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BY ECF AND EMAIL

The Honorable Shira A. Scheindlin
United States District Judge
Southern District of New York
500 Pearl Street
New York, NY 10007-1312

SEC v. Wyly et al., No. 1:10-CV-5760 (SAS)

Dear Judge Scheindlin:

At the conference last Thursday, the Court instructed the SEC to submit a revised proposed temporary freeze order that lists the assets to which the freeze would apply. [10/23/14 Tr. at 24-25 (rough draft)] Your Honor stated, "I think people are entitled to know what is being frozen." [*Id.* at 24] The SEC has disregarded the Court's direction. Its latest proposed asset freeze order (third iteration) identifies *no* specific assets or family members. It does not even define "family members."

As a result, the proposed order would effectively give a government agency unfettered power to freeze all assets of its choosing held by any of over 40 innocent children, spouses of children, grandchildren, and great-grandchildren of all ages. As a practical matter, all the SEC would have to do to freeze any of their assets is serve the order on the financial institution holding the asset and point to the account it wants to freeze. The financial institution would have no way of knowing on its own whether the order applies to the account designated by the SEC. For example, how could the financial institution determine if the funds in the account "were, at any time, the property of the [defendants], the IOM Trusts and Companies, loaned by the IOM Trusts and Companies, or acquired with funds received from the IOM Trusts and Companies and/or any additional entities that received funds received from the IOM Trusts and Companies"? (Proposed Order at 2) And, if so, how could the financial institution know if the funds fall within any of the order's carve-outs? (*Id.* at 3-4.)

In the face of such ambiguity, most prudent financial institutions—rather than risk being in contempt of an order of this Court—would likely defer to the SEC's assurances and freeze the account. Eventually, the family member would find out the account was frozen, perhaps when an ATM rejects a withdrawal request or a utility cuts off service after a bank refuses to honor a check. She would then have to try to find out from the financial institution or utility why the

account was frozen, consult a lawyer, try to persuade the SEC that the account should be unfrozen, and, if unsuccessful with the SEC, seek a hearing before this Court.

Due Process. The SEC's system of "guilty until proven innocent" would turn due process upside-down. The fundamental requirement of due process is the opportunity to be heard "at a meaningful time and in a meaningful manner." *Matthews v. Eldridge*, 424 U.S. 319, 333 (1976). Due process includes, at a minimum, "notice and the opportunity to respond." *O'Connor v. Pierson*, 426 F.3d 187, 198 (2d Cir. 2005). To determine whether notice and opportunity to respond are constitutionally sufficient, a court must weigh (1) the impact of the official action on private interests, (2) the risk of erroneous deprivation through the procedures used and the value of other safeguards, and (3) the government's interest. *See Matthews*. 424 U.S. at 335.

The SEC's proposed asset freeze fails this test. Non-party family members have not received adequate notice or a meaningful opportunity to respond to a potential freeze because the proposed order does not specify any particular family member or asset. *See, e.g., Spinelli v. City of New York*, 579 F.3d 160, 172 (2d Cir. 2009). A freeze would have a significant impact on the family member's property interests, *see, e.g., Town of Castle Rock, Colo. v. Gonzales*, 545 U.S. 748, 789 (2005), and the risk of erroneous deprivation is high, since the order provides no useful guidance to a financial institution as to whether it applies to any specific account. This risk could be substantially reduced by requiring the SEC to obtain the Court's permission, after notice to the account holder, *before* freezing any particular asset. Moreover, such a requirement would not meaningfully impair the SEC's interest in preventing the dissipation of collectible assets, since the SEC could obtain prompt judicial authorization to freeze an account if it can prove the account is covered by the order.

Fourth Amendment. Because of its lack of specificity, a freeze of the assets of a non-party family member under the SEC's proposed order would also constitute an unconstitutional warrantless seizure of property. A temporary asset freeze constitutes a seizure of property because it interferes with a possessory interest in the asset. *See, e.g., United States v. Jacobsen*, 466 U.S. 109, 113 (1984); *Al Haramain Islamic Found., Inc. v. U.S. Dep't of Treasury*, 585 F. Supp. 2d 1233, 1262-63 (D. Or. 2008). The proposed freeze order would not satisfy the warrant requirement, because it does not describe the property to be seized with specificity. *See, e.g., Groh v. Ramirez*, 540 U.S. 551, 557 (2004).

