

1 BEFORE THE FINANCIAL INDUSTRY

2 REGULATORY AUTHORITY

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5 In the Matter of

6 MCGINN SMITH & COMPANY

7 20090179845

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11 VOLUME II

12 INVESTIGATIVE TESTIMONY OF

13 DAVID SMITH

14 WOODBRIDGE, NEW JERSEY

15 FEBRUARY 2, 2010

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BEFORE THE FINANCIAL INDUSTRY
REGULATORY AUTHORITY

In the Matter of
MCGINN SMITH & COMPANY
20090179845

Continued Investigative testimony of DAVID SMITH,
taken at FINRA, 581 Main Street, 7th Floor, Woodbridge, New
Jersey, on February 2, 2010, commencing at 9:30 a.m.

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APPEARANCES:

BY - CHRISTOPHER RATTINER

BY - STEVEN ROWEN

BY - MICHAEL NEWMAN

BY - GARY JAGGS

BY - MICHAEL PAULSEN

BY - REBECCA SMITH

BY - ROBERT MCCARTHY

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ALSO PRESENT:

JOSEPH CARR

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 2 and [REDACTED], purchase of a
 3 \$50,000 First Advisory Income Note on
 4 December 6th, 2005, Bates MGS 0001389 to
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 11 [REDACTED] for the purchase of a
 12 25,000 First Advisory Income Note Senior
 13 Note, November 1st, 2005, Bates MGS
 14 0002537 to MGS 0002541
 15 Exhibit 19, four-page document. First page is a 688
 16 copy of an Excel download of a Quicken
 17 register report
 18 Exhibit 20, three-page document. Excel 719
 19 spreadsheet of a Quicken download in the
 20 file MSTF, of the account titled
 21 checking
 22
 23
 24
 25

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1 DAVID SMITH
 2 MR. JAGGS: We are back on the
 3 record at approximately 9:30 on
 4 February 2nd, 2010. The only addition
 5 to the staff is Rebecca Smith, who is
 6 present today.
 7 Just for the record, my name
 8 is Gary Jaggs, and Mr. Newman would like
 9 to make some comments.
 10
 11 DAVID SMITH, Having been previously sworn, Continues to
 12 testify:
 13
 14 EXAMINATION
 15 BY MR. NEWMAN:
 16 **Q Good morning. I just want to follow**
 17 **up on a couple of things we talked about last night.**
 18 **One was the issue about when the**
 19 **promissory notes were actually signed?**
 20 MR. FRANCESKI: Okay. Whether
 21 the promissory notes were signed?
 22 BY MR. NEWMAN:
 23 **Q When -- when they were signed?**
 24 A The notes in question yesterday, we
 25 checked the records, we discovered they were signed,

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1 DAVID SMITH
 2 I believe, on November 2nd.
 3 **Q November 2nd of?**
 4 A 2009.
 5 MR. FRANCESKI: On or about?
 6 Do you know that's the date when they
 7 were signed?
 8 THE WITNESS: That is the
 9 information I received that --
 10 MR. FRANCESKI: Signed?
 11 THE WITNESS: I guess. Well,
 12 I don't -- wasn't that the information
 13 we got? Do we need to excuse ourselves?
 14 MR. CARR: We know they were
 15 prepared that day.
 16 MR. FRANCESKI: I just want to
 17 be precise here because Mike is asking
 18 signed.
 19 THE WITNESS: I don't know
 20 when they were signed. We have a record
 21 that they were prepared on November 2nd.
 22 They were forwarded to FINRA on some
 23 other date.
 24 BY MR. NEWMAN:
 25 **Q So presumably they were signed on or**

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1 **DAVID SMITH**
 2 **after November 2nd, 2009; is that correct?**
 3 A That is correct.
 4 **Q And just so the record is clear --**
 5 MR. NEWMAN: Mike, these are
 6 the exhibits from last night?
 7 MR. RATTINER: They should be
 8 in the file.
 9 MR. FRANCESKI: Just for the
 10 record, we are answering as to
 11 Exhibit 6, to be precise.
 12 MR. NEWMAN: Right.
 13 Promissory notes were Exhibit 6? I just
 14 want to make sure we're --
 15 MR. RATTINER: (Reviewing).
 16 (Whereupon Exhibit 6
 17 remarked.)
 18 MR. FRANCESKI: (Reviewing).
 19 BY MR. NEWMAN:
 20 **Q Okay. So we have remarked the**
 21 **exhibit, Exhibit 6, what we discussed yesterday,**
 22 **Mr. Smith, correct? The promissory notes?**
 23 A Yes.
 24 **Q And it's your testimony that the**
 25 **promissory notes that are marked as Exhibit 6 were**

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1 **DAVID SMITH**
2 **prepared on November 2nd, 2009?**
3 A That is the information I received.
4 **Q And signed on or after that date?**
5 A That would be a logical conclusion,
6 yes.
7 **Q Do you know why the promissory notes**
8 **are dated October 2nd, 2006?**
9 A That was the date of the execution of
10 the loan and the financial record was kept.
11 **Q So this is a backdated document?**
12 MR. FRANCESKI: I am going to
13 object to that question.
14 THE WITNESS: My counsel has
15 advised me that we are not going to
16 answer any questions regarding that
17 today, so if we want to go on to other
18 subjects, we'll do that.
19 BY MR. NEWMAN:
20 **Q Well, what does that mean?**
21 A It's what it means.
22 **Q Are you asserting the Fifth**
23 **Amendment?**
24 MR. FRANCESKI: He's not
25 asserting the Fifth but he would need

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1 **DAVID SMITH**
2 other counsel to answer those questions.
3 MR. NEWMAN: I am not
4 following that. You are representing
5 him here?
6 MR. FRANCESKI: Yeah, but I
7 can't counsel him on that. So if he's
8 to answer those questions, we need to
9 suspend for him to get other counsel to
10 have him counsel on that, which he's
11 entitled to.
12 We are going to stay and
13 answer other questions for you, but on
14 that particular issue, I can't counsel
15 him. He would be here without counsel,
16 and he deserves counsel on that.
17 MR. NEWMAN: That is a new one
18 to me. I mean, you are representing
19 him. There's two responses: Either
20 he's going to answer the question, or
21 he's going to not answer based on some
22 Fifth Amendment ground, but to say that
23 he needs another counsel.
24 MR. FRANCESKI: He needs
25 counsel to decide which option, and then

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1 **DAVID SMITH**
2 there are other options, which option to
3 take with respect to that. I can't
4 counsel him on that, so that's where we
5 are.
6 MR. NEWMAN: Okay. Well, can
7 you read back the last question I asked.
8 (Whereupon the Question is
9 Read Back.)
10 MR. NEWMAN: That is the
11 question I'm asking. I'm asking him
12 pursuant to FINRA Rule 8210, the witness
13 answer that question.
14 THE WITNESS: Under advice of
15 counsel, I am not going to answer that
16 question.
17 BY MR. NEWMAN:
18 **Q And do you understand that failure to**
19 **answer a question pursuant to FINRA Rule 8210 could**
20 **subject you to disciplinary action, including the**
21 **suspension or bar from the brokerage industry?**
22 A Yes.
23 **Q And having understood that, you still**
24 **wish to assert the right not to answer that question?**
25 A I do.

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1 **DAVID SMITH**
2 MR. FRANCESKI: For now until
3 he has counsel on that question, just to
4 be clear. Is that correct, Mr. Smith?
5 THE WITNESS: I guess that's
6 what we talked about, yes.
7 MR. NEWMAN: Well, the
8 question is being asked in this
9 testimony.
10 MR. FRANCESKI: We understand.
11 I just want to make clear, he's not
12 saying he won't answer at some point, he
13 just needs counsel on that question.
14 BY MR. NEWMAN:
15 **Q Why -- was this promissory note**
16 **provided to FINRA staff?**
17 A I have just stated for the record any
18 questions regarding these notes, on the advice of
19 counsel, I am not going to respond to.
20 **Q And, again, you understand that your**
21 **failure to answer that question could subject you to**
22 **disciplinary action under FINRA Rule 8210?**
23 A I do.
24 **Q Was FINRA staff advised that this**
25 **document had been backdated when it was provided to**

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DAVID SMITH

the staff?

MR. FRANCESKI: Objection, but you may respond as appropriate.

THE WITNESS: Again, we are -- any questions relating to this document, under advise of counsel, I am not answering.

BY MR. NEWMAN:

Q Again, you understand your failure to answer that particular question could subject you to disciplinary action under FINRA Rule 8210?

A I do.

Q Another issue we discussed last night, staff made a request for a copy of the agreement that Mr. Smith referred to in his testimony, the security agreement.

Is that going to be provided to the staff today?

A Mr. McGinn is looking for it.

MR. FRANCESKI: Haven't located it yet, but we are trying.

BY MR. NEWMAN:

Q Do you know when that document was prepared and dated?

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DAVID SMITH

A I stated yesterday that drafted it back in '04 or '05.

Q Yesterday you testified about the Pine Street Capital Partners investment made by the LLCs?

A We had some testimony on that, yes.

Q And I believe I asked you yesterday if -- what interest you had, either individually or through other entities, in that company or partnership?

A That is correct.

Q And you testified that you had an indirect interest through a management company, 20 percent you own of a management company, which owned 2 percent, I believe, of the Pine Street Partnership?

A What I said was -- I believe what I stated was I think my ownership in Pine Street Capital Management LP was approximately 20 percent. I am not totally precise on that number, but I believe it was 20 percent, and that they have a 2 percent interest in the limited partnership.

Q Now, you also testified that your wife had approximately a 10 percent interest in Pine

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DAVID SMITH

Street Capital?

A That is correct.

Q Were those the only -- besides your wife's interest and the interest you have through the management company, do you have any other interest in Pine Street Capital, either individually or through any other entity?

A Not that I am aware of, no.

Q Is there a David William Smith Irrevocable Trust that owns an interest in Pine Street Capital Partners update?

A Yes.

Q And can you explain what the interest is?

A Part of the interest that my wife had, I was aggregated. The interest hasn't changed. Some of the interest is between Lynn Smith and some is between the trust.

Q Okay. So there's a third interest?

A I think -- I believe the trust is just the Lynn Smith Trust. I don't know if it is a Lynn and David Trust.

Q According to the 2008 K-1 that was filed refers to a David and Lynn Smith Irrevocable

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DAVID SMITH

Trust dated 8-4-04.

Does that refresh your recollection?

A It may be in the irrevocable trust at the end of '08. It may be in Lynn Smith Trust at a later date. When I gave you the percentages, I was aggregating the two. The numbers haven't changed.

Q So the 10 percent includes a percentage owned by this trust?

A If it is owned in that trust, yes.

Q Well, you tell me.

A Well, I just said it's either in that trust or it's in another trust. I don't know for sure.

Q Well, how many other trusts are there?

A There's two trusts.

Q And what is the name of the other trust?

A The Lynn Trust and Smith Trust.

Q Okay. There's a David and Lynn Smith Trust, correct?

A Correct.

Q Is there another trust besides that?

A I believe there's a Lynn A. Smith

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1 DAVID SMITH
2 Trust.
3 **Q Are you familiar with a David Smith**
4 **Lifetime QTIP Trust?**
5 A Yes.
6 **Q And what is that?**
7 A No longer exists.
8 **Q As of when?**
9 A Early '09, I believe.
10 **Q Did a David Smith Lifetime QTIP Trust**
11 **own an interest at one point in Pine Street Capital**
12 **Partners?**
13 A I believe that at one time we
14 transferred some interest into that trust
15 inappropriately. My estate planning attorney brought
16 it to my attention that it was transferred and had to
17 be transferred back. So no longer -- the QTIP Trust
18 no longer exists.
19 **Q All right. But my question is did at**
20 **one point the QTIP Trust own an interest in Pine**
21 **Street Capital Partners?**
22 A Same interest that it is in the other
23 two trusts that we are talking about, nothing in
24 addition to.
25 **Q So how is it divided?**

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1 DAVID SMITH
2 **You said approximately 10 percent.**
3 **How much is comprised of the David and Lynn Smith**
4 **Trust, and how much is comprised of the Lifetime QTIP**
5 **Trust?**
6 A Assuming it's in the David and Lynn
7 Smith Trust, which I have now said three times, it
8 may or may not be.
9 **Q Well, I have a 2008 K-1 return.**
10 A It's now 2010.
11 **Q Okay. Well, I'm asking you at any**
12 **point what was the interest?**
13 A Okay. It would be the same aggregate
14 interest, approximately 10 percent.
15 **Q 10 percent. And how is the**
16 **10 percent allocated between the different trusts?**
17 A I think 75 percent of it is in the
18 name of Lynn Smith -- actually got those numbers
19 yesterday, if you give me a moment. The next time we
20 have a break, I will be able to give them precisely
21 to you.
22 **Q So you knew this information**
23 **yesterday?**
24 A No. I got it by way of e-mail last
25 night, so I have it as of yesterday, yes.

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1 DAVID SMITH
2 **Q Is there a reason why you didn't**
3 **mention the trust in your testimony yesterday?**
4 A No, there's no reason. I think of
5 Lynn Smith as Lynn Smith. Whether it's a trust or
6 Lynn Smith, I didn't draw a distinction.
7 **Q Well, it is the Lynn Smith and David**
8 **Smith Trust?**
9 MR. FRANCESKI: I am going to
10 object. We are arguing about something
11 that the witness had told you that he
12 aggregated all of that ownership. He
13 doesn't consider it to be separate.
14 MR. NEWMAN: That's fine. You
15 can note your objection. I am asking
16 why he didn't mention the trust
17 yesterday.
18 MR. FRANCESKI: He told you.
19 THE WITNESS: I just --
20 MR. FRANCESKI: He just did.
21 Now, let's not get into what we did
22 yesterday, which is badgering him over
23 an answer he's already given. I don't
24 have a problem with questions being
25 asked, but if you're insisting on asking

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1 DAVID SMITH
2 the same question more than once, when
3 he's given you the clear answer, it's
4 not appropriate.
5 MR. NEWMAN: Well, that's your
6 characterization of badgering. When a
7 witness doesn't answer a question, I'm
8 going to continue to ask it until he
9 answers it.
10 THE WITNESS: I answered the
11 question.
12 MR. NEWMAN: You can object
13 all you want. I am going to ask the
14 question I'm going to ask.
15 MR. FRANCESKI: The record
16 will show that Mr. Newman is repeatedly
17 asking the same question, which is
18 abusive to the witness. We will go from
19 there. You answer the question,
20 Mr. Smith, I will object.
21 BY MR. NEWMAN:
22 **Q The reason you didn't mention the**
23 **trust yesterday because you were aggregating the**
24 **trust with Lynn Smith's interest?**
25 A That is correct.

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1 DAVID SMITH

2 **Q It's, again, the David and Lynn Smith**
3 **Trust?**

4 MR. FRANCESKI: Objection.
5 BY MR. NEWMAN:

6 **Q What is the percentage of ownership**
7 **in the David and Lynn Smith Trust in the actual**
8 **percentage of ownership in Pine Street Capital?**

9 MR. FRANCESKI: Today?

10 MR. NEWMAN: Today.

11 THE WITNESS: One or the other
12 owns 75 percent. The other owns 25
13 percent. I don't know the distinction.
14 As indicated a few moments ago, I will
15 get that information for you at a break.

