UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 16-CV-21301-GAYLES

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

ARIEL QUIROS, *et al*.,

Defendants, and

JAY CONSTRUCTION MANAGEMENT, INC., *et al*.,

Relief Defendants.
_____/

LEÓN COSGROVE, LLC AND MITCHELL, SILBERBERG & KNUPP'S
CONSOLIDATED REPLY IN SUPPORT OF MOTION TO MODIFY THE ASSET FREEZE

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I. INTRODUCTION[1]

The SEC, joined by the Receiver and Quiros,[2] offers an opposition that is at odds not only with the facts and the law, but also its own prior positions. The SEC's position has nothing to do with protecting investors and everything to do with punishing LC and MSK for doing their jobs – ethically, capably, and zealously. The SEC wants this Court to adopt the following contradictions and inconsistences:

- The SEC says that this Court lacks jurisdiction, because of the pending appeal of LC and MSK's motion to intervene. The law is clear: the relief sought by this Motion is not barred by the pending appeal, because it is not a motion to intervene and because it seeks modification of an injunction on different grounds and seeks different relief than any prior motion. Moreover, the SEC makes this argument, *even though the SEC has moved to dismiss the appeal for lack of jurisdiction*. The SEC apparently believes it can deprive LC and MSK of compensation without having to answer in court for doing so.
- The SEC claims for pages that the motion to modify for changed circumstances is really an improper motion for reconsideration, neglecting to mention the well-established authority expressly holding that a motion to modify an injunction based on changed circumstances is *not* a motion for reconsideration.
- The SEC also claims that this is the "*eighth*" attempt that LC and MSK have made to be paid, ignoring that, other than the ruling awarding LC and MSK $80,000, none of the prior rulings touched the merits, largely because of the SEC's procedural gamesmanship to prevent a hearing on the merits. This is, for instance, the first time the SEC has ever addressed *SEC v. Morriss*, a key case that supports LC and MSK's arguments that insurance for defense costs is not subject to an asset freeze.
- The SEC supports paying Quiros's new counsel (who has represented Quiros during his capitulation to the SEC) but has opposed paying LC and MSK. If paying defense lawyers is a bad thing that is not in the interests investors, then why are Quiros's new lawyers being paid with the SEC and Receiver's blessing?
- The SEC describes fees of $3 million as "exorbitant" for a year-long representation of a client facing more than $100 million in potential exposure in numerous lawsuits, in

[1] LC and MSK adopt the defined terms from the moving papers.

[2] The opposing parties have coordinated their respective responses and, for efficiency, this brief responds to all three briefs. Unless otherwise specified, arguments aimed at the SEC address similar arguments by the Receiver and Quiros.

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numerous jurisdictions, but has supported payments of $25 million to plaintiffs' lawyers in one set of related cases, who essentially cribbed the SEC's allegations and appended several civil claims. The plaintiffs' lawyers' fee is shockingly disproportionate to the effort expended by those lawyers and completely incongruous with the relatively low risk posed to the plaintiffs' lawyers in taking the matter; yet, the SEC and Receiver supported the inflated payment without regard to the interests of investors to whom the amount could have been paid.

- The SEC claims it is "preposterous" that LC and MSK can claim to have relied on this Court's prior rulings, apparently forgetting that LC and MSK did in fact incur $3 million of fees after this Court's prior ruling for which they have not been paid. LC and MSK would never have done that without the Court's prior statements on this matter.
- The SEC erroneously claims that LC and MSK have "misrepresented" the IFA, and asserts that LC and MSK's right to payment is debatable. This is wrong:
    - First, Ironshore did not contest payment to LC and MSK until the SEC / Receiver interceded. Before the Receiver interceded, Ironshore's counsel told LC and MSK that payment was imminent. Attached to this Reply is correspondence from Ironshore, indicating that it had reviewed LC and MSK's bills, and was in the process of approving and paying them, as well as correspondence indicating that certain costs would be paid, and relaying billing guidelines. (*See* Exhibit 1, Declaration of David Gordon ("Gordon Decl.") Exhibits A, B, and C.)
    - Second, and even more crucially, *this motion does not seek to compel any payment by Ironshore under the IFA*. Rather, LC and MSK seek an order that the asset freeze does not prevent insurance payments, including under the IFA. That is all. Even if LC and MSK prevail before this Court, Ironshore and Quiros would be free to raise objections with Ironshore citing the language of the IFA, the amount of fees charged, etc. Ironshore could simply refuse to pay LC and MSK without violating the order sought by LC and MSK through the instant motion. This Motion concerns whether, as a gating issue, the asset freeze should prevent the payment of insurance proceeds to LC and MSK for defense costs, not the manner or amount of such payment.
- Relatedly, the SEC claims circumstances have not changed, despite an influx of $150 million in settlement money from Raymond James. Elsewhere the SEC and

Receiver have proudly touted the impact of this settlement on making great steps to making investors whole. Now, the SEC seeks to contradict its own prior calculation of loss, which were themselves grossly inflated and in violation of 28 U.S.C. § 2462, as recently interpreted by the United States Supreme Court in *Kokesh v. SEC*, 137 S. Ct. 1635, 1645 (2017). The SEC has included in its disgorgement claim amounts that were allegedly misappropriated as far back as 2006, including amounts concerning the acquisition of the Jay Peak Resort that commenced the alleged Ponzi scheme. (DE 152 at 75, 81–83.) Such a position is *irreconcilable* with the Supreme Court's ruling in *Kokesh*. It is telling that the SEC provides no analysis showing that the freeze comports with *Kokesh*; it cannot do so. The SEC's claims to the contrary invite this Court to commit reversible error.

The movants ask for a prompt ruling. If the Court denies the relief requested, LC and MSK ask that the Court retain jurisdiction over an amount sufficient to pay LC and MSK, while appealing the adverse ruling to the Eleventh Circuit.