Nor would the requested freeze fall within any of the exceptions to the warrant requirement, including the "exigent circumstances" exception, which is limited to situations where the government must act so swiftly that there is no time for prior judicial authorization. *See, e.g., Kentucky v. King*, 131 S. Ct. 1849, 1856 (2011); *United States v. Gallo-Roman*, 816 F.2d 76, 79 (2d Cir. 1987); *United States v. Mendoza*, 2009 WL 2407836 (S.D.N.Y. August 6, 2009). Here, absent evidence of a specific imminent asset transfer, there can be no exigent circumstances. The SEC made its request to freeze the Wyly family's assets almost three weeks ago. Providing additional notice to family members before freezing a specific asset should not increase any concern about potential dissipation.

The SEC may argue that its requested freeze would pass muster because it has probable cause to believe that collectible assets have been or may be dissipated. But no amount of probable cause could cure the Fourth Amendment violation, because seizures conducted without a warrant—and that do not fall within "a few specifically established and well-delineated exceptions"—are "*per se* unreasonable under the Fourth Amendment." *Katz v. United States*, 389 U.S. 347, 357 (1967).

Rule 65(d)(2). For the reasons stated in our previous letters, the SEC's latest proposed order would also be inconsistent with Rule 65(d)(2) of the Federal Rules of Civil Procedure. Nowhere in the SEC's three letters or its oral argument before Your Honor has it even attempted to explain how its desired freeze would comply with this fundamental limitation on the equitable power of all Article III courts, as explicated by the Supreme Court and the Second Circuit. [*See* cases cited at ECF Nos. 484 and 489.]

Automatic Stay. At the conference, the SEC side-stepped Your Honor's question whether it believes any family members are holding current assets of the defendants, which are now part of Chapter 11 bankruptcy estates. [10/23/14 Tr. at 24-25 (rough draft)] The SEC may have been reluctant to weigh in on this issue because, to the extent it embraced such a view, its proposed asset freeze would be barred by *SEC v. Brennan*, 230 F.3d 65, 70 (2d Cir. 2000). In that case, the Second Circuit joined four other Circuits in holding that "*anything beyond the mere entry of a money judgment* against a debtor is prohibited by the automatic stay [in Section 362(a) of the Bankruptcy Code]." *Id.* at 71 (emphasis in original). In *Brennan*, as in this case, the SEC "assert[ed] that it is not seeking to collect the…Judgment, but only to prevent [the defendant] from concealing or dissipating [overseas] assets." *Id.* at 73. Nonetheless, the Second Circuit held that a repatriation order went beyond the mere entry of a money judgment and therefore violated the automatic stay. *See id.*

The Second Circuit's teaching in *Brennan* shows that any freeze of the defendants' current assets, whether in their own possession or the possession of others, would violate the automatic stay. Like a repatriation order, an asset freeze would not require the asset holder to relinquish possession of the asset to a creditor, but would subject the asset to the creditor's control and thus would constitute a prohibited act of debt collection. It is immaterial that no final judgment has been entered yet, a purported distinction the SEC buried in a footnote. [ECF No. 491, at 3 n.3] The SEC has openly avowed that it seeks an asset freeze "to preserve the SEC's ability to *enforce a final judgment* in this case which, as this Court's recent order states, may exceed $300 million." [ECF No. 479; emphasis added] Moreover, the Court could enter a final judgment as soon as three weeks from today, following the scheduled final remedies hearing.

Three Additional Requests

First, if the Court is ready to enter a freeze order limited to the defendants, Your Honor may wish to bifurcate it by eliminating the provisions regarding family members. The Court could then enter a freeze order immediately, while further considering the issues we have raised concerning a potential freeze directed at non-party family members.

Second, if the Court decides to enter an order regarding non-party family members over our objections, the order should prohibit the SEC from serving it on any financial institution unless and until the SEC receives permission from the Court based on a finding (on notice to the account holder) that (a) the specific account sought to be frozen represents the proceeds of ill-gotten gains and (b) the account holder does not have a legitimate claim to it. *See, e.g., SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir. 1998); *SEC v. Heden*, 51 F. Supp. 2d 296, 298-300 (S.D.N.Y. 1999).

And third, the SEC should further revise its proposed order to make clearer that assets outside its scope may be freely spent and transferred without regard to the monthly cap on necessary and reasonable living expenses (Section I(3)).

* * * * *

No government agency should be given the power to freeze unspecified assets of an innocent extended family spanning four generations. The SEC's request should be denied.

Respectfully submitted,

David L. Kornblau

cc (by email):

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