.

It is ordered that the defendant must notify the United States attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant must notify the court and United States attorney of material changes in economic circumstances.

August 7, 2013
Date of Imposition of Judgment

United States District Judge

August 13, 2013
Date

DEFENDANT: David Smith
CASE NUMBER: DNYN112CR000028-002

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a total term of:

120 months on each of Counts 1, 8 through 10, 14, 17, and 21 through 26, and 36 months on each of Counts 30 through 32, all counts to run concurrently, for a total term of imprisonment of 120 months.

X The court makes the following recommendations to the Bureau of Prisons:

The defendant be designated to a facility close to his family in Saratoga Springs, New York.

X The defendant is remanded to the custody of the United States Marshal.

☐ The defendant shall surrender to the United States Marshal for this district:

☐ at __________ ☐ a.m. ☐ p.m. on __________ .

☐ as notified by the United States Marshal.

☐ The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons:

☐ before 2 p.m. on __________ .

☐ as notified by the United States Marshal.

☐ as notified by the Probation or Pretrial Services Office.

RETURN

I have executed this judgment as follows:

Defendant delivered on __________ to __________

at __________ , with a certified copy of this judgment.

____
UNITED STATES MARSHAL

By __________
DEPUTY UNITED STATES MARSHAL

DEFENDANT: David Smith
CASE NUMBER: DNYN112CR000028-002

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of:

3 years on each of Counts 1, 8 through 10, 14, 17, 21 through 26, and 1 year on each of Counts 30 through 32, terms to run concurrently.

The defendant must report to the probation office in the district to which the defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

The defendant shall not commit another federal, state or local crime.

The defendant shall not unlawfully possess a controlled substance. The defendant shall refrain from any unlawful use of a controlled substance. The defendant shall submit to one drug test within 15 days of release from imprisonment and at least two periodic drug tests thereafter, as determined by the court.

☐ The above drug testing condition is suspended, based on the court's determination that the defendant poses a low risk of future substance abuse. (Check, if applicable.)

x The defendant shall not possess a firearm, destructive device, or any other dangerous weapon.

x The defendant shall cooperate in the collection of DNA as directed by the probation officer. (Deselect, if inapplicable.)

☐ The defendant shall register with the state sex offender registration agency in the state where the defendant resides, works, or is a student, as directed by the probation officer. (Check, if applicable.)

☐ The defendant shall participate in an approved program for domestic violence. (Check, if applicable.)

If this judgment imposes a fine or restitution, it is a condition of supervised release that the defendant pay in accordance with the Schedule of Payments sheet of this judgment.

The defendant must comply with the standard conditions that have been adopted by this court as well as with any additional conditions on the attached page.

STANDARD CONDITIONS OF SUPERVISION

1) the defendant shall not leave the judicial district without the permission of the court or probation officer;
2) the defendant shall report to the probation officer in a manner and frequency directed by the court or probation officer;
3) the defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;
4) the defendant shall support his or her dependents and meet other family responsibilities;
5) the defendant shall work regularly at a lawful occupation, unless excused by the probation officer for schooling, training, or other acceptable reasons;
6) the defendant shall notify the probation officer at least ten days prior to any change in residence or employment, or if such prior notification is not possible, then within five days after such change;
7) the defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute, import, or manufacture any and all controlled substance and all controlled substance analogues, as defined in 21 U.S.C. § 802, and any paraphernalia related to any controlled substances, except that possession and use of a controlled substance properly prescribed by a licensed medical practitioner is permitted;
8) the defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;
9) the defendant shall not associate with any persons engaged in criminal activity and shall not associate with any person convicted of a felony, unless granted permission to do so by the probation officer;
10) the defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view of the probation officer;
11) the defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;
12) the defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court;
13) as directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record or personal history or characteristics and shall permit the probation officer to make such notifications and to confirm the defendant's compliance with such notification requirement;
14) the defendant shall not possess a firearm, destructive device, or any other dangerous weapon;
15) the defendant shall provide the probation officer with access to any requested financial information; and
16) the defendant shall submit his or her person, and any property, house, residence, vehicle, papers, effects, computer, electronic communications devices, and any data storage devices or media, to search at any time, with or without a warrant, by any federal probation officer, or any other law enforcement officer from whom the Probation Office has requested assistance, with reasonable suspicion concerning a violation of a condition of probation or supervised release or unlawful conduct by the defendant. Any items seized may be removed to the Probation Office or to the office of their designee for a more thorough examination.

DEFENDANT: David Smith
CASE NUMBER: DNYN112CR000028-002

SPECIAL CONDITIONS OF SUPERVISION

1. The defendant shall not incur new credit charges or open additional lines of credit without the approval of the probation officer.

2. The defendant shall participate in a program of financial and credit counseling. The program shall be approved by the United States Probation Office.

3. The defendant shall apply all monies he or she receives from any income tax refunds, lottery winnings, judgments, and/or any other anticipated or unexpected financial gains to the outstanding court-ordered financial obligation.

4. The Court finds there is a reasonably foreseeable risk that the defendant may engage in criminal conduct similar or related to the present offense or the defendant's past criminal conduct. Therefore, the Court directs the defendant to notify any employer of risks that may be occasioned by his criminal record or personal history or characteristics, and directs the probation officer to confirm the defendant's compliance with this notification requirement.

5. The Court has reliable information which indicates the defendant poses a low risk of future substance abuse, so the mandatory drug testing condition is suspended.

DEFENDANT'S ACKNOWLEDGMENT OF APPLICABLE CONDITIONS OF SUPERVISION

Upon a finding of a violation of probation or supervised release, I understand that the court may (1) revoke supervision, (2) extend the term of supervision, and/or (3) modify the conditions of supervision.