II. ARGUMENT

A. The SEC's Attempts to Avoid a Hearing on the Merits Fail

The SEC asks the Court to deny LC and MSK a hearing on the merits because, it says, (i) it duplicates prior motions; (ii) it is an improper motion for reconsideration; and (iii) it covers the same issues as those pending on appeal. These arguments are meritless.

1. The Moving Papers Seek Different Relief than Any Prior Motion or Application

LC and MSK previously sought to intervene in this action to modify or clarify the asset freeze to allow the payment of money owed under the IFA to LC and MSK as third-party beneficiaries. This Court ruled that LC and MSK had no right to intervene.[3] Regardless of the propriety of that ruling, it solely concerned an attempt to intervene in this case regarding the IFA and the facts present at that time. The current Motion is not a motion to intervene. It arises from changed circumstances – notably, a payment of $150 million by Raymond James to compensate investors and the Receiver's public admissions that at least $100 million more assets are potentially available. While, based on these changed facts, LC and MSK do seek to have the Court rule that the asset freeze does not stand in the

[3] The SEC now effectively concedes that intervention is not necessary for the relief sought by LC and MSK, offering no contrary argument or authority that LC and MSK cannot be heard as affected third parties. (DE 406 at 8.)

way of payments under the IFA, it also seeks an allowance of approximately $2 million additional money for amounts that LC and MSK are owed. No prior motion sought that relief.

2. The Court Has Jurisdiction To Hear This Case

The SEC argues that the pending appeal of an earlier attempt to modify deprives this Court of jurisdiction.[4] But, as the SEC concedes, the filing of a notice of appeal only "divests the district court of jurisdiction over the aspects of the case involved in the appeal." *U.S. v. Tovar-Rico*, 61 F.3d 1529, 1532 (11th Cir. 1995). "Of course, the district court retains jurisdiction 'to proceed forward with portions of of the case not related to the claims on appeal.'" *SEC v. Kirkland*, No. 6:06-cv-183-Orl-28KRS, 2006 U.S. Dist. LEXIS 83454, *4 (M.D. Fla. Nov. 16, 2006) (quoting *Green Leaf Nursery v. E.I. Du Pont de Nemours*, 341 F.3d 1292, 1309 (11th Cir. 2003)). Thus, "an interlocutory appeal does not completely divest the district court of jurisdiction. The district court has authority to proceed forward with portions of the case not related to the claims on appeal." *Green Leaf Nursery*, 341 F.3d at 1309.

Here, LC and MSK's motion seeks relief based on changed circumstances – namely the Raymond James settlement and the Receiver's public admissions regarding the significance of frozen assets. The appeal currently pending before the Eleventh Circuit concerns this Court's denial of LC and MSK's request to intervene regarding whether the asset freeze applied to the IFA. That was the only issue. The issue here is not an attempt to intervene, and it concerns not only insurance proceeds under the IFA but also $2 million of additional amounts that LC and MSK are owed. Thus, the issue of whether or not the asset freeze injunction continues to bar LC and MSK from being paid $3 million in legal fees is not before the Eleventh Circuit. Moreover, this Court still retains jurisdiction to modify the asset freeze: "While an appeal is pending from an interlocutory order [] that grants, dissolves, or denies an injunction, the court may suspend, modify, restore, or grant an injunction on terms for bond or other terms that secure the opposing party's rights." Fed. R. Civ. P. 62(c).

The cases cited by the SEC are inapposite. In *Showtime/The Movie Channel, Inc. v. Covered Bridge Condominium Ass'n, Inc.*, the Eleventh Circuit held that the trial court was without jurisdiction to dismiss a case after a notice of appeal had been filed. 895 F.2d 711, 713 (11th Cir. 1990). No interlocutory orders were at issue, nor is there any indication that the Eleventh Circuit considered anything but dismissal of the entire action. *See id.* Similarly, in *Shewchun v. United States*, the Court of

[4] The SEC moved to dismiss the appeal based on a misrepresentation of the record – namely by conflating the IFA (which is not a subject of the coverage action) with the insurance coverage action, and saying (falsely) that no payment could be made under the IFA until the coverage action ended. So, as the SEC would have it, the court lacks jurisdiction because of the pending appeal of a prior ruling, but the prior ruling cannot be appealed. It's a Catch-22. In both instances, the SEC is misstating the facts and law.

Appeals held that the Federal Rules of Criminal Procedure precluded a convict from simultaneously appealing his conviction and seeking to have the trial court set aside his sentence as invalid; in appealing his conviction, the convict necessarily put his sentence before the Eleventh Circuit. 797 F.2d 941,941–42 (11th Cir. 1986).

Likewise, in *United States v. Westberry*, the trial court dismissed for lack of jurisdiction a prisoner's motion to vacate an order denying his *habeus corpus* petition where the prisoner had already appealed an earlier order denying that same petition. No. 3-98-cr-24, 2010 U.S. Dist. LEXIS 81126, *2–3 (N.D. Fla. July 1, 2010). And in *FTC v. 1st Guarantee Mortgage Corp.*, the defendant's "notice of appeal of all orders up to and including appeal of final judgment … divested th[e trial] Court of its jurisdiction to rule on the subject motions seeking release of frozen assets." No. 09-61840-CIV-SEITZ, 2012 U.S. Dist. LEXIS 21084, *4–5 (S.D. Fla. Feb. 22, 2012). The defendant in *FTC* had already appealed all orders when it then sought to modify the order freezing assets. In sum, none of the cases cited by the SEC addressed a situation where a litigant was appealing one interlocutory order – here, a denial of intervention regarding the IFA – while also asking the trial court to modify another interlocutory order – here, the asset freeze injunction – based on changed circumstances.