16 BY MR. NEWMAN:

17 **Q So 75 percent of the entire**
18 **partnership?**

19 A Yeah. 75 percent of my aggregated
20 interest.

21 **Q Which is 75 percent of 10 percent?**

22 A That is correct.

23 **Q Okay. I just want to make clear, we**
24 **are talking about different percentages, and**
25 **25 percent would be in the other?**

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1 DAVID SMITH

2 **your wife's name?**

3 A Yes.

4 **Q And what would they be?**

5 A We own some Deerfield Triarc, DFR.

6 It is a public company. We made an investment in
7 GSC, which was discussed yesterday. Private REIT. I
8 have had investments in Exchange Boulevard. I had a
9 nominee interest in alseT. That's all that comes to
10 mind at the moment.

11 **Q Okay. Of the DFR, what is the**
12 **interest that's owned? How much?**

13 A It's worth -- I don't know the
14 percentage interest of the company.

15 **Q What is the dollar amount?**

16 A Dollar amount is -- it's about a
17 hundred and -- it's about \$16,000. I am trying to
18 think of the first split.

19 MR. FRANCESKI: Which one are
20 we on?

21 THE WITNESS: We are on DFR.
22 I think it is about \$16,000. I think I
23 have about 4,000 shares. I think stocks
24 are around \$4.

25 BY MR. NEWMAN:

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1 DAVID SMITH

2 A 2.5 percent.

3 **Q You will get that information during**
4 **the next break?**

5 A Right.

6 **Q Is there anything else besides the**
7 **two trusts and the management company interest in**
8 **Pine Street Capital that you haven't testified to?**

9 A Not that I am aware of.

10 **Q Did do and your wife have any other**
11 **trust interest in any other entity in which the LLCs**
12 **invested in, whether individually or jointly?**

13 MR. FRANCESKI: Can I hear
14 that question again, please?

15 BY MR. NEWMAN:

16 **Q Yeah.**

17 **Do you or your wife, either**
18 **individually and jointly through a trust, have an**
19 **interest in any other entities in which the LLCs have**
20 **invested?**

21 A Just through the trust or through our
22 names individually in addition to the trust?

23 **Q We'll start with the trust first.**

24 A No.

25 **Q How about individually or through**

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1 DAVID SMITH

2 **Q When was that acquired?**

3 A It was acquired on the original
4 offering which was back in '06, I think, maybe '05.

5 **Q And that's in your name?**

6 A It's in my wife's name.

7 **Q Why is it in your wife's name?**

8 A Because the investment account has
9 been in my wife's name for 20 years.

10 **Q That's true for all your investment**
11 **accounts?**

12 A Pretty much, yes. David Smith has
13 had a small account from time to time, but I don't
14 know if it's even active anymore.

15 MR. FRANCESKI: David meaning
16 you?

17 THE WITNESS: Meaning me, yes.

18 BY MR. NEWMAN:

19 **Q Besides those four entities, are**
20 **there any other entities in which -- in which the**
21 **LLCs have invested which you or your wife have an**
22 **interest?**

23 A Those are all that I recall. If you
24 want to give me the list, Gary, I will go through it
25 and make sure I didn't make any mistakes.

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1 DAVID SMITH
 2 MR. NEWMAN: Exhibit Number 1.
 3 THE WITNESS: I think you had
 4 the list of all the investments.
 5 MR. NEWMAN: Exhibit Number 1.
 6 MR. FRANCESKI: Does somebody
 7 have my copy of 1?
 8 THE WITNESS: One jumps right
 9 out at me, CMET. My wife has an
 10 investment in CMET.
 11 BY MR. NEWMAN:
 12 **Q And what is your wife's interest in**
 13 **that entity?**
 14 A It is a private placement, no value.
 15 She owns 15,000 shares.
 16 **Q When was that acquired?**
 17 A I believe it's in '04, through M&S
 18 Partners Coventry, I think that's approximately about
 19 15 years old. M&S Partners made an investment about
 20 15 years ago, I believe, and then, of course, through
 21 CMS we have a -- but that's not me individually.
 22 I am unsure of Smash Holdings. I
 23 don't think we have an investment there, but there is
 24 a possibility. (Reviewing).
 25 **Q One more question, going back to the**
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1 DAVID SMITH
 2 **promissory note. I know you already testified you**
 3 **are not going to answer any more questions about the**
 4 **promissory note. I understand that.**
 5 **But are there any other documents or**
 6 **agreements that have been provided to FINRA staff by**
 7 **McGinn Smith in which the date on the document does**
 8 **not reflect the date on which the agreement was**
 9 **actually prepared?**
 10 A I don't know. It's my belief, in
 11 talking yesterday, that we -- there was a group of
 12 documents that were prepared, but I don't know what
 13 they are specifically, and I don't know if they were
 14 provided for FINRA. So the answer is I don't know.
 15 **Q When you say a group of documents**
 16 **that were prepared, can you be more specific?**
 17 A I can't. I don't know. I just --
 18 when we went back and looked at the request from
 19 FINRA, which I think was dated in September, there
 20 was a variety of requests put forth for notes for
 21 Lynn Smith and all sorts of other entities.
 22 And I testified yesterday it was my
 23 recollection of signing something in the last couple
 24 of months. Appears that my recollection was
 25 reasonably good. I just didn't know what the

1 DAVID SMITH
 2 document was, and so I am not prepared to say that I
 3 signed one document that day or two documents because
 4 I just don't know.
 5 **Q Is it possible you signed multiple**
 6 **documents?**
 7 A It's possible, yeah.
 8 **Q So it's also possible that there have**
 9 **been other agreements that have been provided to**
 10 **FINRA staff in which the dates on those documents**
 11 **don't reflect the date the actual document was**
 12 **signed?**
 13 A That's possible. We have been
 14 redocumenting since the time Joe Carr joined us.
 15 It's been one of his tasks, and the financial
 16 documentation is always in place, and for personal
 17 things that maybe didn't get done on a same day. We
 18 have been trying to redocument. Whether those
 19 documents were forwarded to FINRA, I don't know.
 20 **Q How would you be able to identify**
 21 **that?**
 22 MR. FRANCESKI: Identify what?
 23 BY MR. NEWMAN:
 24 **Q What documents were dated at a later**
 25 **date, backdated?**

1 DAVID SMITH
 2 MR. FRANCESKI: Objection to
 3 the form. Suggestion of backdating.
 4 BY MR. NEWMAN:
 5 **Q They were dated on a day other than**
 6 **which the agreement was actually --**
 7 A I don't know other than -- I guess
 8 the way we found out last night was there's a record
 9 within the computer, and so seems to me that would be
 10 the way we would, you know, pull the documents and
 11 see what date they were printed out of the computer.
 12 **Q And what computer are you referring**
 13 **to?**
 14 A Supposed to be multiple computers
 15 within the office.
 16 **Q McGinn Smith's office?**
 17 A In McGinn Smith's office, yes.
 18 **Q Is there one particular computer that**
 19 **you are looking at to identify that information?**
 20 A I think -- I was not, so I don't know
 21 the answer to that, no.
 22 **Q Did you know from another source what**
 23 **computer was looked at for that information?**
 24 A No.
 25 MR. NEWMAN: FINRA would

1 DAVID SMITH
 2 request that McGinn Smith provide a
 3 statement indicating what agreements
 4 have been provided to the staff or
 5 documents that have been provided to
 6 staff in which the dates on those
 7 agreements or documents do not reflect
 8 the date in which those agreements or
 9 documents were actually prepared.
 10 MR. FRANCESKI: Put that in
 11 writing, if you would, Mike.
 12 MR. NEWMAN: Well, I just want
 13 to put on the record we are making that
 14 request. We will send -- we will
 15 provide a confirmation that we would
 16 like a written response to that.
 17 MR. FRANCESKI: I understand.
 18 MR. NEWMAN: Okay.
 19 THE WITNESS: Just for my
 20 edification, you are referring to those
 21 documents that were requested in a
 22 specific document request from FINRA?
 23 BY MR. NEWMAN:
 24 **Q Any documents that have been**
 25 **provided, whether it was voluntarily or pursuant to a**
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1 DAVID SMITH
 2 **document request. Any documents or agreements that**
 3 **have been provided to the staff in which the dates on**
 4 **those documents and agreements do not reflect the**
 5 **date in which the document agreement was actually**
 6 **prepared.**
 7 A Okay.
 8 MR. FRANCESKI: Not prepared,
 9 the date -- signed, I think is what you
 10 mean?
 11 MR. NEWMAN: Signed is fine.
 12 That's fine. Yeah, that's fine.
 13 THE WITNESS: Well, they may
 14 not be fine. We had a document
 15 yesterday there was no date on it, if
 16 you remember, you know.
 17 MR. FRANCESKI: Just let the
 18 staff put their request in writing, and
 19 we will deal with it because I am not
 20 even sure that's exactly -- that could
 21 be responded to, but put it in writing,
 22 and we will deal with it from there. I
 23 have a sense of what you're after.
 24 BY MR. JAGGS:
 25 **Q How was First Independent introduced**
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1 DAVID SMITH
 2 **to McGinn Smith sales force?**
 3 A By way of conference call and
 4 one-on-one meetings with staff, but generally the
 5 first -- the first one, my recollection was, we had a
 6 meeting in our conference room. Most of our brokers
 7 at that time were situated in Albany. We still had
 8 the 45 Broadway office at that time, and we had a few
 9 outline brokers, Bill Lex being one, and a couple of
 10 others, and my recollection is we had a sales call or
 11 a conference call.
 12 **Q And who led the call?**
 13 A I did.
 14 **Q And can you please explain what was**
 15 **discussed during the call?**
 16 A We described the nature of the LLC,
 17 that it was going to be a specially financed company,
 18 that we would use a variety of financial instruments,
 19 if you will. We really weren't going to be
 20 constrained by anything. The nature of the business
 21 being that the credits often required some innovative
 22 approaches. So we could use leases, mortgages, the
 23 preferred stock, to options, whatever. We tried to
 24 pretty much not constrain ourselves if the
 25 opportunity arose.
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 2 We talked about it being in the
 3 context of one of the trades known as a CDO,
 4 collateralized debt obligation. There was going to
 5 be three tranches, senior tranche, senior subordinate
 6 tranche, junior tranche, which would really, as I
 7 mentioned yesterday, be the equivalent of an equity
 8 tranche, stressing the waterfall, if you will.
 9 The seniors were due to be paid
 10 first, both interest and principal. We talked about
 11 the seniors, in particular, the first one, First
 12 Independent Income Notes, had the seniors was a
 13 one-year rollover. It was -- rate was tied to prime.
 14 Prime plus one, I believe, was how it was structured.
 15 Subordinate -- senior subordinate note in First
 16 Independent Income Note, I believe, had a three-year
 17 maturity, had the same capability if the customers
 18 wanted to roll over, as the term we used, or extend
 19 the maturity to the five-year maturity, in which the
 20 juniors were at. They had that ability.
 21 In terms of what was going to be in
 22 the portfolio, we didn't discuss that because we
 23 didn't know. You know, we talked about the primary
 24 mission and the primary client, if you will, customer
 25 would be, for the most part, private entities that we
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2 would be lending money to, more on a mezzanine
3 approach.

4 We talked about that yesterday that
5 we had been in the same formation of talking about
6 Pine Street Capital. That whole concept of mezzanine
7 financing was something that we found was going to be
8 attractive to our clients. And so there was -- you
9 know, we explained mezzanine financing, if you will.
10 I think most of our representatives understood it but
11 we certainly talked about it.

12 **Q Okay. Was there any discussion**
13 **regarding the number of entities that First**
14 **Independent would look to invest in?**

15 A Probably. I can't recall. I mean, I
16 think, you know, we had a \$20 million offering, and
17 we talked about, you know, what we thought would
18 probably be the average credit facility being in the
19 2 to \$3 million range.

20 So, you know, I think we probably
21 talked about 10 to 15 entities would be the number,
22 obviously not holding ourselves to it, but logical we
23 had that conversation.

24 **Q Was any documentation provided**
25 **through the reps?**

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2 A Prospectus, there was no sales
3 material that I remember that accompanied that. All
4 they got was the prospectus.

5 **Q Were representatives given any**
6 **instructions regarding the type of investors that**
7 **should be solicited regarding First Independent?**

8 A Well, instructions might be a bit of
9 a harsh word, but we certainly talked about. We
10 talked about it in terms of the seniors being for
11 those clients that wanted to keep their investment
12 horizon short term, at least until they could make
13 the decision to roll over.

14 We talked about those investors
15 being, in our judgment, certainly the more
16 conservative. They were giving up yield for security
17 by being on a senior position. The junior we talked
18 about that that, again, was more of an equity
19 equivalent that yields were equivalent to equity
20 returns, 10 and a quarter.

21 And the senior subordinate was, you
22 know, was another tranche that sort of fit somewhere
23 in the middle, and for those customers that were
24 somewhat in-between those two objectives, that would
25 be appropriate.

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2 **Q Okay. What investment objectives and**
3 **risk tolerance were suitable for each class, in your**
4 **opinion?**

5 A Well, I don't think --

6 MR. FRANCESKI: Objection.
7 Asked and answered. That was covered
8 yesterday.

9 MR. NEWMAN: Not that specific
10 question wasn't covered.

11 MR. FRANCESKI: It was
12 covered. That's my objection.

13 MR. NEWMAN: We are going to
14 ask it again. I don't think it was
15 covered. Your objection is noted.

16 MR. FRANCESKI: Again, I am
17 going to object to any question that I
18 consider to be unnecessarily repetitive
19 and abusive to the witness here. That
20 was one of them.

21 MR. NEWMAN: Okay.

22 MR. FRANCESKI: You may
23 continue.

24 BY MR. JAGGS:

25 **Q Again, what investment objectives and**

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2 **risk tolerance was suitable for each class of First**
3 **Independent?**

4 A Well, for the senior class the
5 objectives were income and security and short term
6 nature of the maturity. It didn't have a long term
7 horizon. The junior class were equity. It was an
8 equity class. It was a high risk class, and the
9 subordinate class was, you know, basically people had
10 a three-year horizon. The risk was, we felt, you
11 know, quite controllable. The equity class was
12 50 percent of the structure so that the senior
13 subordinate class was, we believed, quite reasonably
14 protected.