The conditions of supervision have been read to me. I fully understand the conditions and have been provided a copy of them.

Defendant ______________ Date ______________

U.S. Probation Officer/Designated Witness ______________ Date ______________

DEFENDANT: David Smith
CASE NUMBER: DNYN112CR000028-002

CRIMINAL MONETARY PENALTIES

The defendant must pay the total criminal monetary penalties under the schedule of payments on Sheet 6.

	Assessment	Fine	Restitution
TOTALS	$ 1,500	$ 50,000	$ 5,989,736

☐ The determination of restitution is deferred until ________. An *Amended Judgment in a Criminal Case* (AO 245C) will be entered after such determination.

X The defendant must make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately proportioned payment, unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. § 3664(I), all nonfederal victims must be paid before the United States is paid.

Name of Payee	Total Loss*	Restitution Ordered	Priority or Percentage
Victims 1-841	$5,748,722	$5,748,722	1st
Internal Revenue Service	$241,014	$241,014	2nd
TOTALS	$ 5,989,736	$ 5,989,736	

☐ Restitution amount ordered pursuant to plea agreement $ ________

☐ The defendant must pay interest on restitution and a fine of more than $2,500, unless the restitution or fine is paid in full before the fifteenth day after the date of the judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6 may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).

X The court determined that the defendant does not have the ability to pay interest and it is ordered that:

X the interest requirement is waived for the X fine X restitution.

☐ the interest requirement for the ☐ fine ☐ restitution is modified as follows:

* Findings for the total amount of losses are required under Chapters 109A, 110, 110A, and 113A of Title 18 for offenses committed on or after September 13, 1994, but before April 23, 1996.

DEFENDANT: David Smith
CASE NUMBER: DNYN112CR000028-002

SCHEDULE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties are due as follows:

A X In full immediately; or

B ☐ Lump sum payment of $ ______________ due immediately, balance due

☐ not later than ______________________ , or
☐ in accordance with ☐ D, ☐ E, ☐ F, or ☐ G below; or

C ☐ Payment to begin immediately (may be combined with ☐ D, ☐ E, or ☐ G below); or

D ☐ Payment in equal ___________ (e.g., weekly, monthly, quarterly) installments of $ ____________ over a period of __________ (e.g., months or years), to commence _________ (e.g., 30 or 60 days) after the date of this judgment; or

E ☐ Payment in equal ___________ (e.g., weekly, monthly, quarterly) installments of $ ____________ over a period of __________ (e.g., months or years), to commence _________ (e.g., 30 or 60 days) after release from imprisonment to a term of supervision; or

F ☐ Payment during the term of supervised release will commence within _________ (e.g., 30 or 60 days) after release from imprisonment. The court will set the payment plan based on an assessment of the defendant's ability to pay at that time; or

G X Special instructions regarding the payment of criminal monetary penalties:

The Court orders that any cash value of the assets collected thus far by the Receiver, William J. Brown, appointed by the Court in this case may be deducted from the total restitution amount and may be distributed to the victims by the Receiver as such assets are available for distribution, and for long as the Receiver is in operation. Any remaining restitution is due immediately, with any remaining restitution payable at a minimal rate of 25% of the defendant's gross income while incarcerated and a minimal rate of $100 per month or 10% of the defendant's gross income, whichever is greater, upon his release from imprisonment. If at any time the defendant has the resources to pay full restitution, he must do so immediately. Payments may be forwarded to Lawrence K. Baerman, U.S. District Court Clerk, Federal Building, P.O. Box 7367, 100 South Clinton Street, Syracuse, New York 13261-7367

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to **Clerk, U.S. District Court, Federal Bldg., 100 S. Clinton Street, P.O. Box 7367, Syracuse, N.Y. 13261-7367**, unless otherwise directed by the court, the probation officer, or the United States attorney. If a victim cannot be located, the restitution paid to the Clerk of the Court for that victim shall be sent to the Treasury, to be retrieved if and when the victim is located.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

X Joint and Several

X Defendant and Co-Defendant Names and Case Numbers (including defendant number), Total Amount, Joint and Several Amount, and corresponding payee, if appropriate.

Timothy M. McGinn, DNYN112CR000028-001, $5,992,800 (total), $5,748,722 (joint and several as to Victims 1-841)

☐ The Court gives notice that this case involves other defendants who may be held jointly and severally liable for payment of all or part of the restitution ordered herein and may order such payment in the future.

☐ The defendant shall pay the cost of prosecution.

☐ The defendant shall pay the following court cost(s):

X The defendant shall forfeit the defendant's interest in the following property to the United States:
$6,336,440

Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal,(5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

STATE OF NEW YORK)
) ss.: **AFFIDAVIT OF**
COUNTY OF NEW YORK) **CM/ECF SERVICE**

I, Kersuze Morancy, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age.

On September 29, 2014

deponent served the within: **Brief and Special Appendix for Defendant-Appellant-Cross-Appellee David L. Smith**

upon:

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for the Northern District of New York
Brenda K. Sannes
100 South Clinton Street 900
Syracuse, NY 13261
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United States Attorney's Office
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Elizabeth C. Coombe
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via the CM/ECF Case Filing System. All counsel of record in this case are registered CM/ECF users. Filing and service were performed by direction of counsel.

Sworn to before me September 29, 2014

/s/ Mariana Braylovskaya s/Kersuze Morancy

Mariana Braylovskaya
Notary Public State of New York
No. 01BR6004935
Qualified in Richmond County
Commission Expires March 30, 2018

Job No. 255423