3. <u>A Motion to Modify an Injunction is Not a "Motion for Reconsideration"</u>

The SEC calls LC and MSK's Motion a "Motion for Reconsideration." (DE 406 at 10–14.) This argument, which stretches for pages, is contrary to well-established case law. A motion to modify an injunction is procedurally distinct from a motion for reconsideration. *See Riccard v. Prudential Ins. Co.*, 307 F.3d 1277, 1298 (11th Cir. 2002) ("A district court has broad discretion to modify an existing injunctive order when factual circumstances have changed or new ones have arisen since the order was issued, as long as notice and an opportunity to be heard are provided before the modification is made." (citing *Rufo v. Inmates of the Suffolk County Jail*, 502 U.S. 367, 380 (1992))); *Polaris Pool Sys. v. Great Am. Waterfall Co.*, 2006 U.S. Dist. LEXIS 7220 at *10–11 (3d Cir. 2006) ("In light of the number of challenges that have been directed to the preliminary injunction, and the length of time that passed between its entry and the filing of the current motion, the motion cannot plausibly be viewed as a motion for reconsideration."); *Favia v. Ind. Univ. of Pa.*, 7 F.3d 332, 337–38 (3d Cir. 1993) ("Rather, it is what it is called: a motion to dissolve or modify the preliminary injunction. There are no time constraints on a court to vacate or modify a preliminary injunction."); *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1124 (9th Cir. 2005) (same).

While the SEC may wish to argue that circumstances are not sufficiently changed to warrant the relief sought by LC and MSK, it cannot argue that a $150 million payment is not a changed

circumstance *vis-à-vis* allegedly defrauded investors, such that LC and MSK should be denied a hearing in the first place. The Court should reject the SEC's illogical and legally unfounded attempt to again deny LC and MSK a hearing.

B. An Asset Freeze Should Not Stand in the Way of Insurance Payments under the IFA

1. The Motion Does Not Seek to Have Ironshore Pay Anything

LC and MSK ask that the Court look closely at what they have sought and how it differs from the SEC and Ironshore's characterization of what LC and MSK have sought. LC and MSK are *not* asking this Court to:

- Order Ironshore to pay LC and MSK anything;
- Rule on any issue of insurance coverage;
- Decide whether amounts sought by LC and MSK from Ironshore are reasonable; or
- Resolve whether Quiros has a valid objection to payments by Ironshore.

Rather, the motion seeks to have the Court order that the asset freeze does not apply to insurance proceeds or IFA payments. In other words, LC and MSK are asking this Court to affirm only that *if* Ironshore were to pay LC and MSK for their services it would not put LC and MSK in contempt of this Court's asset freeze order.

2. LC and MSK Have not Ever "Misrepresented" Their Rights Under the IFA

As it does with numbing frequency, the SEC again falsely accuses LC and MSK of unethical conduct with a lengthy argument that LC and MSK have "misrepresented" the IFA. (DE 406 at 15–19.) These accusations are utterly contemptible and wrong.

There are several things that are notable about the SEC's claims of misrepresentation. First, they are unsubstantiated. Nowhere in the SEC's brief does it quote something LC and MSK have said or omitted to say, and provide evidence that the statement was false or misleading. The SEC's claims are *assertions*, completely bereft of supporting evidence. Second, the declaration from Ironshore's lawyer is actually consistent with LC and MSK's factual representations regarding the IFA, but nearly all of those statement are irrelevant to the issues before the Court. LC and MSK have not asked this Court to determine:

- the amount Ironshore should pay;
- the amount LC and MSK are owed under the IFA;
- the reasonableness of LC and MSK's fees; or
- whether and how Quiros can object to the payment.

Because the Court is only being asked to determine the scope of its asset freeze, most of the SEC's alleged "misrepresentations" are simply irrelevant to the Court's determination. For instance, the fact that LC and MSK are third-party beneficiaries (and not parties) to the IFA[5] is not contrary to LC and MSK's representations, but it is not relevant to the narrow issue of the Motion. Similarly, the amount LC and MSK are owed under the IFA is not before the Court. LC and MSK do indeed believe they are due $1 million under the IFA, but LC and MSK are not asking (and have never asked) this Court to make any such ruling. The Court could, for instance, agree that insurance should not be subject to the asset freeze and Ironshore could still decline to pay LC and MSK *anything*. Ironshore would not violate this Court's order by so refusing. Rather, LC and MSK would have to sue Ironshore for payment.[6] The only issue here is the scope of the asset freeze. The other issues are matters of private contract, negotiation, and, if necessary, litigation.[7]

3. Insurance for Defense Costs Is Not Subject To An Asset Freeze

The SEC offers absolutely no authority for its argument that insurance proceeds should be subject to a receivership or asset freeze. The SEC instead tries to distinguish *SEC v. Morriss* No. 4:12-CV-80 (CEJ), 2012 U.S. Dist. LEXIS 64465, at **6, 16 (E.D. Mo. May 8, 2012), relied upon by LC and MSK. The SEC says that its analysis should be followed because SEC lawyer Bob Levenson worked on the case and is "very familiar with the details of that case." (DE 406 at 16.) The problem is that the actual language of the decision – a decision that Mr. Levenson resoundingly lost – simply does not support his argument here.

Without quoting or citing any part of the actual decision (and once again falsely accusing LC and MSK of wrongdoing), the SEC argues that LC and MSK "have repeatedly failed to inform the Court of one key difference between Morriss and this case that renders Morriss completely inapposite. Unlike Quiros, Morriss, the defendant seeking defense costs under the applicable insurance policy, *was not subject to the asset freeze*." (*Id*.) This distinction is illusory, unprincipled, illogical, and contrary to actual the holding of *Morriss*.

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[5] While it is not an issue before the Court, it should be noted that statements by the SEC and others that LC and MSK are not "parties" to the IFA are immaterial.

[6] While LC and MSK expect Ironshore to pay LC and MSK in full if the Court rules that the IFA is not subject to the asset freeze, if Ironshore refuses to do so, it would breach Ironshore's obligations to LC and MSK under the IFA, as explained below, and risk litigation between LC / MSK and Ironshore.