15 **Q Were representatives instructed to**
16 **present the senior First Independent notes to clients**
17 **as part of their fixed income portfolio?**

18 A I don't recall making that specific
19 recommendation.

20 **Q In your talk to brokers when you**
21 **introduced First Independent, did you make any**
22 **reference that these notes should be solicited as**
23 **part of a client's fixed income portfolio?**

24 A I don't recall making that
25 representation. I mean, it was a fixed income

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 2 element to it, so, I mean, logic would suggest that
 3 some people would certainly look at it that way.
 4 Again, I think the junior class was clearly indicated
 5 that was an equity type return, and it was a way to
 6 get, you know, current income but certainly with a
 7 risk of an equity type.
 8 The other two was -- the other two
 9 classes were certainly more designed for those that
 10 were looking for short term and fixed income returns,
 11 but I don't specifically remember if I made that
 12 statement as you've so indicated.
 13 **Q Okay. Was this process the same when**
 14 **the other LLCs were introduced?**
 15 A Process meaning the same explanation?
 16 **Q As far as -- as far as the LLC being**
 17 **rolled out to the sales force, did you go through the**
 18 **same process, we had a meeting or a conference call?**
 19 A You know, it wasn't -- I think the
 20 first meeting with First Independent was more
 21 extensive and more in-depth. I think when we rolled
 22 out the subsequent LLCs, you know. We had sales
 23 calls, as I said, generally once a week but not
 24 always totally regular, but that certainly that would
 25 have been a topic, and it would have been presented

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 2 in the same -- same fashion. I think there was some
 3 -- there was one change, I believe, in the First
 4 Excelsior and subsequent ones that -- and the senior
 5 subordinate, they had different maturity.
 6 Now that I think about it, I think
 7 First Independent Income Notes had a five-year
 8 maturity of the senior subordinate, and then the
 9 subsequent ones we had a three-year maturity and a
 10 rollover mechanism. I would have to check my
 11 prospectus on that. It was one or the other.
 12 **Q Did you sign the Subscription**
 13 **Agreements for the LLCs?**
 14 A I believe I did, sure.
 15 **Q Did you conduct the suitability**
 16 **review for clients before you signed the Subscription**
 17 **Agreements?**
 18 MR. FRANCESKI: Objection,
 19 asked and answered yesterday.
 20 MR. NEWMAN: Go ahead and
 21 answer the question. Objection is
 22 noted.
 23 THE WITNESS: Suitability to
 24 the LLCs? I guess maybe I didn't fully
 25 understand the question.

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1 DAVID SMITH
 2 MR. NEWMAN: Well, let me ask
 3 the question differently. Did you sign
 4 the Subscription Agreements? Did you
 5 personally sign those agreements when
 6 they came in?
 7 MR. FRANCESKI: Objection.
 8 Asked and answered.
 9 THE WITNESS: You need to be
 10 more specific. Which Subscription
 11 Agreements? For the LLCs?
 12 MR. NEWMAN: Yes. When an
 13 investor made an investment, the
 14 agreements would be forwarded to McGinn
 15 Smith's offices, correct?
 16 THE WITNESS: Yes.
 17 MR. NEWMAN: Who -- and
 18 there's a principal signature on those?
 19 MR. FRANCESKI: Objection.
 20 THE WITNESS: I don't know. I
 21 don't have the document in front of me.
 22 I could have been a signatory so could
 23 have Mr. McGinn.
 24 MR. NEWMAN: You don't know if
 25 you signed the Subscription Agreements?

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 2 THE WITNESS: Are you
 3 referring to the --
 4 MR. NEWMAN: For the LLC
 5 investments?
 6 THE WITNESS: No. I don't
 7 know. I just said it could have been
 8 myself, could have been Mr. McGinn.
 9 Probably, but I don't have the document
 10 in front of me. One of us had to sign
 11 it.
 12 MR. NEWMAN: Did you ever sign
 13 a subscription agreement for an LLC
 14 investment?
 15 THE WITNESS: I probably but I
 16 don't have it in front of me so I can't
 17 --
 18 MR. NEWMAN: When you signed
 19 it, what was your signature
 20 representing?
 21 THE WITNESS: I was -- the
 22 subscription agreement, I was signing on
 23 behalf of the LLC.
 24 MR. NEWMAN: And was there any
 25 other significance to that other than

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1 DAVID SMITH
 2 the fact you were signing on behalf of
 3 the LLC?
 4 MR. FRANCESKI: Objection.
 5 THE WITNESS: The signatory of
 6 the subscription document is the one who
 7 is subscribing. The one who was
 8 subscribing was the LLC. I was the
 9 managing member of the LLC, so I signed
 10 it.
 11 MR. NEWMAN: Who reviewed the
 12 Subscription Agreements for suitability?
 13 Who within the firm reviewed those
 14 Subscription Agreements for suitability?
 15 THE WITNESS: I testified
 16 yesterday that those came -- started at
 17 the broker level, they went to the
 18 managerial level, and eventually landed
 19 on my desk.
 20 MR. NEWMAN: So who reviewed
 21 those from a supervision standpoint?
 22 Who did the supervisory review of those?
 23 THE WITNESS: There was two
 24 levels of -- or maybe three levels of
 25 supervisory. It started at the broker

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 2 level, it went to the managerial level.
 3 That is a supervisory level. When Mr.
 4 Guzzetti joined us, he may very well
 5 have supervised it. And finally, when I
 6 was compliance office up through '07, I
 7 would have signed it.
 8 MR. NEWMAN: So was it the
 9 process for the Subscription Agreements,
 10 when somebody made an investment in the
 11 LLC, there was two supervisors who
 12 reviewed it? There was a review done by
 13 a principal at the branch level, and
 14 then they were reviewed by compliance
 15 or -- explain the process to us. That's
 16 what we are trying to --
 17 MR. FRANCESKI: Objection.
 18 Asked and answered. And, Mike, you have
 19 to make a distinction between --
 20 MR. NEWMAN: It wasn't asked
 21 and answered.
 22 MR. FRANCESKI: It was asked
 23 and answered. Let me finish my comment.
 24 MR. NEWMAN: If you are going
 25 to have frivolous objections, we will be

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1 DAVID SMITH
 2 here until Friday.
 3 MR. FRANCESKI: My objections
 4 aren't frivolous, but thank you for the
 5 clarification. It doesn't matter how
 6 long we are here because it's your
 7 repetitive questions that's are making
 8 this longer than it should be.
 9 Put all that aside, my remark
 10 was, you need to make a distinction on
 11 some of these orders between the orders
 12 that go to a branch office and the
 13 orders that go through a non-branch
 14 because the process is a little
 15 different.
 16 MR. NEWMAN: Let's go through
 17 each one. We are not trying to confuse
 18 you. We are trying -- as regulators, we
 19 are trying to find out the -- you don't
 20 need to laugh --
 21 THE WITNESS: I said I was
 22 going to bring a little levity, Mike.
 23 It's been pretty serious.
 24 MR. NEWMAN: Okay. We are
 25 trying to find out the process as a

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1 DAVID SMITH
 2 regulator. We are looking at an
 3 offering, and you are a principal,
 4 president of the firm, who is involved
 5 in offerings. We just need an
 6 explanation from you, clearly as you
 7 can, to what the supervisory process was
 8 for that.
 9 MR. FRANCESKI: Objection.
 10 Asked and answered, but you may do what
 11 you like.
 12 THE WITNESS: The process,
 13 Mike, it certainly was probably not
 14 going to be consistent over three or
 15 four years with everyone. But in
 16 general, okay, the client is presented
 17 with a subscription agreement. He, in
 18 effect, goes over that subscription
 19 agreement with his broker, which is the
 20 first level. Whether that was over the
 21 telephone or whether it was present, I
 22 never asked the question, never knew.
 23 But the presumption is it was one or the
 24 other.
 25 That application was then

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 2 submitted to the branch office where
 3 they worked, okay, whether it was mailed
 4 in by the client or whether it was
 5 brought in by the broker, I would have
 6 no idea.
 7 Once that reached that level,
 8 there -- in some cases, and I don't know
 9 to what degree, it would find its way to
 10 the manager's desk. It would then find
 11 its way to Miss Sicluna, as I testified
 12 yesterday, who was the administrator of
 13 these things.
 14 She would be matching them up
 15 with the order tickets, which were
 16 submitted by the broker. The broker,
 17 upon getting an order, would submit a
 18 ticket, would generally be ahead of the
 19 subscription agreement being received
 20 because there was a process. They might
 21 be mailing out a separate subscription
 22 agreement.
 23 She would then process it.
 24 Those applications or Subscription
 25 Agreements would find their way to my

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 2 desk in Albany, New York, where I would
 3 review them and I would sign them.
 4 MR. FRANCESKI: What about Mr.
 5 Guzzetti?
 6 THE WITNESS: Mr. Guzzetti
 7 never signed them. I was the one who
 8 signed it. I was the compliance officer
 9 up through '07, so I signed them.
 10 MR. FRANCESKI: But Mr. Newman
 11 asked --
 12 THE WITNESS: Well, I said --
 13 well, the process was, as I said, that
 14 sometimes they would go into the office,
 15 and I wasn't there at the office. I
 16 know in some cases the managers reviewed
 17 them. They didn't sign them. They
 18 submitted them to Patty. Ultimately
 19 they found a way to my desk. I am the
 20 guy that ultimately signed it as the
 21 responsible party.
 22 MR. NEWMAN: Okay. But when
 23 you sign that agreement, did you conduct
 24 any supervisory review of that
 25 transaction?

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 2 THE WITNESS: I
 3 testified yesterday --
 4 MR. FRANCESKI: For McGinn
 5 Smith?
 6 MR. NEWMAN: Right.
 7 THE WITNESS: I testified
 8 yesterday that I, at that time, I
 9 reviewed the subscription agreement and
 10 the questionnaire. If there was any
 11 question, I would generally talk to the
 12 broker, but most of the time the
 13 questionnaire and the subscription
 14 agreement was what I used as my basis to
 15 approve of the orders.
 16 MR. NEWMAN: Did that review
 17 include a review for suitability in the
 18 investment?
 19 THE WITNESS: The suitability
 20 that was -- you know, these were for
 21 accredited investors. The objectives
 22 were on the subscription agreement. We
 23 had accounts. If there was any
 24 questions, I could review the New
 25 Account form or New Account application.

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1 DAVID SMITH
 2 But did I contact the client or contact
 3 the broker with regularity on that, no.
 4 MR. NEWMAN: I guess what I am
 5 trying to find out is as part of your
 6 review, did part of your supervisory
 7 review include a supervisory assessment
 8 of whether or not the investment was
 9 suitable for the specific customer who's
 10 making the investment?
 11 THE WITNESS: Yes, and I have
 12 indicated I depended on the
 13 questionnaire and the subscription
 14 document.
 15 MR. NEWMAN: Did your firm
 16 have any Written Supervisory Procedures
 17 which describe how the supervision was
 18 going to be conducted for the offerings
 19 the firm participated in?
 20 THE WITNESS: The specific
 21 offering or offerings in general?
 22 MR. NEWMAN: Well, these
 23 specific offerings.
 24 THE WITNESS: No, I don't
 25 think there was any specific language in

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1 DAVID SMITH
 2 the supervisory guide regarding these
 3 specific investments.
 4 MR. NEWMAN: Okay. Was there
 5 any supervisory guidance regard
 6 offerings in general, how they would be
 7 reviewed from a suitability standpoint?
 8 THE WITNESS: Yes, I believe
 9 there's language that suggests that the
 10 compliance officer --
 11 MR. NEWMAN: And generally
 12 what were those procedures, those
 13 written procedures? What was the
 14 supervisory system or process that was
 15 described in those procedures?
 16 THE WITNESS: Process was is
 17 that all subscriptions had to be
 18 accepted by the compliance officer. I
 19 believe my name was listed in the
 20 supervisory manual.
 21 MR. NEWMAN: Anything else
 22 besides that that you remember?
 23 THE WITNESS: Not that I can
 24 recall.
 25 MR. NEWMAN: Was there ever an
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 2 instance when you, as a supervisor
 3 reviewing a suitability agreement -- I'm
 4 sorry, subscription agreement for one of
 5 the LLC investments determined that that
 6 investment was not suitable and rejected
 7 it?
 8 THE WITNESS: I don't recall.
 9 MR. NEWMAN: You don't
 10 remember, sitting here today, any time
 11 that happened?
 12 THE WITNESS: No.
 13 BY MR. JAGGS:
 14 Q When you were reviewing individual
 15 Subscription Agreements, did you look for the
 16 client's other holdings at McGinn Smith, if they had
 17 any other holdings?
 18 A As I have testified, most of the time
 19 I relied on the subscription agreement and the
 20 questionnaire. The first line of defense, if you
 21 will, is always the broker, and we rely a great deal
 22 on that.
 23 Q Okay. But I am just trying to
 24 determine what your typical practice --
 25 A The typical practice was, when I
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 2 received that subscription document and that
 3 questionnaire, I did not pull up the client's
 4 account, if he was an account holder and see if, you
 5 know, what positions he owned and see if that was
 6 compatible or consistent with this.
 7 Q Did you check to see what their
 8 investment objectives were?
 9 A Not on a regular basis.
 10 Q All right. For accounts, for clients
 11 that did not have accounts at NFS, did you conduct
 12 any other search for information other than what was
 13 on the subscription agreement?
 14 A I believe there was a time when we
 15 developed a more extensive questionnaire for that,
 16 and I don't know what time that was but that it would
 17 have the more specific investment objective
 18 information.
 19 Q After the LLCs were issued, did any
 20 representatives request information concerning the
 21 underlying investments for any of the LLCs?
 22 A The only one that I ever recall, and
 23 it was several years later, was, in fact it might
 24 even have been after the LLCs were experiencing
 25 difficulty, Bill Lex requested it, and my
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1 DAVID SMITH
 2 recollection is, is I told him that we didn't provide
 3 that information but that I would give him a
 4 breakdown as to the categories, if you will, the --
 5 you know, whether it was manufacturing, software,
 6 real estate, finance, insurance, and I believe at
 7 least on one occasion I provided that.
 8 Q Do you recall approximately when that
 9 was?
 10 A I think it was probably after '08
 11 because I think that's when some questions started to
 12 arise. But, you know, with Bill it might have been
 13 any day.
 14 Q Did the firm ever provide
 15 representatives with updates regarding the
 16 performance of the LLCs?
 17 A Not until basically they were all
 18 performing up through '07 and at the latter part of
 19 '07, we had that discussion and indicated what our
 20 plan was in terms of trying to preserve capital, and
 21 that it was going to require a cut in the
 22 distribution.
 23 Q How are the reps informed regarding
 24 the availability of different LLCs, including the no
 25 class?
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2 A You mean other private placements?

3 Q No, just staying with the LLCs -- if

4 I am one of your brokers, and I want -- I want to
5 know how much is left in an LLC, would that be
6 something that would be communicated to me weekly?

7 A How much? You mean how much is
8 available to be sold?

9 Q Yes.

10 A Yes, that was provided, I think, on a
11 regular basis, certainly after Mr. Guzzetti arrived.
12 He put out a daily of, for lack of a better term,
13 product availability, you know, ideas, sales ideas, I
14 guess is a better way, but also in terms of what
15 would be available. So if we were in the midst of
16 selling one of the LLCs, and there was a certain
17 amount of juniors left or senior subordinates or
18 seniors, that would be listed in an e-mail to all
19 sales representatives.

20 Q And that e-mail would go out pretty
21 much daily?

22 A I believe, yes, pretty much daily,
23 yeah.

24 Q And when did Mr. Guzzetti arrive?

25 A '05.

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2 complaint, and to some extent he prevailed.

3 MR. FRANCESKI: Well, Dave,
4 that's not a conclusion. It wasn't done
5 well enough, that was the conclusion
6 that the panel concluded.

7 THE WITNESS: Yes. Okay.

8 MR. NEWMAN: As of right now.

9 MR. FRANCESKI: As of right
10 now, until we get it reversed. So be
11 careful how you characterize those
12 things.

13 THE WITNESS: Yeah. Okay.

14 BY MR. JAGGS:

15 Q How are the clients notified when the
16 LLCs matured?

17 A Well, you are talking about the
18 senior class because the LLCs -- by the time the LLCs
19 matured, we were already into a restructuring mode
20 because they were underperforming, or non-performing.

21 The senior notes, which had the
22 one-year maturity that we talked about, were notified
23 by mail. I think the first three years -- don't hold
24 me to it, first two years maybe -- with a notice that
25 it was maturing, and if they wanted to reinvest, they

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2 Q So prior to '05, how would that be
3 communicated to the reps?

4 A I -- I don't really remember. I
5 don't recall anybody -- not from my orders. Possibly
6 Miss Sicluna might have done it but I don't believe
7 it was done on a regular basis. I think there would
8 be -- you know, if there was availability, I might
9 say to Patty, you know, send out an e-mail to see
10 what is available, but I don't recall if we did that
11 on a regular basis.

12 Q Okay. Did the firm conduct a review
13 for concentration of a client's assets or net worth
14 in the LLCs?

15 A Well, obviously, not well enough in
16 some instances. I think -- I guess the flat answer
17 is no.

18 Q Did the firm have any exception
19 reports for this?

20 A No.

21 Q And you just said that in some
22 instances it wasn't done well enough. What are you
23 referring to?

24 A Well, we had an arbitration with
25 Dr. Chang, and that was the central theme of their

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2 had to submit a new application, a new subscription
3 agreement, and went through that process, which was,
4 you know, a lengthy and difficult process.

5 And so at some point, whether it was
6 two years or three years, we notified them again by
7 mail but indicated by way of a negative consent that
8 if they did not -- if they wanted to roll over, then
9 they just didn't have to respond. I don't know
10 exactly what year that was.

11 Q Were clients provided any type of
12 disclosures regarding the current financial condition
13 of LLC?

14 A Not until '08.

15 Q I'm sorry. I should have specified.

16 When a note matured at that point in
17 time, when the rollover notice would be sent out to
18 the client, were they given any financial information
19 regarding the status of the LLC?

20 A No.

21 Q What would happen if a client
22 expressed an interest in liquidating an LLC prior to
23 maturity?

24 A We would look at the circumstances.
25 Generally, the policy was that they weren't

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2 available. These were private placements. We were
3 sensitive to the fact that we didn't want to be --
4 lose our exemption. We've always had a policy with
5 our private placements that there was certain
6 circumstances, if a client had a particular need,
7 that need didn't extend to the fact that he wanted to
8 buy a new car.

9 But if he had a need, you know, a
10 medical need or a college need or something that he
11 hadn't properly planned for and it came up, we would
12 do our best to provide some liquidity and find
13 another buyer or the other LLC, in the case we are
14 talking about LLCs, would potentially redeem it.

15 MR. NEWMAN: You said you were
16 sensitive that you didn't want to lose
17 your exemption. Can you explain what
18 you mean by that?

19 THE WITNESS: Well, these were
20 done under 506 Reg Ds as a private
21 placement, so you got an exemption from
22 registering the securities, and
23 certainly part of the private placement
24 exemption is that they are not traded
25 publicly, and if there was a, you know,

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2 her spouse, has a net income of 300,000
3 for that same period of time.

4 MR. NEWMAN: How was the --
5 how did the firm monitor, if at all, the
6 offerings to determine if it had
7 satisfied that exception?

8 THE WITNESS: We kept track of
9 them as the Subscription Agreements came
10 in, we were generally not obviously
11 promoting them. There was some
12 circumstances where we would allow it,
13 particularly if it was a client of some
14 duration who knew their circumstances to
15 be acceptable, but in terms of keeping
16 track, Miss Sicluna kept track of those.

17 MR. NEWMAN: Did she keep
18 track of how many non-accredited
19 investors there were?

20 THE WITNESS: That is correct.

21 MR. NEWMAN: And were you made
22 aware of that?

23 THE WITNESS: Yes.

24 MR. NEWMAN: And do you know
25 how she kept track of that?

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2 active market, if you will, in a
3 secondary market, that would be a
4 concern by jeopardizing exemption.

5 MR. NEWMAN: Are you aware of
6 how many non-accredited investors are
7 allowed in a 506 offering?

8 THE WITNESS: I am.

9 MR. NEWMAN: What is the
10 number?

11 THE WITNESS: 35.

12 MR. NEWMAN: Do you know
13 generally what the definition is of a
14 non-accredited investor?

15 THE WITNESS: I do.

16 MR. NEWMAN: And what is that?

17 THE WITNESS: Well, let's say
18 what an accredited investor is.

19 MR. NEWMAN: That's fine.

20 THE WITNESS: Accredited
21 investor is someone who either on his
22 own has a net worth of a million
23 dollars, or has an income of \$200,000 a
24 year for the last two years, or in
25 combination with his spouse or his or

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2 THE WITNESS: She relied
3 entirely on the subscription
4 agreement -- or, excuse me, the
5 questionnaire.

6 MR. NEWMAN: Did the part of
7 your review of the agreements as they
8 came in include a review to determine if
9 the investor was accredited versus
10 non-accredited?

11 THE WITNESS: It did.

12 MR. NEWMAN: And how did you
13 do that?

14 THE WITNESS: I would review
15 the questionnaire.

16 MR. NEWMAN: Were there -- was
17 there ever an instance when you noticed
18 that an investor had been designated as
19 an accredited investor when in fact they
20 were not?

21 MR. FRANCESKI: Objection. I
22 am not sure what you mean by that, Mike.
23 You mean from the face of the document
24 that the numbers in the document didn't
25 match the representation of accredited?

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1 DAVID SMITH
 2 MR. NEWMAN: Correct.
 3 MR. FRANCESKI: Do you
 4 understand that, Dave?
 5 THE WITNESS: I guess are you
 6 suggesting that he may have checked the
 7 box that said he was not accredited when
 8 in fact the information contained
 9 therein showed that he was accredited or
 10 vice-versa?
 11 MR. NEWMAN: Either situation.
 12 THE WITNESS: I don't recall
 13 with any specificity but I am sure there
 14 were times over the years that may very
 15 well have happened. People sometimes
 16 check wrong boxes.
 17 MR. NEWMAN: Was there ever an
 18 instance for any of the four LLC
 19 offerings in which the offering had an
 20 excess of 35 non-accredited investors?
 21 THE WITNESS: I don't recall.
 22 I don't think so. Wouldn't have --
 23 unless we had an influx of them, but no,
 24 I don't believe so.
 25 MR. NEWMAN: Are you familiar

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1 DAVID SMITH
 2 with the concept of integration under
 3 Regulation D?
 4 THE WITNESS: I am?
 5 MR. NEWMAN: What is your
 6 understanding of that concept?
 7 THE WITNESS: My understanding
 8 is, is that if the offering is basically
 9 the same in structure and in the same of
 10 its investment, objective in the same
 11 content, that you could possibly be in
 12 violation of integration. Generally,
 13 it's a very difficult concept to hold
 14 to.
 15 We have been through this many
 16 times, even when we did alarm contract
 17 things, the idea that -- the nature of
 18 the asset is exactly the same, but the
 19 fact is that the contract is different.
 20 If the contract is different with the
 21 underlying homeowner, and we got under
 22 advice of counsel that that was fine.
 23 Case of the LLCs, there are obviously
 24 different loans to different parties,
 25 and even though the structure was

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1 DAVID SMITH
 2 basically identical, we were not
 3 concerned that there was an integration
 4 issue.
 5 MR. NEWMAN: So were you aware
 6 that issue --
 7 THE WITNESS: I am aware of
 8 that issue, sure.
 9 MR. NEWMAN: Let me finish my
 10 question. As these offers are being
 11 rolled out in a consecutive manner, did
 12 you have any concerns that the offerings
 13 may be deemed to be integrated for
 14 purposes of Regulation D?
 15 THE WITNESS: I did not have a
 16 concern because we talked about it with
 17 counsel, and as I just said, that the
 18 fact that there are -- the underlying
 19 assets were -- excuse me -- the vast
 20 majority with different parties,
 21 different loans, different nature of
 22 financing, whether it be mezzanine loans
 23 or preferred stock, or whatever it might
 24 be, there was substantial difference in
 25 the nature of the entities.

1 DAVID SMITH
 2 MR. NEWMAN: Did you seek a
 3 legal opinion on that issue?
 4 THE WITNESS: A written legal
 5 opinion, no.
 6 MR. NEWMAN: Did you seek an
 7 oral opinion, verbal opinion?
 8 THE WITNESS: It was discussed
 9 with my securities counsellor, yes.
 10 MR. NEWMAN: And who is your
 11 securities counsel?
 12 THE WITNESS: Gersten Savage.
 13 MR. NEWMAN: Did they give you
 14 advice or opinion on that issue?
 15 THE WITNESS: We talked about
 16 it and we were comfortable with it, yes.
 17 MR. NEWMAN: So I know you
 18 can't discuss the opinion, but I want to
 19 know if they gave you an opinion whether
 20 or not these offerings would have to be
 21 integrated for purposes of Regulation D?
 22 MR. FRANCESKI: Opinion,
 23 advice, Mike, distinction? I'm just
 24 trying to get what you want.
 25 MR. NEWMAN: I guess -- were

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1 DAVID SMITH
 2 you given advice as these would not have
 3 to be integrated for purposes of
 4 Regulation D?
 5 THE WITNESS: I don't know if
 6 it was advice. My recollection is that
 7 when we talked about it with counsel,
 8 that was the subject that came up, and
 9 obviously we were comfortable with the
 10 decision.
 11 MR. NEWMAN: So you discussed
 12 it with counsel but you didn't get
 13 advice on a specific issue?
 14 THE WITNESS: Well,
 15 discussion, advice, I mean, we are
 16 parsing words here. I mean, I don't
 17 know, you know. We didn't get a written
 18 opinion, A, we didn't want to pay for
 19 it. We didn't think it was necessary.
 20 We had a long experience in these
 21 things, and my recollection is, is I had
 22 that discussion with counsel, and for
 23 the reasons that I've just stated,
 24 everyone was comfortable that there was
 25 not an integration question.

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1 DAVID SMITH
 2 MR. NEWMAN: I want to go back
 3 to your discussions with the sales force
 4 when these LLCs were rolled out. These
 5 are investors in these LLCs are
 6 receiving notes as evidence of their
 7 investment?
 8 THE WITNESS: Promissory
 9 notes, yes.
 10 MR. NEWMAN: So it is a note
 11 investment in a Limited Liability
 12 Company?
 13 THE WITNESS: That is correct.
 14 MR. NEWMAN: How were
 15 salesmen, the sales force instructed on
 16 how they should describe this investment
 17 in terms of other investments, as a
 18 stock, as a bond? Was there any analogy
 19 that was given to them to use to
 20 describe this to any other types of
 21 investments?
 22 MR. FRANCESKI: Objection.
 23 Asked and answered. I take it that last
 24 question, Mike, that you want
 25 answered --

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1 DAVID SMITH
 2 MR. NEWMAN: Right.
 3 MR. FRANCESKI: There were,
 4 like, three questions there. Go ahead.
 5 THE WITNESS: Then we better
 6 get the last one again, then.
 7 MR. FRANCESKI: Okay.
 8 MR. NEWMAN: I am trying to
 9 find out from you, we weren't there,
 10 again, you were the person.
 11 THE WITNESS: I don't think my
 12 answer would be any different than what
 13 I said to Gary. We talked about that
 14 there was basically three tranches that
 15 really fit different investors, that the
 16 risk tranche, the lower tranche was
 17 really equivalent to an equity tranche.
 18 The senior tranche, we felt
 19 very comfortable was, it was equivalent
 20 to, you know, a good fixed -- short-term
 21 fixed income investment, and the
 22 subordinate tranche was somewhere
 23 in-between for that investor that fell
 24 in-between.
 25 MR. NEWMAN: What did you

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1 DAVID SMITH
 2 discuss specifically with the sales
 3 force about risk, how risk should be
 4 explained to the customers?
 5 THE WITNESS: Well, we talked
 6 about risk because the prospectus was
 7 replete with it. There was -- I think
 8 the thing that we emphasized the most,
 9 my recollection, was that the
 10 illiquidity, that we were going to be
 11 making loans, that these -- first of
 12 all, it was not an investment fund. It
 13 was an operating company who's borrowing
 14 money to be in the specialty finance
 15 business that would, in effect, be
 16 making loans.
 17 Loans in and of themselves are
 18 not liquid. They are generally would
 19 have a maturity date. If at the time of
 20 maturity, the borrower's in a capable
 21 position to repay the loan, it's
 22 wonderful. If he's not in a position to
 23 repay the loan, then you have to go into
 24 extensions or restructuring. All of
 25 those things impact liquidity.

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1 DAVID SMITH

2 So I would say that of the
3 risk factors that we talked about, you
4 know, that was number one. Number two,
5 was certainly the underlying credits
6 were -- you know, they weren't AAA
7 credits by any stretch of the
8 imagination. They were non-rated
9 credits. These were private companies,
10 generally smaller in nature, and that
11 therefore there was -- there was, you
12 know, a credit risk.

13 In terms of, you know, other
14 types of investments, in terms of
15 providing liquidity, the mission and
16 what was basically explained to the
17 salesmen in terms of what would happen
18 at maturity of the notes, because
19 that -- you know, that becomes a
20 critical question, is that we would
21 basically be trying to time to some
22 degree the loans that would reach with
23 maturity, but it was not going to be
24 possible to do that 100 percent. That
25 would be foolish to think one could.

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1 DAVID SMITH

2 So that there was going to be
3 a certain amount of liquidity that would
4 be provided by the maturity of loans.
5 Hopefully that that would address those
6 that were looking to redeem. We assumed
7 that there would be a number of people
8 that would, in effect, want to extend
9 their investment, that had been the
10 history of the firm.

11 People had sought our firm out
12 for these type of investments, and they
13 had become very satisfied with them and
14 they always were looking for more.

15 And finally, again, this was
16 an operating company that would be
17 looking for other forms of financing.
18 There may be -- we may have found other
19 forms of financing that were cheaper
20 than what we were presently paying, you
21 know. We had an average coupon of about
22 8 and 3/4 percent, which I thought was
23 appropriate.

24 Basically, it was a startup
25 company, or a startup venture, so but

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1 DAVID SMITH

2 the goal always was that as this company
3 matured and basically established a
4 track record, they might be able to get
5 cheaper forms of financing, if that was
6 available to us. We would be the first
7 ones to take out the 10 and a quarters
8 and replace them with something cheaper.

9 MR. NEWMAN: Did you tell the
10 sales force during these meetings that
11 the majority of the LLC proceeds were
12 being invested in illiquid, non-public
13 companies?

14 THE WITNESS: Yes.

15 MR. NEWMAN: Did you tell the
16 sales force that there would be the
17 loans made by the LLCs to McGinn Smith
18 affiliates?

19 THE WITNESS: We talked about
20 that the -- it's in the prospectus, we
21 did talk about --

22 MR. NEWMAN: What did you tell
23 them about that issue?

24 THE WITNESS: We said there
25 will be -- you know, we will be doing --

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1 DAVID SMITH

2 possibly doing bridge loans for
3 transactions that we are doing. We
4 talked about it always being done at
5 the, you know, the same rate that would
6 be gotten out in the marketplace.