[7] In point of fact, as set forth in Exhibits A-C to the Gordon Declaration attached hereto, correspondence from Ironshore to LC and MSK show that Ironshore was, until the intervention of the Receiver, ready, willing, and able to pay LC and MSK under the IFA. The claim that LC and MSK have exaggerated their rights under the IFA is not only irrelevant, it is demonstrably false.

Morriss arose from a long-running securities fraud scheme, in which defendant Morriss allegedly misappropriated $88 million from investors, $9 million of which Morriss personally misappropriated and transferred to himself and an entity Morriss controlled. 2012 U.S. Dist. LEXIS 64465, at *2. While the SEC appears to be correct that Morriss's personal assets were not subject to the asset freeze, this neglects what is important: the actual scope of the asset freeze. The asset freeze extended to the investment entities that Morriss used to effect the fraud. Just like this case – one of the business entities subject to the asset freeze owned the insurance policy. *Id*. at *7 ("Defendant Morriss does not contest that the policy belongs to Acartha. However ownership of the policy does not dictate whether the proceeds are part of the receivership estate.") Moreover, it is simply not the case that Morriss was personally untouched by the freeze. Morriss was *personally* restrained from "transferring or receiving any assets of the investment entities and Morriss Holdings." *Id*. And, facing serious securities fraud charges, the asset freeze extended to an entity that Morriss controlled and owned, where Morriss had stashed his ill-gotten gains. *Id*.

Furthermore, in a separate section of the *Morriss* decision, the court held its asset freeze order—with language identical to this Court's Asset Freeze Order—inapplicable to advancements of defense costs by a D&O insurer. *Id.* at *6 ("The SEC's argument is directed [at] the efforts of defendants to gain access to their own assets placed under an asset freeze. Morriss is not asking the Court to release frozen assets and the SEC's argument has no application here." (emphasis added)); *id.* at *16 ("[T]he asset freeze order previously entered does not bar Federal from disbursing proceeds to pay Morriss's defense costs in accordance with the policy's terms and conditions.").

Accordingly, the relevant relationships are the same here as in *Morriss*: An entity subject to the asset freeze order owned a policy of insurance that the SEC and Receiver sought to prevent from being used for defense costs for an individual insured under the policy. *Id*.

On the same material facts as the instant case, the court rejected the SEC's argument that "the proceeds belong to the investment entities and are subject to the asset freeze." *Id*. at 10. The court's reasoning, contrary to the SEC's unsupported argument in this case, had *absolutely nothing* to do with whether Morriss was personally subject to the asset freeze (instead of the entity he owned and controlled). Rather, the court's reasoning hinged on the following:

1. That, just like this case, the SEC's potential claims against former officers would be barred by the fraud exclusion in the insurance policy. *Id*. at 11–12. (Hence, the SEC and investors would never be able to recover insurance proceeds.)

2. That, just like this case, the priority of payments provision required payment of defense costs to individuals prior to other payments. *Id*. at 12. (As a result, the receiver's claims were "subordinate to coverage for" individuals.)

In this way, the court's well-reasoned decision rejected the very argument advanced by the SEC here: namely, that a receiver's potential claims can stand in the way of payments for defense costs. *Id*. at 13. The court also rejected the argument, also made by the SEC here, that payment should not be made, because the individual defendant might be forced to repay amounts once fraud was established against him. *Id*. at 16; *c.f.* DE 406 at 17 (noting Quiros's obligations to repay if Ironshore prevails in the coverage action).[8]

The SEC's attempt to distinguish Morriss focuses on an irrelevancy. The *Morriss* court did not even mention in its analysis that Morriss's personal assets were not subject to the asset freeze, because it is utterly irrelevant. The case concerned an insurance policy owned by an entity that *was* subject to the freeze. The SEC's interpretation of *Morriss* simply cannot be squared with the language or the reasoning of the case.[9] Notably, the SEC posits absolutely no contrary authority supporting its position. It has none; its arguments should be rejected.

4. <u>The Insurance Policy Cannot Be Used to Pay Disgorgement or Penalties</u>

As a key consideration in its decision, the *Morriss* court noted that there would be no coverage for fraud or disgorgement under the policy in that case. There is similarly *no possibility* of indemnification for an SEC disgorgement claim or recovery by allegedly defrauded investors under the Ironshore Policy, which specifically excludes coverage for indemnifying any claim arising out of the insured "gaining any profit or remuneration to which they were not legally entitled" or committing fraudulent acts.[10] (Ironshore Policy § III.A, ECF No. 288-1 at Pg. 10 of 64.) Thus, if Quiros is ultimately required to pay a disgorgement award or reimburse allegedly defrauded investors, the

[8] Notwithstanding anything this Court may do, Quiros is free to object to the payment of fees to LC and MSK by Ironshore by raising the issue with Ironshore, LC, and MSK. But the fact that he might have to repay amounts paid to LC and MSK is not a reason that LC and MSK should not be paid. That was the deal Quiros struck, when he had no other way of paying for his defense because of this Court's prior rulings. The IFA was not (as Quiros's new lawyers seem to suggest) an agreement by Ironshore and Quiros to extract legal services from LC and MSK for which LC and MSK will never be paid.

[9] The SEC's attempts to distinguish the receivership cases cited in the moving papers as "not involving asset freezes" is similarly unprincipled and unsupported by any contrary authority. The point is that bankruptcy receiverships closely parallel receiverships and have been used by many cases, including *Morriss*, to determine the proper scope of an asset freeze.

[10] The Policy also expressly does not cover the payment of civil fines and penalties. This exclusion is also limited to payment of fines and penalties, and is expressly inapplicable to defense costs for claims seeking such fines and penalties.

Ironshore Policy's exclusions will necessarily bar indemnification for such an award. Consequently, preventing the advancement of defense costs will not further the goal of the asset freeze of preserving funds for disgorgement or compensation of defrauded investors.[11] Denying payment under the IFA would not increase the pool of assets for disgorgement by one cent.