7 MR. NEWMAN: Did you tell them
8 that the loans would be made to McGinn
9 Smith affiliates?

10 THE WITNESS: I believe so,
11 sure.

12 MR. NEWMAN: Anybody question
13 that, have concerns about it?

14 THE WITNESS: Not that I
15 recall, no.

16 MR. NEWMAN: Did you identify
17 for the sales force what companies that
18 the LLCs were going to be investing in?

19 THE WITNESS: No.

20 MR. NEWMAN: Did anybody ask
21 you?

22 THE WITNESS: Well, we hadn't
23 even raised the money yet, but so we
24 didn't know what we were going to invest
25 in. So if there were any questions, it

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1 DAVID SMITH
2 would have related to, again, to the
3 type of companies, but we didn't have
4 anything specifically in mind.

5 MR. NEWMAN: As things
6 progressed, once the money was raised or
7 as it was being raised, did you ever
8 receive any inquiries from McGinn Smith
9 salesmen as to what was being invested
10 in, what companies were being invested
11 in?

12 THE WITNESS: I think there
13 was, you know, one or two instances,
14 certainly, where people knew some of the
15 things that we were doing. I don't
16 recall if anyone specifically called and
17 said where are we, but, you know, again,
18 this was a small firm and people, you
19 know, have a pretty good idea what is
20 going on. I mean, there was certainly
21 people knew that we had made investments
22 in Palisades. I mean, that was a
23 presence that was known.

24 Pine Street Capital, I think
25 virtually everybody in the firm knew

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1 DAVID SMITH
2 that we were invested in Pine Street
3 Capital.

4 MR. FRANCESKI: I don't mean
5 to slow you down here, Dave, but I don't
6 think Mr. Newman was asking what they
7 knew. He asked whether they raised
8 questions.

9 THE WITNESS: Well, the
10 questions that they raised, I guess the
11 answer would be on a sporadic basis over
12 time and whether they got that
13 information by asking a specific
14 question or by assimilation of knowing
15 what we were doing, I don't recall, but
16 there were certainly some instances
17 where salespeople knew what was in the
18 -- what some of the assets were.

19 MR. NEWMAN: Again, as the
20 money was invested and time rolls on, do
21 you convey to the sales force how the
22 money has been invested?

23 THE WITNESS: No.

24 MR. NEWMAN: Why is that?

25 THE WITNESS: Two reasons:

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1 DAVID SMITH
2 One is confidentiality, number of the
3 borrowers are not interested in having
4 people know that they are borrowing
5 money. We made a number of local loans
6 to folks that, quite frankly, most
7 people don't want to have their
8 financial affairs discussed; and second
9 of all, this is a bit disparaging, I
10 guess, but, you know, brokers sometimes
11 have a very short focus as to what
12 information they assimilate and how they
13 disseminate it.

14 And, you know, there's often,
15 as information is passed from party to
16 party, it gets quite either embellished
17 or distorted. In either case something
18 not that we would look forward to so it
19 was -- you know, most money managers
20 don't -- or most asset managers don't
21 spend a lot of time discussing the
22 specifics with sales staff.

23 MR. NEWMAN: Did you ever
24 explain or provide information to the
25 LLC investors, explain to them how their

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1 DAVID SMITH
2 money had been invested?

3 THE WITNESS: If they asked,
4 sure. But with the same caveats, that
5 we did not, you know, share names for
6 the same reasons that I just discussed.

7 MR. NEWMAN: So you wouldn't
8 tell them specifically what entities or
9 companies the money had been invested
10 with?

11 THE WITNESS: Quite frankly, I
12 don't recall getting asked a whole lot,
13 maybe once or twice.

14 MR. NEWMAN: When you were,
15 would you provide that information?

16 THE WITNESS: I don't believe
17 so. I mean, I guess maybe if it was a
18 party that I knew extremely well or had
19 confidence in their ability to accept
20 that information, but for the most part,
21 no.

22 MR. NEWMAN: So who at McGinn
23 Smith knew how the money was invested
24 besides yourself?

25 THE WITNESS: Mr. McGinn, Mr.

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1 DAVID SMITH
 2 Livingston, certainly Mr. Rees saw the
 3 financials.
 4 MR. NEWMAN: Anybody else?
 5 THE WITNESS: I mean, I think
 6 as time went on, you know, some of the
 7 key brokers probably had not an entire
 8 knowledge of the portfolio but knew of,
 9 again, some of the investments.
 10 MR. NEWMAN: Who would be the
 11 key brokers who knew that?
 12 THE WITNESS: Well, I would
 13 put Phil Rabinovich in that class. I
 14 would put Brian Mayer, Ryan Rogers,
 15 Frank Chiappone is probably where I
 16 would draw the line.
 17 MR. NEWMAN: How about Bill
 18 Lex?
 19 THE WITNESS: Bill Lex, I
 20 don't think other than a cursory
 21 oversight of some of the things would
 22 have had that much knowledge.
 23 MR. NEWMAN: Did Bill Lex ever
 24 ask you how the money had been invested?
 25 THE WITNESS: I believe Bill

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1 DAVID SMITH
 2 Lex asked me, and when I responded to
 3 Gary, that's who I was thinking of. I
 4 remember drawing up an allocation of by
 5 asset class or by, you know, what it
 6 was, as I said, manufacturing, software.
 7 I remember providing that to Bill.
 8 MR. FRANCESKI: We should get
 9 when, Mike, on that.
 10 MR. NEWMAN: Pardon?
 11 MR. FRANCESKI: We should
 12 define when Bill asked, to make sure the
 13 record is clear.
 14 MR. NEWMAN: That's fine.
 15 When did he ask?
 16 THE WITNESS: I am not sure,
 17 but it was, I believe, after the --
 18 somewhere after the restructuring,
 19 somewhere in '08.
 20 MR. NEWMAN: Prior to that had
 21 he asked you how the money was going to
 22 be invested?
 23 THE WITNESS: I don't recall.
 24 MR. NEWMAN: How much did Bill
 25 Lex invest in the LLCs, approximately,

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1 DAVID SMITH
 2 personally?
 3 THE WITNESS: Personally?
 4 MR. NEWMAN: Hm-hm.
 5 THE WITNESS: I believe Bill
 6 had investments of 4 to \$500,000 range.
 7 MR. NEWMAN: Did you ever tell
 8 any of the sales force that the
 9 investments were going to be made by the
 10 LLCs would be made in separate entities,
 11 that they would not be overlapping
 12 investments?
 13 THE WITNESS: Well, I mean,
 14 the design of the LLCs were to look at
 15 new opportunities. So yes, I mean, that
 16 was discussed. The contrary was is, was
 17 there going to be at some times funds
 18 would have investments in similar or the
 19 same companies, that was -- that was
 20 known. I don't know if I specifically
 21 mentioned it, but, you know, depending
 22 on the size and the spread of the risk
 23 after we had all four LLCs operating,
 24 that certainly was the case in some
 25 instances.

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1 DAVID SMITH
 2 MR. NEWMAN: There were
 3 overlapping investments with all the
 4 LLCs, correct?
 5 THE WITNESS: By overlapping,
 6 where the LLCs made the same investment
 7 at times, yes.
 8 MR. NEWMAN: My question to
 9 you is a specific question. Did you
 10 ever tell any -- Mr. Lex or any member
 11 of the sales force that the LLCs would
 12 be investing in separate entities and
 13 companies, that they would not be
 14 overlapping investments?
 15 THE WITNESS: Well, I don't
 16 believe I would say that, no. I mean, I
 17 don't -- you know, I don't recall. The
 18 only time it would have been asked is
 19 later when there was a couple of
 20 prominent size investments and people
 21 knew there was in, but I don't
 22 specifically -- certainly don't --
 23 certainly wouldn't have -- if the
 24 implication is that mislead somebody by
 25 saying that, the answer is absolutely

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1 DAVID SMITH
2 no.
3 MR. NEWMAN: Well, there's no
4 implication. The question is a specific
5 question. Did you say that to Mr. Lex
6 or anybody else?
7 THE WITNESS: I don't believe
8 so. I have no recollection.
9 MR. NEWMAN: You have been the
10 compliance officer for McGinn Smith for
11 how many years?
12 THE WITNESS: Well, I was
13 really the compliance officer from the
14 date of formation, which was basically
15 1981, January of '81 is when we opened
16 the doors, and held that title until, I
17 think, September 2007 when Stephen
18 Smith, who had been working in that
19 department, eventually got his
20 principal's license and assumed that
21 role officially.
22 MR. NEWMAN: You are familiar
23 with the New Account form for McGinn
24 Smith?
25 THE WITNESS: I am.

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1 DAVID SMITH
2 MR. NEWMAN: And the New
3 Account form specifies investment
4 objectives?
5 THE WITNESS: Correct.
6 MR. NEWMAN: What are the
7 investment objectives that are specified
8 on the New Account form?
9 THE WITNESS: Generally
10 specify whether it's growth or income,
11 trading for profits. I don't know, you
12 know. I mean, those were the
13 categories. Whether that is the
14 specific language or not, I don't know.
15 MR. NEWMAN: Is speculation
16 also?
17 THE WITNESS: Speculation.
18 MR. NEWMAN: That's a separate
19 objective?
20 THE WITNESS: I believe so,
21 yes.
22 MR. NEWMAN: Are there risk
23 tolerance categories on the New Account
24 form?
25 THE WITNESS: There are, I

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1 DAVID SMITH
2 believe so.
3 MR. NEWMAN: What would those
4 be?
5 THE WITNESS: You know, high
6 risk -- or generally, I think, my
7 recollections is they are categorized
8 more risk in terms of income or
9 speculation, that sort of thing.
10 MR. NEWMAN: Is there a low,
11 moderate, high risk designation?
12 THE WITNESS: Yes.
13 MR. FRANCESKI: Mike, can I
14 ask a clarifying question here? Do you
15 mind?
16 MR. NEWMAN: Go ahead.
17 MR. FRANCESKI: Dave, when you
18 are answering Mr. Newman's questions on
19 the New Account form, he characterized
20 it as a McGinn Smith New Account form.
21 Do you have in mind New Account form
22 that the clearing firm provides or this
23 other form you discussed from time to
24 time that McGinn Smith created? I just
25 want to make sure you're clear on that.

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1 DAVID SMITH
2 THE WITNESS: That is a good
3 point. I was thinking in terms of the
4 form provided by the clearing firm.
5 MR. NEWMAN: Right. That's
6 what I'm asking you about.
7 THE WITNESS: But --
8 MR. FRANCESKI: That's all.
9 THE WITNESS: -- there was a
10 time we had our own.
11 MR. FRANCESKI: That's all,
12 David. I want to make sure you two are
13 on the same wavelength.
14 MR. NEWMAN: Looking at these
15 three classes of notes, senior notes,
16 senior subordinate, and junior notes,
17 what would be the -- looking first at
18 the senior notes, looking at the
19 different objectives, can you tell us
20 what each one, where each one would fall
21 within the continuum?
22 THE WITNESS: Yeah. I mean, I
23 think the objectives for all three
24 classes would be income because it was
25 paying current income, and that's

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1 DAVID SMITH
 2 generally what people wanted when they
 3 invested in these things. From the risk
 4 level, as I have indicated, I would
 5 classify the seniors as low risk, the
 6 senior subordinates is moderate risk,
 7 and, you know, the equity tranche, if
 8 you will, would certainly be considered
 9 with more risk.
 10 MR. NEWMAN: So --
 11 THE WITNESS: But let me --
 12 MR. NEWMAN: Go ahead.
 13 THE WITNESS: The fact is, is
 14 that I think it is fair that you have to
 15 fit that within one's entire portfolio,
 16 similar to the question Gary was asking
 17 earlier, I mean, you know, if a guy's
 18 got a million dollars of treasury bills
 19 and he invests \$10,000 in this, and he
 20 buys the junior tranche, I don't think
 21 he suddenly become a speculative
 22 investor. I mean, you know, sort of on
 23 a pro rata basis of what his entire
 24 portfolio looks like.
 25 MR. FRANCESKI: Well, I don't

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1 DAVID SMITH
 2 think Mr. Newman was asking you about
 3 the investor side. He was asking about
 4 the investment and how you characterize
 5 the risk of the investment.
 6 THE WITNESS: Actually, I
 7 thought you were asking about the
 8 investor on the application.
 9 MR. NEWMAN: Well, I am
 10 saying --
 11 THE WITNESS: How that fit
 12 with the three different tranches?
 13 MR. NEWMAN: Right. Right.
 14 You are saying, though, that in some
 15 circumstances that the risk of the
 16 investment will be predicated on what
 17 the holdings are, all the holdings?
 18 THE WITNESS: Predicated on,
 19 you know, obviously, some objectives but
 20 certainly financial status and which
 21 could obviously have a broad range of
 22 viewpoints, both from the perspective of
 23 the investor and the perspective of the
 24 broker.
 25 MR. NEWMAN: All right. Why

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1 DAVID SMITH
 2 don't we take a 10-minute break.
 3 (Whereupon a Recess is Taken.)
 4 MR. JAGGS: We are back on the
 5 record at this time.
 6 The staff would like to
 7 introduce Exhibit Number 7. It's an
 8 e-mail from Jennifer Spinner to Patricia
 9 Sicluna dated March 20th, 2006, and it
 10 concerns accredited -- a list of
 11 accredited/non-accredited investors for
 12 the four LLCs, and it's a total of 11
 13 pages.
 14 (Whereupon Exhibit 7 is
 15 Marked.)
 16 BY MR. JAGGS:
 17 **Q First of all, Mr. Smith, do you**
 18 **recognize this e-mail?**
 19 A I don't.
 20 **Q If you could turn to Page 2.**
 21 **Do you recognize the schedule on**
 22 **Pages 2 through 11?**
 23 A I don't believe I have ever seen
 24 this.
 25 MR. NEWMAN: The question is,

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1 DAVID SMITH
 2 you might not have seen this particular
 3 e-mail, have you ever received anything
 4 in this type of format from Sicluna?
 5 THE WITNESS: I don't believe
 6 I have seen this format, no. I am
 7 looking at the categories of false/true.
 8 I don't even know what they are
 9 referring to, so, no, I haven't seen
 10 this.
 11 BY MR. JAGGS:
 12 **Q Did Patricia Sicluna ever tell you**
 13 **the LLCs had gone over 35 non-accredited investors?**
 14 A Could very well have, sure. She kept
 15 track of them and tried to -- if that was the case,
 16 we tried to see if there was -- a number of times the
 17 subscription documents and the questionnaires, as
 18 earlier alluded to, would sometimes not be
 19 consistent. Or if there was an investor that wasn't
 20 suitable, we would see that it was filled out, but,
 21 yes, kept track of it.
 22 **Q Did you ever -- did Patricia ever**
 23 **tell you that you've gone over 35 by a significant**
 24 **amount?**
 25 A Could be. I don't remember

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1 DAVID SMITH
2 specifically, but could be, sure.
3 **Q Okay. Do you recall -- do you have**
4 **any approximate time frame for when Patricia might**
5 **have come to you and said that we have more than 35**
6 **non-accredited investors for an LLC?**
7 A No.
8 **Q Do you ever recall Patricia telling**
9 **you that there were as many as 40 to 45**
10 **non-accredited investors for an LLC?**
11 A As opposed to 35?
12 **Q Yes.**
13 A No, but could be.
14 **Q What action, if any, would you take**
15 **as a result of that?**
16 A Review the questionnaires, see if
17 that's in fact the case.
18 **Q So if you did have more than 35**
19 **non-accredited investors for a particular LLC, did**
20 **you take any action?**
21 A It would -- the action we would take,
22 is we would review it, and if that was the case, they
23 were truly an accredited investor, we would make note
24 that they were. I mean, oftentimes people did not
25 count their other assets, if you will, their homes,

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1 DAVID SMITH
2 their pension plans, they just -- they think -- they
3 don't think of themselves as wealthy. They don't
4 think of themselves as a million dollars, and they've
5 got a pension account worth a half a million dollars.
6 They have got -- they think of their, what do I have
7 in my investment account, and so if that's the case,
8 we would review that and see if in fact they did
9 qualify.
10 **Q But if they didn't qualify and they**
11 **were still non-accredited and was still over the 35,**
12 **would you try and refund the customer's investment to**
13 **stay at 35 or below non-accredited investors?**
14 A There was always the intent to stay
15 35 or below. I don't recall if we made any specific
16 refunds, or what have you. My recollection is we
17 were quite strict on that.
18 **Q Okay.**
19 MR. NEWMAN: I don't
20 understand, was there ever a time when
21 you as the chief compliance officer at
22 McGinn Smith determined, based on the
23 information that you were either
24 provided or your own independent
25 research, that any of the four offerings

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1 DAVID SMITH
2 had exceeded 35 non-accredited
3 investors?
4 THE WITNESS: I didn't really
5 get involved too much with that, Mike.
6 I was -- I review the specific
7 subscription. I know Patty kept track
8 of them. Certainly, we were sensitive
9 to it, and may very well have asked to
10 go back, but I don't believe I would
11 have gotten specifically involved. It
12 generally would have been a broker
13 question. They are the ones that knows
14 the information on the client.
15 MR. FRANCESKI: That's not
16 what he's asking, I don't think,
17 Mr. Smith. He's asking whether you were
18 ever aware factually that you had more
19 than 35 non-accredited investors?
20 THE WITNESS: Yes. I think I
21 responded to Gary yes.
22 MR. FRANCESKI: Not that they
23 were classified as non-accredited but
24 that you had 35.
25 THE WITNESS: Yes, we were

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1 DAVID SMITH
2 aware of the list and there were times
3 it was over that. I mean, as I said, we
4 dealt with it.
5 MR. FRANCESKI: Okay.
6 MR. NEWMAN: How did you deal
7 with it?
8 THE WITNESS: Dealt with it
9 was to go back and review the
10 subscription documents. As I said,
11 there was many times where people
12 erroneously marked those questionnaires.
13 MR. FRANCESKI: Time out. If
14 it's marked erroneously, you are not
15 over. That's not a non-accredited
16 investor. What Mike is asking is
17 whether after you do that process, did
18 you ever conclude, now you had 35 that
19 were really non-accredited?
20 THE WITNESS: Okay.
21 MR. FRANCESKI: Is that fair,
22 Mike?
23 MR. NEWMAN: That's fair.
24 THE WITNESS: No.
25 MR. NEWMAN: And whose

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1 DAVID SMITH
 2 responsibility was it within McGinn
 3 Smith, supervisory responsibility to
 4 review the offering documents to ensure
 5 that the firm didn't exceed 35
 6 non-accredited investors?
 7 THE WITNESS: Well, that
 8 information was brought to my attention.
 9 So I guess I was -- from the
 10 supervisory -- first of all, the
 11 supervisory started with the broker. I
 12 mean, he's supposed to know and he's
 13 supposed to make sure -- he reviews the
 14 questionnaire, and he's supposed to know
 15 that it accurately presents his client,
 16 and as I said, when I reviewed it, and
 17 if the number came to me, then we would
 18 go back and see if in fact there was
 19 instances where it was not correctly
 20 identified as accredited versus
 21 non-accredited.
 22 MR. NEWMAN: And the situation
 23 where that occurred, were there
 24 situations where after your own personal
 25 review, after the fact, led you to

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1 DAVID SMITH
 2 believe that the form had not been
 3 completed completely by the customer in
 4 terms of indicating that they were a
 5 non-accredited investor when in fact
 6 they were accredited investor?
 7 THE WITNESS: Yes.
 8 MR. NEWMAN: How would you
 9 handle the documentation in that
 10 situation?
 11 THE WITNESS: Well, I could
 12 remember one specific one we had a
 13 customer that was an investor in
 14 multiple deals. And we went back and
 15 reviewed all his questionnaires, and on
 16 some he marked that he was accredited,
 17 and some he marked he wasn't accredited,
 18 and we knew he was accredited. So
 19 that's what I am telling you that
 20 sometimes people don't -- they fill
 21 these out quickly, they don't think
 22 about all their assets.
 23 In that case we would adjust
 24 the fact that he's an accredited and we
 25 would remove him from the unaccredited

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1 DAVID SMITH
 2 list.
 3 MR. NEWMAN: And how would the
 4 documentation be handled? The
 5 subscription agreement, how would that
 6 be handled?
 7 THE WITNESS: I don't think --
 8 we wouldn't alter the subscription or
 9 the questionnaire because the customer
 10 put the information on it and signed it,
 11 and so we wouldn't go back and change
 12 it. On our list, we would qualify him
 13 as an accredited investor because we
 14 knew he was an accredited investor.
 15 MR. NEWMAN: So in that
 16 situation the documentation would not
 17 match what you have on your list as far
 18 as the designation for that particular
 19 customer?
 20 THE WITNESS: That is correct.
 21 MR. NEWMAN: How often did
 22 that occur where there was a disconnect
 23 between what was on the form, the
 24 questionnaire form, and what was on the
 25 firm's internal list in terms of the

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1 DAVID SMITH
 2 accreditation status of the customer?
 3 THE WITNESS: Not a lot but
 4 enough, you know, enough.
 5 MR. NEWMAN: Can you give me
 6 some approximate? More than 10, 25
 7 times, 50 times?
 8 THE WITNESS: Well, certainly
 9 more than 10. You know, we are talking
 10 hundreds and hundreds of investors over
 11 lots of years. So yes, certainly more
 12 than 10, certainly more than 25.
 13 MR. FRANCESKI: You are not
 14 limiting this to the LLC investors, I
 15 take it?
 16 THE WITNESS: No, investors.
 17 MR. NEWMAN: I am talking
 18 about the LLCs. So that's what we have
 19 been talking about for the last day and
 20 a half here.
 21 MR. FRANCESKI: Be careful
 22 about that. Mike was only asking about
 23 the LLCs.
 24 THE WITNESS: I think it could
 25 still be more than 25. There are a lot

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1 DAVID SMITH
2 of investors in those LLCs.
3 MS. SMITH: I would like to
4 ask a question. When did you actually
5 sign off on the subscription agreement?
6 Was it before or after it was handed
7 over to Patty Sicluna?
8 THE WITNESS: It was after.
9 BY MR. JAGGS:
10 Q At this point the staff would like to
11 introduce Exhibit 8. It is a subscription agreement
12 for [REDACTED] purchase of a \$25,000 Third
13 Albany Jr note May 23rd, 2005.
14 Mr. Smith, do you recognize this
15 document?
16 A I recognize the form.
17 Q And can you please explain what the
18 form of the document is?
19 A It is a subscription agreement for
20 the purchase of the Third Albany Income Notes.
21 Q And if you go to the fourth page, the
22 purchaser questionnaire?
23 MR. FRANCESKI: Bates number?
24 BY MR. JAGGS:
25 Q Bates number MGS 0008131 and 8132.

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1 DAVID SMITH
2 Can you please explain for us, you
3 know, what the purchaser questionnaire represents?
4 A Well, it's designed primarily to tell
5 us whether the client is an accredited or a
6 non-accredited investor. It calls for the
7 information both in terms of income and net worth are
8 used to qualify. There's also, as you can see on the
9 bottom portion of the line, that basically reinforces
10 the fact that whether they are capable of evaluating
11 the risk.
12 Q On Bates Page 8131, Miss [REDACTED]
13 approximate net worth was listed between 50,000 and a
14 hundred thousand. If you turn to the following page
15 her approximate gross income for the calendar year
16 2003 was 25,000 to 100,000 and her approximate gross
17 income for the calendar year 2004 was 25,000 to
18 100,000.
19 On Bates Page 8130, did you sign off
20 on this form, on this subscription agreement?
21 A On 8131?
22 Q I'm sorry, 8130.
23 A (Reviewing). That is my signature,
24 yes.
25 Q Did you conduct this suitability

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1 DAVID SMITH
2 review on behalf of the broker-dealer for Miss
3 [REDACTED] purchase?
4 A I have no idea.
5 Q Would it be your practice to conduct
6 a suitability review on behalf of the broker-dealer?
7 A No. No. I am the CEO of the firm.
8 I don't do those sorts of things in terms of -- you
9 are talking about researching her individual
10 information?
11 Q Well, as far as -- when you review
12 this document, were you also reviewing this document
13 as in your role as a principal of McGinn Smith
14 broker-dealer conducting a suitability review for
15 this transaction?
16 A I believe I was reviewing -- in
17 regards to questionnaire, I was reviewing it both in
18 a dual role. I don't have two separate brains. One
19 would be as the issuer accepting the subscription
20 document, and the other is -- which is, of course,
21 what my signature says, on behalf of Third Albany
22 Income Notes. And in addition to reviewing the
23 subscription document questionnaire in terms of
24 accepting it for accredited or non-accredited, I
25 would be doing that.

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1 DAVID SMITH
2 Q But you wouldn't also be checking for
3 the suitability of the purchase for Miss Holleran?
4 A On this particular instance, no,
5 there's not enough information to do that. It's
6 dependent on the broker and the manager for that.
7 MR. NEWMAN: Wait a second.
8 So who performed the supervisory review
9 for this customer's investment from the
10 firm's perspective?
11 THE WITNESS: From the firm's
12 standpoint, I am approving it whether
13 she is an accredited or non-accredited
14 investor. There's no chance that I
15 undertook the specific investigation as
16 to, you know, her suitability to Gary.
17 MR. NEWMAN: Is that where --
18 THE WITNESS: That would have
19 been done at the broker level or the
20 manager's level.
21 MR. NEWMAN: Is that true in
22 every instance there was an investment
23 made by an LLC investor?
24 THE WITNESS: No. I mean, I
25 just -- you know, if there is something

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1 DAVID SMITH
 2 that raises a red flag, I would, but in
 3 general, I am signing in this case for
 4 Third Albany Income Notes, and the other
 5 hat I am signing as in terms of
 6 accredited or non-accredited investor,
 7 and that would be the extent of where I
 8 would be looking at that moment.
 9 MR. NEWMAN: So I thought we
 10 discussed this earlier, but now I am a
 11 little confused. So who at McGinn
 12 Smith, if anybody, is responsible for
 13 reviewing these investments from a
 14 suitability standpoint -- supervisory
 15 standpoint?
 16 THE WITNESS: Well, it starts
 17 with the broker, and that's who we
 18 depend on mostly because he knows the
 19 client. I don't know the client
 20 individually. The manager would be the
 21 second line of defense. He would have
 22 some review. When it gets to my desk,
 23 unless there is some reason, if I know
 24 the client, which the case of a lot of
 25 our clients I do because it is a small

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1 DAVID SMITH
 2 firm, I have been in the business for
 3 30 years, it is a local firm for the
 4 most part, I would -- I would have some
 5 knowledge of whether it was suitable or
 6 not, but not in every instance.
 7 MR. NEWMAN: But did you -- as
 8 part of your role as compliance officer,
 9 did you review these agreements,
 10 questionnaires for suitability?
 11 THE WITNESS: These documents
 12 what Mr. Jaggs had shown me, in and of
 13 itself, does not give you sufficient
 14 evidence for suitability.
 15 MR. NEWMAN: That wasn't my
 16 question.
 17 THE WITNESS: Well the answer
 18 is no.
 19 MR. NEWMAN: Okay. So is it
 20 your testimony that the suitability of
 21 these investments was reviewed from a
 22 supervisory standpoint by the branch
 23 managers or the managers you have
 24 described?
 25 THE WITNESS: Yes, the second

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1 DAVID SMITH
 2 line of defense. The first line of
 3 defense is the broker has the
 4 responsibility from a suitability
 5 standpoint.
 6 MR. FRANCESKI: Yeah, but he's
 7 not asking about the broker because the
 8 broker is not a supervisor. He's asking
 9 about the supervisor, correct, Mike?
 10 MR. NEWMAN: Right.
 11 THE WITNESS: Yes, the
 12 manager.
 13 MR. NEWMAN: And who are the
 14 managers who were involved in these
 15 offerings?
 16 THE WITNESS: Manager of the
 17 45 Broadway office was Brian Mayer.
 18 The -- excuse me, the manager of the
 19 Clifton Park office was Carl Nicolosi
 20 and/or Andy Guzzetti. Andy worked out
 21 of there and spent -- did a lot of the
 22 supervision with that office.
 23 MR. NEWMAN: Brian Mayer?
 24 THE WITNESS: That's Mayer,
 25 M-a-y-e-r.

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1 DAVID SMITH
 2 MR. NEWMAN: How long was he
 3 the manager of the New York office or
 4 the New York City office?
 5 THE WITNESS: Since 2001.
 6 MR. NEWMAN: And how about
 7 Carl Nicolosi? What period of time was
 8 he a manager?
 9 THE WITNESS: He was the
 10 manager from the time we opened up the
 11 Clifton Park office, which I think was
 12 2004.
 13 MR. NEWMAN: To the present?
 14 THE WITNESS: He's not now. I
 15 think over the last year Andy Guzzetti
 16 sort of assumed that responsibility.
 17 MR. NEWMAN: Andy Guzzetti,
 18 what tenure has he had?
 19 THE WITNESS: He joined us, I
 20 believe, in 2005.
 21 MR. NEWMAN: Are all three of
 22 those individuals Series 24 principals?
 23 THE WITNESS: Yes.
 24 MR. NEWMAN: Do you know for a
 25 fact that those individuals you've