5. LC and MSK are Third-Party Beneficiaries of the IFA

As noted above, this Motion does not seek or require in any way that this Court decide whether LC and MSK should be paid under the IFA or, if so, the amount LC and MSK should be paid. LC and MSK do note that the fact that the IFA is a contract between Ironshore and Quiros, does not mean the LC and MSK cannot sue on the contract. LC and MSK are entitled to payment as intended / express third-party beneficiaries. *Carvel v. Godley*, 939 So.2d 204, 207–08 (Fla. 4th DCA 2006) ("A known beneficiary is owed the same duty and is entitled to the same remedy as the party to a contract." (quoting *Moyer v. Graham*, 285 So 2d 397, 402 (Fla. 1973))); *M-I LLC v. Util. Directional Drilling, Inc.*, 872 So.2d 403, 404 (Fla. 3d DCA 2004) (third party designated to receive payment in a contract is an intended third-party beneficiary); *DeLine v. CitiCapital Commercial Corp.*, 24 A.D.3d 1309, 1311 (N.Y. 4th Dep't. 2005) (quotations omitted) ("A third party may recover as a third-party beneficiary by establishing (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for the third party's benefit and (3) that the benefit to the third party is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate the third party if the benefit is lost."); *Fourth Ocean Putnam Corp. v. Interstate Wrecking Co.*, 66 N.Y.2d 38, 44 (1985) ("Essential to status as an intended beneficiary … is either that performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary or that the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance. Among the circumstances to be considered is whether manifestation of the intention of the promisor and promisee is sufficient, in a contractual setting, to make reliance by the beneficiary both reasonable and probable.").

The SEC claims: "While Leon Cosgrove and Mitchell Silberberg & Knupp are two of four law firms authorized to receive any payments on behalf of Quiros under the Agreement, Ironshore disputes

[11] While these exclusions apply to indemnification, they do not apply to defense costs prior to the outcome of litigation because they are triggered only if there is a final adjudication that such triggering conduct occurred. *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 600 F.3d 562, 567 (5th Cir. 2010). It is well-established that "[t]he duty to defend is of greater breadth than the insurer's duty to indemnify, and the insurer must defend even if the allegations in the complaint are factually incorrect or meritless," and "[a]ny doubts regarding the duty to defend must be resolved in favor of the insured." *Jones v. Fla. Ins. Guar. Ass'n*, 908 So. 2d 435, 443 (Fla. 2005).

the law firms' claim that they are third-party beneficiaries under the Agreement with a contractual right to payment." (DE 406 at 17). The second part of that sentence is a telling concession of how weak the argument is – the SEC punts to Ironshore. It is hard to see how anyone could be a third-party beneficiary, if LC and MSK were not, under the above facts: they are named recipients of money under the IFA and they reasonably acted in reliance by performing services under the IFA for Quiros's benefit. Regardless, this is not an issue the Court needs to resolve to grant the relief requested. If the Motion is granted, Ironshore would be free to attempt to deny any payment to LC and MSK, whether legally correct or not. LC and MSK's remedy for any nonpayment would be to sue Ironshore in another forum.

C. Regarding Non-Insurance Payments, Circumstances Have Changed; The SEC's Math Doesn't Add Up

1. The SEC's Disgorgement Analysis Flouts *Kokesh*

Beyond the issue of the IFA,[12] the SEC's insistence on an essentially limitless asset freeze is contrary to the unanimous Supreme Court's ruling in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), and fails as a matter of arithmetic.

The SEC wants the Court to ignore the landmark *Kokesh* decision, but it is directly applicable here. *Kokesh* arose from a long-running scheme in which Kokesh used investment-adviser firms he owned to misappropriate money from investors. *Id*. at 1641. Kokesh did not personally pocket all of the misappropriated money, but Kokesh was ordered by the district court to pay the government as disgorgement of ill-gotten gains, the full amount of misappropriated funds of $35 million and prejudgment interest of $18 million. Most of these amounts was misappropriated more than five years before the SEC filed suit. In a lucid opinion by Justice Sotomayor, the Court confirmed that disgorgement, as applied by the courts, "operates as a penalty under § 2462" and "any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued." *Id.* at 1645.

The parallels to the instant case are so remarkable, that SEC's refusal to address the must be deliberate. Quiros and entities Quiros controlled, according to the SEC's own numbers, allegedly misappropriated $156 million. (DE 152 at 83.) To that amount, the SEC seeks additional money for prejudgment interest and other amounts totaling $191.8 million. (*Id*.; *see also* DE 496 at 13) (claiming

[12] Importantly, because insurance proceeds cannot be used for disgorgement, the scope of the asset freeze is irrelevant to payments for insurance (which is limited by the maximum amount the SEC could disgorge).

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that a number of "more than $190 million" is "still valid today").[13] The SEC arrived at $156 million as follows: "a reasonable approximation of Quiros' disgorgement at this stage of the case is the more than $50 million he personally pocketed, and an additional $106 million ($67 million from Stateside Phase VI and $39 million from Biomedical Phase VII) for which he may be jointly and severally liable with the Phase VI and VII corporate Defendants – a total of at least $156 million." (DE 152 at 83.)

There are a number of problems with the SEC's formulation in light of *Kokesh*. First, the alleged disgorgement amounts include amounts that would have been first misappropriated in December 2006, under the SEC's allegations, when Quiros first allegedly solicited money from investors that he would personally misappropriate to buy a ski resort. (DE 152 at 10– 13 (describing scheme generally); 20–26 (describing purchase of ski resort in 2008); DE 152 at 83 (summarizing disgorgement calculation).) The SEC's case is built on alleged misappropriations that largely occurred prior to 2011 – *i.e.*, more than five years prior to the filing of the SEC's complaint. This is certainly true of the $50 million estimate for Quiros, which largely stemmed from the "original sin" of purportedly buying a ski resort with investor money. The SEC's $106 million figure for joint and several liability for Phases VI and VII "commingles" (to borrow a term) shortfalls the SEC admits were caused by much earlier alleged misappropriations (the same money can only be misappropriated from investors once, after all) with those actually solely pertinent to Phases VI and VII, and it fails to account for funds that were inarguably properly spent on Phases VI and VII, building, for instance, a hotel for Phase VI and on substantial investments to legitimate, well-known vendors for the AnC Bio facility. *Kokesh* bars any claims for disgorgement beyond five years, yet – despite the SEC's sleight of hand – that is exactly what the SEC is asking this Court to do and precisely the flimsy justification for denying LC and MSK payment. There is absolutely no credible way a disgorgement amount of $191.8 million can be squared with *Kokesh*. That said, even if $191.8 million were a legally defensible potential disgorgement number, there are still sufficient funds to pay LC and MSK for the reasons set forth below.

2. The SEC Seeks Penalties (Not Equitable Relief / Disgorgement)

It should be noted that *Kokesh* raised, but did not definitively resolve, a much deeper question present in this case, regarding the legality of the SEC disgorgement remedy. In making its ruling regarding the statute of limitations, the Court ruled that the SEC's disgorgement remedy was a "penalty"

[13] Elsewhere the SEC and Receiver mention the $264 million that Phase II-VI invested in their respective projects. Of course, the gross amount of an investment would not be a proper measure of disgorgement, damages, or investor loss, since some money was properly spent and many of the projects have been built as promised. The mention of this figure is disingenuous and legally invalid.

and thus met the limitations period for "enforcement of a civil fine, *penalty*, or forfeiture" of 28 U.S.C. § 2462 (emphasis added.). The Court rejected the SEC's argument that disgorgement is not a penalty but merely an "equitable" remedy that "restores the status quo." 137 S. Ct. at 1644. The Court noted, that – as in this case – the SEC had sought disgorgement that *exceeds* the amount that a defendant personally received, by seeking disgorgement of amounts "misappropriated" by related entities. Such a remedy "leaves the defendant worse off" than the status quo ante. *Id.* Accordingly, the Court accepted the argument that an order to "disgorge" more than a defendant gained imposes a penalty.

The SEC now has a big problem. There is no statutory authorization for disgorgement that amounts to a penalty. The statutes that authorize disgorgement speak of "*equitable relief*" but *not civil penalties*. *See, e.g.*, Sarbanes Oxley Act of 2002, 15 U.S.C. § 78u(d)(5) (2016) (allowing the SEC to "seek . . . any equitable relief that may be appropriate or necessary for the benefit of investors")[14] Justice Sotomayor included a footnote that has been widely quoted and interpreted:

> Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context.

137 S. Ct. at 1642 n.3. Accordingly, the Court's reasoning has called into question the future of the disgorgement remedy, and particularly theories of disgorgement that constitute a *penalty* that Congress has not authorized. In this case, even the SEC alleges that Quiros only personally supposedly pocketed $50 million from his purported scheme (and, as noted, that number includes amounts time-barred by *Kokesh*).

3. The SEC's Math Doesn't Add Up

The SEC argues that the $150 million Raymond James settlement has no bearing on the amount of ill-gotten gains Quiros received and that it therefore does not present a "changed circumstance" warranting relief. As noted, the SEC is counting in its disgorgement amount of $191.8 million amounts that are time-barred under *Kokesh* and that, the SEC admits, vastly exceed the amount that Quiros supposedly personally received and includes amounts that *entities* purportedly "misappropriated." Such amounts are *penalties* without any statutory authorization, not proper equitable disgorgement.

But assuming *arguendo* that $191.8 million is the right number. Even then, there are sufficient funds available to cover that amount and pay LC and MSK the amounts that they are owed. The primary rationale for the SEC's disgorgement remedy has been to protect the investing public (not to

[14] There are separate statutes that concern "civil penalties," but those are not relevant to the statutory authorization of disgorgement.

create a windfall for the U.S. Treasury). And, in fact, the SEC has posed a number of cases in which the *interests of investors* have been used to limit modifications to asset freezes.[15] The funds secured from Raymond James will be used (after the investors paid inflated fees of $25 million to their lawyers) to help make investors whole. Such a large payment fundamentally changes the rationale for the asset freeze, because it significantly makes investors whole and diminishes the necessity to protect investors.

In addition to the $150 million payment, the value of assets controlled by the Receiver must be considered. The Receiver has estimated that the Resort will potentially sell for at least $100 million.[16] This number is consistent with the estimate Quiros provided during the preliminary injunction proceedings and far greater than the $41 million figure (based on cash flows from periods of lousy snowfall in Vermont) offered by the SEC. Moreover, the Receiver has already secured a $13.3 million payment from Citibank. Accordingly, even if the $191.8 million figure is correct, then there are vastly more assets available to cover that amount than necessary – approximately, $263 million.[17] Moreover, in light of this Court's allowance to pay Quiros's current lawyers and to pay plaintiffs' counsel

---

[15] But there is an important factual distinction between our situation and those in the cases the SEC cites – the cases cited by the SEC in which courts denied requests to modify asset freezes were situations where the amounts frozen were not close to the total investor losses. In *SEC v. McGinn, Smith & Co.*, the court explained: "Preservation of the status quo is imperative for many of the same reasons as have already been discussed in previous Court orders. The total amount of investor funds obtained through defendants' alleged fraud far exceeds the value of assets frozen by the SEC for the benefit of those investors in the event the SEC prevails in this action…. There still remains no likelihood that a surplus will exist from the frozen assets in the event the SEC prevails in this action. The investors, on whose behalf the assets were frozen, thus possess a heightened interest in having those assets maintained without further diminution pending the outcome of the action." No. 10-CV-457, 2014 U.S. Dist. LEXIS 21741, at *10– 11 (N.D.N.Y. Feb. 21, 2014). In *SEC v. Forte*, the court explained: "The release Defendant seeks is obviously not in the interest of those who invested in Forte, L.P. First, Defendant seeks funds for his personal use only. Moreover, it does not appear that the frozen assets will remotely cover the lost investments. In its ongoing investigation, the Government has thus far discovered: (1) approximately $3,000 in assets of the Limited Partnership; (2) approximately $100,000 in liquid assets held personally by Defendant; and (3) other personal assets, including Defendant's shore house, which, when sold may yield approximately $500,000. These amounts represent approximately one percent of the total investor loss caused by Defendant's alleged fraud. Given the paltry assets that remain to compensate Defendant's alleged victims, any release of funds seems unwarranted." 598 F. Supp. 2d 689, 692–93 (E.D. Pa. 2009).