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1 DAVID SMITH
 2 identified reviewed the investments for
 3 suitability as supervisors of the firm?
 4 THE WITNESS: No.
 5 MR. NEWMAN: So what do you
 6 base your statement on that they
 7 reviewed it the --
 8 THE WITNESS: I know they
 9 reviewed some. I know that was their
 10 responsibility, but I don't know in fact
 11 they reviewed every one. I couldn't
 12 possibly know that.
 13 MR. NEWMAN: Was there a
 14 written procedure or requirement that
 15 the firm had that they were to review --
 16 supervisors were to review these
 17 investments for suitability or other
 18 concerns?
 19 THE WITNESS: I don't think
 20 there was a specific reference in our
 21 suitability guideline as regards to
 22 these LLCs. I think I answered that
 23 earlier.
 24 MR. NEWMAN: Did that concern
 25 you as a chief compliance officer for
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1 DAVID SMITH
 2 the firm, that hundreds of people are
 3 investing substantial amounts of money
 4 in these offerings and there was no
 5 requirement that the supervisor review
 6 those investments?
 7 MR. FRANCESKI: Objection.
 8 That's not what he said.
 9 MR. NEWMAN: No written
 10 requirement?
 11 MR. FRANCESKI: That's not
 12 what he said.
 13 MR. NEWMAN: Was there a
 14 written procedure which required them to
 15 review these investments for
 16 suitability?
 17 THE WITNESS: What I said is I
 18 am not aware of a specific written
 19 requirement for these LLCs.
 20 MR. FRANCESKI: Mike, focusing
 21 on these LLCs, all orders, there's a
 22 written procedure that the branch
 23 manager review all orders. This is an
 24 order. I think he's answering -- you
 25 guys are just going different paths.
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1 DAVID SMITH
 2 He's saying nothing specific that
 3 mentions these LLCs, correct?
 4 THE WITNESS: Yeah. His
 5 question was specifically to the LLCs,
 6 was there language in the supervisory
 7 guide, and the answer is no.
 8 MR. FRANCESKI: You can't know
 9 his question, but not to worry, that's
 10 how you were interpreting it.
 11 MR. NEWMAN: Well, that was my
 12 question.
 13 THE WITNESS: That was his
 14 question, so the answer is no.
 15 MR. NEWMAN: Was there a --
 16 in -- what -- in general, where there
 17 was supervisory review of any securities
 18 transactions within McGinn Smith, how
 19 was that annotated or noted? Was there
 20 any requirement that specified that?
 21 THE WITNESS: The requirement
 22 is that the managers responsible for all
 23 orders, he initials them every night.
 24 They were also reviewed by Stephen
 25 Smith, who was in our compliance
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1 DAVID SMITH
 2 department, eventually became the
 3 compliance officer. He reviewed every
 4 order.
 5 MR. NEWMAN: Between 2003 and
 6 2007, what percentage, approximately, of
 7 McGinn Smith's revenues were derived
 8 from these particular LLC offerings?
 9 THE WITNESS: Let's do the
 10 math.
 11 MR. NEWMAN: Approximately.
 12 THE WITNESS: Give me a
 13 minute. I would guess about 15 percent.
 14 MR. FRANCESKI: I'm sorry.
 15 What was that percentage?
 16 THE WITNESS: 15.
 17 MR. FRANCESKI: What did that
 18 represent?
 19 THE WITNESS: The question was
 20 what percentage between the years 2003
 21 and 2005, '6, whatever, what percentage
 22 of the revenues was attributed to the
 23 LLCs.
 24 MR. FRANCESKI: All right.
 25 MR. RATTINER: The procedures
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1 DAVID SMITH
2 that you have in the manual, do those
3 apply to both brokerage business and
4 application way business such as
5 promissory notes?
6 MR. FRANCESKI: Do you
7 understand that term?
8 THE WITNESS: That is a new
9 term to me. I have only been in the
10 business 30 years so why should I know?
11 Are you referring to all private
12 placements, Chris?
13 MR. RATTINER: Correct, versus
14 the brokerage account going through NFS?
15 THE WITNESS: Without looking
16 at the specific language, I wouldn't
17 answer that one way or the other.
18 MR. RATTINER: I know you said
19 the procedures don't have specific
20 procedures regarding the LLCs so what I
21 am trying to derive is whether or not
22 the procedures have procedures for
23 non-brokerage business?
24 THE WITNESS: Yeah, I think
25 the --

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1 DAVID SMITH
2 MR. FRANCESKI: Hold on. I am
3 going to object to that question, but go
4 ahead and answer.
5 THE WITNESS: The procedures
6 would apply to whatever business we are
7 doing. I mean, you know, we are not
8 distinguishing between a private
9 placement and an order to buy a hundred
10 shares of IBM.
11 MR. RATTINER: And how would
12 the manager evidence his approval on the
13 document that Mr. Jaggs provided?
14 THE WITNESS: I don't think he
15 would --
16 MR. FRANCESKI: Objection.
17 THE WITNESS: -- evidence his
18 approval by initialing or signing. They
19 review the orders, and they may or may
20 not initial each order. I know
21 sometimes they would, over the course of
22 time, on a daily basis, would have a
23 stack of orders. They would review them
24 and they would initial the top order.
25 MR. RATTINER: Those would be

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1 DAVID SMITH
2 order tickets you are talking about?
3 THE WITNESS: Those would be
4 order tickets, right.
5 MR. RATTINER: So how does
6 that relate to the subscription?
7 THE WITNESS: Because there's
8 an order ticket associated with these.
9 MR. RATTINER: Would the
10 ticket be attached to the subscription
11 document at that moment that they are
12 signing it?
13 THE WITNESS: Not at that
14 moment. Generally, what the
15 procedure -- procedure is an incorrect
16 term. Often practice would be that the
17 broker would, in effect, place an order
18 by way of the ticket. That would be
19 part of the daily ticket. That would be
20 reviewed by the manager.
21 Subsequently to that, not
22 always, but quite often, the
23 subscription agreement would come in
24 along with the questionnaire. That
25 would generally be collected by the

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1 DAVID SMITH
2 broker, often reviewed by the manager.
3 I can't say if it was done all the time.
4 In fact, I would doubt if it was done
5 all the time.
6 It would then find its way to
7 Patty Sicluna who we referred to. Patty
8 would process the rest of it, and
9 eventually -- by eventually, you know,
10 next day or two days, depending on my
11 availability, by way of inner office
12 mail, would find its way to my desk at
13 which point I would review.
14 MR. RATTINER: Now, the
15 signature on the -- would the manager
16 sign the ticket or sign off or initial?
17 MR. FRANCESKI: Objection.
18 Asked and answered, but go ahead.
19 THE WITNESS: Yeah. I believe
20 the procedure was, and it may vary, but
21 over time, practice sometimes take
22 precedence, rather than initial every
23 single ticket, if you had 35 tickets for
24 the day, and you were reviewing all the
25 tickets, I know at the end of the day

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1 DAVID SMITH
2 the top ticket would be initialed,
3 bundled and put away.
4 MR. RATTINER: Okay. And what
5 would that signature represent?
6 THE WITNESS: That they had
7 reviewed the tickets.
8 MR. RATTINER: For a
9 non-brokerage customer, where there's no
10 New Account form through NFS, how would
11 they determine suitability by reviewing
12 just the ticket?
13 THE WITNESS: I don't know the
14 time frame, but at some point in time
15 we, for non-brokerage accounts or those
16 that had an account with the clearing
17 firm, in this case NFS, or at least in
18 recent years NFS, we developed the form
19 of which they filled out and basically
20 matched. In terms of information, the
21 same information that was supplied on
22 the New Account form. I don't know
23 exactly when that timing was. There was
24 a period of time when we didn't have
25 that, and there was a period of time

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1 DAVID SMITH
2 when we felt that that was necessary to
3 have it.
4 MR. RATTINER: And what was --
5 is Mr. Smith's role started in
6 September -- Steve Smith's role started
7 in September 2007?
8 THE WITNESS: No. He was
9 actually active before that but he
10 didn't have the supervisory designation.
11 But he worked in compliance. He worked
12 in the administrative side of it, but he
13 didn't have the responsibility until he
14 successfully passed his 24, which I
15 believe the date was sometime in
16 September/October '07, I think is the
17 date.
18 MR. RATTINER: And what would
19 his role be with reviewing the private
20 placements?
21 THE WITNESS: Really, I don't
22 believe -- Stephen reviewed daily
23 tickets, initial daily tickets. I don't
24 believe Stephen ever ended up reviewing
25 the private placements, per se.

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1 DAVID SMITH
2 MR. RATTINER: Okay. So that
3 would still fall under your purview?
4 THE WITNESS: I think you will
5 find that the vast majority of the
6 signatures are mine.
7 MR. RATTINER: Okay. Go
8 ahead.
9 MR. NEWMAN: So I am clear,
10 there was a requirement that for these
11 LLC investments that there be an order
12 ticket completed by the broker?
13 THE WITNESS: Yes. And I
14 don't know if that was consistent from
15 2003 to 2008, but at some point
16 procedures changed and yes, we required
17 a ticket.
18 MR. NEWMAN: When,
19 approximately, did that go into effect?
20 THE WITNESS: I think it's
21 been in effect quite a while, but I
22 couldn't tell if it was 2003 or 2005,
23 but it's been in effect for quite a
24 while.
25 MR. NEWMAN: And what

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1 DAVID SMITH
2 information would be on the order ticket
3 for the LLC investments?
4 THE WITNESS: Basically, what
5 they would buy, you know, whether it was
6 the senior tranche of Third Albany
7 Income Notes and the rate of interest
8 and how much, obviously, that sort of
9 thing.
10 MR. NEWMAN: But there would
11 be no background information about the
12 customer?
13 THE WITNESS: No.
14 BY MR. JAGGS:
15 **Q Mr. Smith, would you consider the**
16 **fact that Miss [REDACTED] invested \$25,000 in a Third**
17 **Albany Income junior note when her net worth is**
18 **stated to be between 50,000 and a hundred thousand as**
19 **a red flag?**
20 A Possibly, possibly. Again, customers
21 have varying degrees of risk tolerance and
22 objectives. Generally, you know, when things are
23 working out, they have all sorts of risk tolerances.
24 When things happen, they suddenly discovered that
25 they didn't have that kind of tolerance. But I don't

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1 DAVID SMITH

2 think -- I do not subscribe to the theory that if
3 someone has a limited income, what we will refer to
4 as a limited income of 25 to 50,000, they are not
5 entitled to take risk, clients want to take risks all
6 the time.

7 **Q And in this situation would it be**
8 **your practice to go back to the branch manager and**
9 **have the branch manager get further information**
10 **regarding the client's net worth?**

11 A May or may not. I may have done
12 that; I may not have done that.

13 MR. JAGGS: At this time Staff
14 would like to introduce Exhibit Number
15 9. It's an e-mail from Georgia
16 Goldstein to [REDACTED] dated May
17 5th, 2009. And second page is a letter
18 to [REDACTED] dated February 15th,
19 2008, total two pages.

20 (Whereupon Exhibit 9 is
21 Marked.)

22 THE WITNESS: (Reviewing).

23 Yes.

24 BY MR. JAGGS:

25 **Q Mr. Smith, do you recognize this**

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1 DAVID SMITH

2 be redeemed, and what I was attempting to do here is,
3 best as I recall this, was that he had in fact missed
4 his ability to redeem the note by negative consent
5 and that therefore we were now into '08 when things
6 were no longer in a position -- certainly, were --
7 what we had indicated to our investors that there was
8 some difficulty with liquidity, and so we had, as per
9 my language here, basically suggesting that now that
10 he's trying to, in effect, redeem this, that would
11 not be appropriate.

12 That is the best of my recollection.

13 I think -- I think it had a second leg to it. I
14 think there was, subsequent to that, Mr. Price
15 continued to work with us and work with our
16 attorneys. Since that time I think the issue has
17 been laid to rest.

18 MR. JAGGS: Okay. Okay. I
19 appreciate that explanation. At this
20 point Staff would like to introduce
21 Exhibit Number 10.

22 Exhibit number 10 is an e-mail
23 from David Rees to mailbox@lexsmith.com
24 dated August 9th, 2007, and contains
25 portfolio information for First

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1 DAVID SMITH

2 document?

3 A I do.

4 **Q Could you please explain kind of what**
5 **was behind your letter to Mr. [REDACTED] and what the**
6 **letter is referring to?**

7 MR. FRANCESKI: This document
8 being the e-mail, the letter or both?

9 BY MR. JAGGS:

10 **Q The letter, I'm sorry.**

11 A Yeah. Best of my recollections, the
12 [REDACTED] are folks from the Binghamton area, owns
13 [REDACTED] Wholesale Foods, probably worth a hundred
14 million dollars, if they are worth a dollar. My
15 recollection was, is that Mr. [REDACTED], Mr. [REDACTED]
16 [REDACTED] by negative consent rolled his note, did not
17 indicate.

18 I believe Mr. [REDACTED] then
19 subsequently died, and the attorney for the estate,
20 which is this Mr. Price -- I think we saw his name
21 somewhere on here, the e-mail, he was the attorney,
22 and he was trying to basically, for estate purposes,
23 they didn't need it for liquidity, but he was looking
24 to wind down the estate.

25 And so he had requested that the note

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1 DAVID SMITH

2 Independent Income Notes and Third
3 Albany Income Notes, a total of five
4 pages.

5 (Whereupon Exhibit 10 is
6 Marked.)

7 THE WITNESS: (Reviewing). Go
8 ahead.

9 BY MR. JAGGS:

10 **Q Mr. Smith, do you recognize this**
11 **e-mail?**

12 A I don't.

13 **Q Do you recognize the schedules on**
14 **Pages 2 through 5?**

15 A I don't recall these. I think I
16 testified earlier, and this was my belief, that Bill
17 Lex asked any number of times for portfolio
18 breakdowns, and I both testified and don't remember
19 ever giving it to him. I think I had always
20 indicated we would give it to him by category,
21 insurance, what have you.

22 This is obviously something different
23 than that, shows not all the investments but shows --
24 not all the assets of the two funds, and obviously
25 was sent to him, I guess, by Dave Rees. And I would

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1 DAVID SMITH
 2 think it's highly unlikely that Dave sent this on his
 3 own. I mean, you know, it's kind of not the way the
 4 firm works. So I would have to assume he showed it
 5 to me, and I probably having had 15 calls from Bill,
 6 said, okay, do it. But I don't know with certainty,
 7 but that would be a logical conclusion.
 8 The only other conclusion is that
 9 Dave Rees took it upon himself to do that, and
 10 that's -- that's just not likely within our firm.
 11 **Q So you don't recall specific**
 12 **conversation with Dave Rees?**
 13 A No.
 14 **Q Did, on or around August 9th, 2007,**
 15 **do you recall ever receiving a phone call from**
 16 **William Lex discussing the portfolio holdings?**
 17 A I don't but Bill was -- you know,
 18 Bill, if I didn't specifically mention him, he was
 19 certainly the one I had in mind, and had, for a
 20 number of times had been interested in that sort of
 21 thing. He was evidently had some interest from his
 22 clients.
 23 I think he was, you know, in the
 24 process of making sales and wanted to do that, much
 25 as I testified. The policy, we did not want to share

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1 DAVID SMITH
 2 that, but obviously we did, and whether Bill wore me
 3 down or caught me at a weak moment, I don't know, but
 4 I don't remember the specific conversation. I do
 5 remember conversations where Bill asking for that
 6 information, and most of the time I successfully told
 7 him we didn't provide that, for the reasons that I've
 8 articulated earlier, and I continued to insist that
 9 there was a time when I think I did it by asset class
 10 as opposed to specific investments.
 11 But this certainly, as I said, is
 12 obviously a percent, and I would have to believe that
 13 I would have approved it.
 14 MR. RATTINER: Is Mr. Lex the
 15 only investor, as he ultimately bought
 16 these notes, that would have access to
 17 this information?
 18 THE WITNESS: Yeah. I mean,
 19 we just didn't give this -- and this, by
 20 the way, again, to the best of my
 21 recollection, was not provided to Mr.
 22 Lex as an investor but Mr. Lex as a
 23 broker who was trying to garner this
 24 information. I don't think for a moment
 25 that Bill was trying to have some

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1 DAVID SMITH
 2 insight as an investor as opposed to
 3 anybody else.
 4 Mr. Lex is a, you know, is a
 5 persistent sort of guy, and as I said,
 6 there may have been a time when, after
 7 asking me, and I maybe even had said to
 8 Dave Rees, you know, put something
 9 together for Bill, and let's move on. I
 10 don't recall specifically.
 11 MR. FRANCESKI: Let me caution
 12 Mr. Smith. Speculation is not going to
 13 help these folks. If you know what
 14 happened, testify to what you know
 15 happened. Speculation is not going to
 16 help them.
 17 MR. RATTINER: Subsequent to
 18 this e-mail on August 9th, did Mr. Lex
 19 redeem any of his notes?
 20 THE WITNESS: I don't know the
 21 answer to that.
 22 MR. RATTINER: All right.
 23 MR. JAGGS: At this point
 24 Staff would like to introduce Exhibit
 25 Number 11. It is a letter dated

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1 DAVID SMITH
 2 October 15th, 2002, from David Smith to
 3 DR Investor, a total of two pages.
 4 (Whereupon Exhibit 11 is
 5 Marked.)
 6 THE WITNESS: (Reviewing).
 7 This investigation was only for 2003.
 8 MR. RATTINER: I stipulated it
 9 was, in the beginning, it was mainly
 10 from 2003.
 11 THE WITNESS: Qualifying now.
 12 MR. FRANCESKI: It's only bad
 13 if we are inconsistent. If they are,
 14 they get away with it. We will let them
 15 go.
 16 THE WITNESS: Give me a
 17 minute, Gary, to read this.
 18 BY MR. JAGGS:
 19 **Q Do you recognize this document?**
 20 A I don't remember it but I recognize
 21 it, certainly my writing, and it's my writing style,
 22 so lengthy.
 23 **Q And would you please explain why the**
 24 **letter was sent to investors?**
 25 A Best of my recollection, it's -- you

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know, we were in the process of talking with investment bank, not mentioned there, but it was Friedman, Billings. We had approached them sometime, I think, in 2002, obviously earlier than October, with an opportunity to get more capital. We had sort of -- we had a large line of credit with Key Bank, about 125 million at the time, and we were pushing the limits of that, and in our conversations with Friedman, Billings, they really advocated another approach to taking the whole enterprise public, something that we had not considered up to that time, but they made a pretty good story for.