[16] The Receiver's claim that he was talking about not only the value of the Resort but also the properties held by the limited partnerships is unsupported by any evidence and lacks credibility. The value of the resort Quiros owned and what the partnerships separately own is vastly greater than $100 million.

[17] The fact that the Receiver might be spending some of these amounts is irrelevant. (*See* DE 406 (SEC Response) at 12; DE 407 (Receiver's Opposition) at 5– 7.) The partnerships had a very high level of inherent risk (apart from the alleged fraud), and the payments of amounts necessary to operate the partnership entities are inevitable and still make investors whole, as are the inevitable gains attributable to a good snow season.

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$25 million (most of which surely could have been paid to investors instead without shortchanging the Plaintiffs' counsel), it is inconsistent to not allow payment to LC and MSK.

D. LC and MSK reasonably relied on this Court's rulings.

Relying on selective quotation of this Court's rulings, the SEC says it is "preposterous" that LC and MSK claim to have reasonably relied on this Court's rulings, and its delay in ruling in incurring attorney fees. (DE 406 at 4). At the risk of stating the obvious, LC and MSK and their lawyers did not invest almost $3 million of their time, including many late nights and time away from family, to receive a payment of $80,000. LC and MSK are very experienced in handling this sort of litigation and have never experienced a situation remotely like this.

E. Quiros Defrauded LC and MSK and has falsely and repeatedly and falsely accused counsel of divulging client confidences.

Counsel for Quiros have repeatedly – without legal authority – falsely accused LC and MSK of divulging client confidences in seeking their fees. (DE 408 at 3.) Counsel's allegations seem to stem from a stubborn misunderstanding of the law governing privilege[18] and the law as it applies after there is a dispute with a client. *See* Fla. Bar Rule 4-1(c). What the record does show is that Quiros repeatedly induced LC and MSK to perform services and not withdraw as counsel with promises that LC and MSK would be paid for their legal services. The asset freeze has, in this case, helped enable Quiros's wrongful attempt to avoid paying LC and MSK.

III. CONCLUSION

The Motion should be granted. If it is not, in whole or part, the Court should retain jurisdiction and not distribute sufficient funds to pay LC and MSK until such time as the Eleventh Circuit can rule on the matters contained herein, to avoid permanent prejudice to LC and MSK.

[18] As every bar taker knows, privilege does not extend to all communications between a client and his or her lawyer. Rather, privilege extends only to communications related to the procurement of legal advice. *Maplewood Partners, L.P. v. Indian Harbor Ins. Co.*, 295 F.R.D. 550, 582-83 (S.D. Fla. 2013) ("[T]he attorney-client privilege has long been understood to protect from compelled disclosure those confidential communications between a client to the client's attorney made *for the purpose of obtaining or rendering legal advice*." (emphasis added.)) Privilege does not extend to thank you notes from clients to lawyers, or misrepresentations by clients to induce performance from their lawyers.

Dated: September 14, 2017

Respectfully submitted,

By: *s/ Scott B. Cosgrove*

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Former Counsel for Defendant Ariel Quiros

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this on September 14, 2017, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I also certify that the foregoing documents are being served this day on all counsel of record via transmission of Notices of Electronic Filing generated by CM/ECF or in the manner stated in the service list attached.

s/ Scott B. Cosgrove
Scott B. Cosgrove

SERVICE LIST
US District Court, Southern District of Florida
Case No.: 16-cv-21301-DPG

Securities and Exchange Commission v. Ariel Quiros, et al.

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EXHIBIT 1

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 16-CV-21301-GAYLES

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

ARIEL QUIROS, *et al.*,

Defendants, and

JAY CONSTRUCTION MANAGEMENT, INC., *et al.*,

Relief Defendants.
_____/

DECLARATION OF DAVID B. GORDON IN SUPPORT OF CONSOLIDATED REPLY REGARDING MOTION TO MODIFY ASSET FREEZE

I, David B. Gordon, declare:

1. I am an attorney at law duly licensed to practice law in the State of New York and was formerly admitted *pro hac vice* before this Court. I am, through my professional corporation, a partner in the law firm of Mitchell Silberberg & Knupp LLP ("MSK"). Unless otherwise noted, I have personal knowledge of the following facts and, if called and sworn as a witness, could and would competently testify thereto.

2. To this declaration I have attached three emails threads from Ironshore to Leon Cosgrove ("LC") and/or MSK that refute the contentions that LC and MSK were working without strong assurances from Ironshore that payment would be imminent, or that LC and MSK do not have vested rights as third-party beneficiaries under the interim funding agreement ("IFA").

3. Attached as Exhibit A is a true and correct copy of an email thread from January 11-13, 2017 in which Ironshore's outside counsel, MaryJo Barry a partner at

D'Amato & Lynch LLP, confirmed Ironshore's agreement to pay substantial costs LC and MSK were incurring related to use of the Relativity document review platform. Ironshore has not paid these amounts; meaning that LC and MSK have paid out-of-pocket to upload millions of documents for Quiros's benefit without being paid by Ironshore or Quiros.

4. Attached as Exhibit B is a true and correct copy of an email from January 24, 2017, in which Ironshore transmitted its billing guidelines to LC for use by the attorneys working for Quiros.

5. Attached as Exhibit C is a true and correct copy of an email thread dated from January 26, 2017 to February 15, 2017, between Ms. Barry and me, indicating that bills for MSK and Dinse (a law firm in Vermont) were being processed. Ms. Barry wrote: "David: These invoices are being processed and I should be able to tell you next week exactly when they will be paid." The thread also informed Ironshore that MSK's invoice for December 2016 would be "about $176,000" and that a rough estimate for January 2017 time for MSK would be "$225,000."

I declare under penalty of perjury under the laws of the State of New York and Florida that the foregoing is true and correct.

Executed September 14, 2017, at New York, New York.

David B. Gordon

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EXHIBIT A

From: Jeremy Kahn <jkahn@leoncosgrove.com>
Date: January 13, 2017 at 9:01:36 AM EST
To: "Barry, MaryJo" <MJBarry@damato-lynch.com>
Cc: Derek Leon <dleon@leoncosgrove.com>
Subject: Re: IFA

Great. Thank you.

On Jan 13, 2017, at 8:59 AM, Barry, MaryJo <MJBarry@damato-lynch.com> wrote:

> I will have to you later this morning. Also, Relativity costs are approved subject to signing ifa.
>
> Sent from my iPhone
>
> On Jan 13, 2017, at 7:48 AM, Jeremy Kahn <jkahn@leoncosgrove.com> wrote:
>
> > Good morning Mary Jo,

I wanted to follow up on the IFA so we can get it finalized today. Do you have any edits to what we sent you?

Also, can you please send the billing guidelines that we and the other firms should follow?

Thank you,

Jeremy

On Jan 11, 2017, at 11:59 AM, Barry, MaryJo <MJBarry@damato-lynch.com> wrote:

> At a hearing today but will back back in office later this afternoon and hope to have a chance to discuss with my client then. We will get it done and signed up this week
> To
> Sent from my iPhone
>
> On Jan 11, 2017, at 11:53 AM, Derek Leon <dleon@leoncosgrove.com> wrote:
>
> > Good morning Mary Jo. Following up again regarding the IFA and the approval for the Relativity upload. I am told there are millions of documents that need to be uploaded and reviewed by MSK for depositions commencing in three weeks, and further delay will prejudice Mr. Quiros's defense. Please let me know when you expect to turn the doc. We really need to have this finalized soon. Thanks. Derek
> >
> > **Derek E. León**
> > León Cosgrove, LLC
> > 255 Alhambra Circle Suite 800
> > Coral Gables, FL 33134
> > D 305.740.1977 | M 305.761.5369
> > dleon@leoncosgrove.com
> >
> > <image001.png>

Disclaimer

EXHIBIT B

From: Barry, MaryJo [mailto:MJBarry@damato-lynch.com]
Sent: Tuesday, January 24, 2017 3:57 PM
To: Jeremy Kahn <jkahn@leoncosgrove.com>
Subject: Ironshore Claims Billing and Reporting Guidelines

Jeremy: I am attaching the billing guidelines from Ironshore. The Vendor used by Ironshore for billing purposes is Legal X/Bottom Line. If you could forward the proper contact person for each firm Bottom Line will contact them individually to set the firm up on the Bottom Line system.

Mary Jo Barry

EXHIBIT C

From: Barry, MaryJo [mailto:MJBarry@damato-lynch.com]
Sent: Wednesday, February 15, 2017 5:13 PM
To: Gordon, David
Subject: RE: Defense Costs

David: These invoices are being processed and I should be able to tell you next week exactly when they will be paid. Once question that came up is the Dinse invoice – it is not on any official letterhead and appears it may be a pre-bill rather than a final invoice. Could you ask that any future bills show the law firm letterhead.

From: Gordon, David [mailto:dbg@msk.com]
Sent: Thursday, January 26, 2017 4:55 PM
To: Barry, MaryJo <MJBarry@damato-lynch.com>
Cc: Paulucci, Maria <mcp@msk.com>; Ritchie Berger <rberger@DINSE.COM> (rberger@DINSE.COM) <rberger@DINSE.COM>
Subject: RE: Defense Costs

Mary Jo, attached are the invoices for December work of MSK and Dinse. Thank you for your attention to this.

msk
David B. Gordon | Partner, through his professional corporation
T: 917.546.7701 | dbg@msk.com
Mitchell Silberberg & Knupp LLP | www.msk.com
12 East 49th Street, 30th Floor, New York, NY 10017

From: Barry, MaryJo [mailto:MJBarry@damato-lynch.com]
Sent: Thursday, January 26, 2017 3:01 PM
To: Gordon, David
Subject: RE: Defense Costs

Ok thanks

From: Gordon, David [mailto:dbg@msk.com]
Sent: Thursday, January 26, 2017 2:58 PM
To: Barry, MaryJo <MJBarry@damato-lynch.com>; 'Derek Leon' <dleon@leoncosgrove.com>; 'Jeremy Kahn' <jkahn@leoncosgrove.com>
Subject: RE: Defense Costs

Mary Jo:

For December work, our firm's invoice will be about $176,000. I don't have the numbers for the other law firms yet, but my best guess is another $15,000 or so.

For January work, I'd estimate $225,000. But, as I know you understand, there is some guesswork with that number.

David

msk
David B. Gordon | Partner, through his professional corporation
T: 917.546.7701 | dbg@msk.com
Mitchell Silberberg & Knupp LLP | www.msk.com
12 East 49th Street, 30th Floor, New York, NY 10017

From: Barry, MaryJo [mailto:MJBarry@damato-lynch.com]
Sent: Thursday, January 26, 2017 12:22 PM
To: 'Derek Leon'; 'Jeremy Kahn'; Gordon, David
Subject: Defense Costs

Since we have not yet received any budgets, could you give me an approximation of the amount of fees that are going to be submitted for Jan? I need to let Ironshore know so they can budget Feb payments on their side

Mary Jo Barry
D'Amato & Lynch, LLP
Two World Financial Center
New York, NY 10281
MJBarry@Damato-Lynch.com
Direct Line: 212-909-2188
Fax Number: 212-269- 3559

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