And so what I believe this letter is, is in anticipation of that public offering, we were trying to get these trusts in a more fungible manner and acceptable manner, and so we were offering in exchange for some of the trusts for some bonds and integrated which would then ultimately become the public company.

Q Were there trusts or bonds issued through private placements?

A The trusts were, yes.

Q In the first paragraph it states, many of you have participated in several of these

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recycled Brian Shea. He's back.

And there was -- let me add, there was other people in that function. I mean, there was -- we have had other administrative people. I know the name Jennifer Spinner had come up here earlier. I forgot about Jennifer but she was somebody that worked in that area at some time at McGinn Smith, and there may be others.

Q And how were those escrow funds tracked?

A You mean they were tracked on a -- we had access, they were always deposited with a banking institution. For the most of our time, we have used M&T Bank, or what is the successor, what was then Union National Bank was our first bank.

We had escrow accounts at other banking institutions from time to time, but my guess is they handled 90 percent. When an escrow is opened, an agreement is signed. They are quite accommodative. We were able to track them online. We can access the balance on a daily basis.

Q Was there an internal system that tracked those funds as well or were you relying primarily on those statements?

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offerings and have included in them as an important part of your fixed income portfolio, having been attracted to the high monthly income that they have provided.

Did McGinn Smith market these private placements to clients as fixed income investments?

A The alarm business was marketed as a high yield fixed income investments, yes. There was no equity component. There was no upside. The client basically bargained to get a high rate of return and his money back.

MR. JAGGS: Thank you, sir.

MS. SMITH: I am going to be asking some questions now.

EXAMINATION

BY MS. SMITH:

Q Who is responsible for keeping track of client funds invested in the escrow accounts for each of the LLCs?

A I think that process was generally controlled by our treasurer or finance guy which, you know, changed over time but was at one point was Brian Shea and then it was David Rees and now we have

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DAVID SMITH

A Well, when you say track the funds, you mean the deposits and what --

Q Correct.

A -- happened after the deposits?

Yeah, I mean, I guess -- there was really only a two-step process. I mean, when we made the deposit, we kept track of the deposit. And eventually when the escrow account reached a point where it could be broken, because it met the minimum, or was necessary to be broken, because we needed the funds to whatever we were doing with them, whether we were -- presumably most cases we were buying assets, then -- then, you know, we would instruct the bank, and they would make sure that the requirements that they had in the escrow agreement, which usually, for the most part, centered around a minimum, were there, and would release the funds.

Q And what type of funds were deposited into escrow?

Was it primarily customer -- was it only customer deposits or were there any other funds that would go into the escrow account?

A I think -- generally, there were customer deposits, yeah, people who were subscribing

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1 DAVID SMITH
2 to the thing. There may have been some instances --
3 I don't know this for a fact. Well, I do know for a
4 fact. I think there was a time when sometimes what
5 we should have -- when the escrow was eventually
6 broken and the thing was done, the correct procedure
7 in which I think we filed fairly religiously, at
8 least in the last five years, hopefully, maybe more,
9 you'd open an operating account for that entity.

10 And then if there was any other
11 deposits or corporate business or entity business, it
12 should have been done through the operating account.
13 I think there was a time, I think, I emphasize that,
14 when once the escrow account was broken, it continued
15 to use the escrow account as an operating account.
16 They didn't relabel them. So I don't know that for a
17 fact but I have those things rattling around in the
18 back of my brain that that might have happened.

19 **Q Okay. You don't recall for sure**
20 **whether that happened or which --**

21 A I double it. It's just -- the fact
22 I'm remembering it, it must have happened. I am
23 not -- it was no longer an escrow account but nobody
24 bothered to say it was. Once the account is broken
25 and the funds are disbursed, it's not an escrow

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1 DAVID SMITH
2 account anymore. I think that could have happened.
3 **Q Okay. And who is responsible for**
4 **keeping track of the actual client's funds that were**
5 **invested in each of these LLCs?**

6 A Within the escrow account?

7 **Q Once we leave the escrow and now we**
8 **are in the operating account, who was actually**
9 **keeping track, in total, I guess, who's tracking the**
10 **client investments?**

11 A I think those, I testified yesterday,
12 you weren't here, but we had a database that was
13 primarily controlled by Patty Sicluna. So that
14 information would go in there. We would know the
15 investor name and the amount, the time of purchase.
16 If there was a rollover as regards to the seniors,
17 there would be a designation columns for that. If
18 there was wires in or wires out, interest payments,
19 all of that is within the same database.

20 **Q And who would review her work or was**
21 **responsible for supervising those -- that work she**
22 **was doing?**

23 A Well, I am not sure -- you mean
24 reviewing whether she submitted the name correctly
25 into the database? I don't think there was anybody

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1 DAVID SMITH
2 that was -- yeah, I was her overall supervisor, but,
3 you know, I mean, as a CEO, I didn't go up there at
4 the end of the day and ask her if she put in
5 Mrs. Jones' entry correctly.

6 **Q But you were kept informed of the**
7 **dollar amount invested?**

8 A That data was available to us on a
9 daily, hourly basis.

10 MR. NEWMAN: You are referring
11 to the Quicken records?

12 THE WITNESS: No. No, I am
13 not. I didn't think, and I apologize
14 for being a little bit of a technical
15 moron, but the Quicken records, I think,
16 are quite separate -- we have a database
17 at McGinn Smith that was designed by an
18 employee of McGinn Smith, and it
19 contains all the information for all of
20 our private placements going back as
21 long as I can --

22 MR. NEWMAN: Right. That's
23 for the investors, right. Then you have
24 the Quicken records which would show the
25 daily financial transactions?

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1 DAVID SMITH
2 THE WITNESS: Correct.
3 MR. NEWMAN: Besides the
4 database that Patty Sicluna was involved
5 with, dealing with the investments
6 themselves, and then the Quicken records
7 that track on a daily basis the flow of
8 money, what other records were
9 maintained for the four LLCs, whether
10 financial or other records were
11 maintained for those entities?

12 THE WITNESS: Vis-a-vis client
13 deposits and things of that nature?

14 MR. NEWMAN: Any record by the
15 firm, what record?

16 THE WITNESS: Well, the firm
17 has -- the firm does not have, because
18 the firm doesn't have control of the due
19 diligence files. That's MS Advisors. I
20 don't think that's where you are
21 getting. So financial records, I don't
22 believe there's anything other than the
23 Quicken files in the database.

24 MR. NEWMAN: Was there a
25 balance sheet statement of cash flow

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1 DAVID SMITH
2 that was prepared for the LLCs?
3 THE WITNESS: That I believe
4 comes off the Quicken records.
5 MR. NEWMAN: And in terms of
6 the tax return, was there a tax return
7 filed by the LLCs?
8 THE WITNESS: The tax -- the
9 LLCs did not file a specific tax return.
10 As an LLC, they move up through the
11 chain, if you will, and MS Advisors and
12 actually MS Holdings, there is a -- I
13 believe a -- they do tax work, but they
14 don't file the return because I think it
15 is a flow-through up to MS Advisors and
16 then MS Holdings.
17 MR. NEWMAN: MS Advisors and
18 MS Holdings; is that correct?
19 THE WITNESS: I believe so,
20 yes.
21 MR. NEWMAN: MS Advisors and
22 MS Holdings file tax returns?
23 THE WITNESS: Again, I don't
24 think MS Advisors would file a tax
25 return. I think -- it's my

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1 DAVID SMITH
2 understanding, and I am not probably as
3 knowledgeable as I should be, but the MS
4 Advisors as a flow-through would then go
5 on up to MS Holdings which owns
6 100 percent of it, and that would be the
7 ultimate entity that would be
8 responsible for the tax return.
9 MR. NEWMAN: MS Holdings did
10 file a tax return?
11 THE WITNESS: As far as I
12 know, yes.
13 MR. RATTINER: Can I just
14 clarify something on that? Yesterday we
15 discussed before, I thought the four
16 LLCs didn't file tax returns for 2008.
17 I think you said it was due around
18 September 2009. So how does that differ
19 from what we are talking about now?
20 THE WITNESS: What I -- and if
21 I was unclear yesterday, and I may very
22 well have been, they do -- our
23 accountants Piaker Lyons come in and
24 they do tax work, because in order to
25 do -- to have a flow-through to Advisors

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1 DAVID SMITH
2 and Holdings, they have to do the work
3 at the LLC level. So that is what I was
4 referring to. I don't believe the LLC
5 in and of itself is responsible for
6 filing a tax return.
7 MR. RATTINER: But the upper
8 MS Holdings, they wouldn't be able to
9 file a return unless the LLC is done?
10 THE WITNESS: That is
11 absolutely correct.
12 MR. RATTINER: So do you think
13 that Holdings did file a tax return for
14 2008?
15 THE WITNESS: I don't think
16 they did file. I think we are behind,
17 yes.
18 MR. RATTINER: Okay. I think
19 it was the opposite stated a minute ago.
20 That's why I just wanted to clarify.
21 THE WITNESS: No.
22 MR. NEWMAN: So were there any
23 filings made by the LLCs with any state,
24 federal agency that you are aware of?
25 Did the LLC make any filings -- did the

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1 DAVID SMITH
2 LLCs make any filings with any state or
3 governmental agencies, whether it was a
4 tax return or some other documents?
5 THE WITNESS: I think they
6 filed certainly at the time of
7 incorporation. I think they filed at
8 the time from a securities standpoint.
9 I believe there was probably a filing
10 made but there's not an annual filing
11 that I am aware of.
12 BY MS. SMITH:
13 **Q Okay. So what you said earlier was**
14 **that Patty Sicluna basically kept track of the client**
15 **funds, and she kept track of that information in a**
16 **database, and she would communicate that information**
17 **to you on a regular basis?**
18 A When you say client funds, I mean,
19 she made the entries of what the client was investing
20 in. She didn't have control or access with the cash,
21 just so we are clear on that.
22 **Q Right.**
23 A But, yes, once that information was
24 in the database, that would be available to myself or
25 Mr. McGinn and Mr. Shea, I would believe.

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1 DAVID SMITH

2 **Q So would she send you an e-mail**
3 **communicating the level of client investments in each**
4 **one of the LLCs or would it be up to you to go into**
5 **the database to get that information?**

6 A I would never go into that database.
7 That would never happen. No, she would send me an
8 e-mail at times, I would say probably most of the
9 time telephonically, and just pick up the phone, ask
10 for the information. She would retrieve it and tell
11 me.

12 **Q And how often would she communicate**
13 **that to you?**

14 A You know, fairly often. You know, I
15 mean, I guess hard to quantify, but I might chat with
16 Patty any number of times a day, and I don't think I
17 was seeking or needed that information on a daily
18 basis. But my guess is I certainly did several times
19 a month, and it varies, of course, as, you know, once
20 the LLC was completed, obviously the need for that
21 information diminishes.

22 When it was in the offering period, I
23 think that's what you're alluding to, I would be more
24 active in seeking that information.

25 **Q This was asked earlier, I believe.**

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1 DAVID SMITH

2 Patty. Patty would probably call me and say, we have
3 an X redemption. Fine, yes, go forward. But
4 ultimately I think I would know the information and
5 be responsible for approving it.

6 **Q Okay. And then who would be**
7 **responsible for making sure that that got processed?**
8 **Would that be Patty?**

9 A That the paperwork was processed,
10 yes, that would be Patty.

11 **Q And that the funds were redeemed, is**
12 **that also Patty?**

13 A That the dollars?

14 **Q Hm-hm.**

15 A No, that would be Patty. Generally
16 Dave Rees or whoever is handling the bank account
17 would release the funds.

18 **Q Okay.**

19 MR. PAULSEN: Who approved the
20 redemption, authorized the remittance of
21 the monies from, say, the operating
22 account to the investor making the
23 request?

24 THE WITNESS: Ultimately that
25 would be my responsibility.

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1 DAVID SMITH

2 **The question has to do with redeeming notes early.**
3 **Did clients ever redeem their notes**
4 **early?**

5 A Yes -- early, I apologize. Just so I
6 am clear, you are not referring to matured senior
7 notes, but you are referring to those notes that had
8 not reached the maturity and someone wanted to redeem
9 them?

10 **Q Well, we can talk about -- that would**
11 **be to me a resale?**

12 **Would that be a fair statement?**

13 A Okay. That is a fair statement,
14 sure.

15 **Q Okay. So I would like to talk about**
16 **both. So if a customer, their note --**

17 A Matured.

18 **Q -- matured, and they wanted to redeem**
19 **their note, was there any approval required by**
20 **anyone, by yourself or anyone else?**

21 A Yeah. I think you wanted to make
22 sure there was a question of liquidity. But so,
23 yeah, I mean, I would be -- I think the chain of
24 command would be the broker would have a request for
25 such redemption. Check with probably -- notify

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1 DAVID SMITH

2 BY MS. SMITH:

3 **Q Okay. We also talked about -- or**
4 **mentioned reselling a note. So were there times**
5 **where a customer wanted to, again, redeem their note**
6 **early and perhaps would need to re-sell that**
7 **investment?**

8 A There were times when that happened,
9 yes.

10 **Q Again, would you or someone else**
11 **approve that?**

12 A I would say almost all the times. I
13 can't imagine there were any times that I didn't
14 approve it. I mean, generally I think the way it
15 would happen -- not always but generally, is that the
16 broker would, in effect, have the ability to re-sell
17 it and would, you know, seek my approval. And if I
18 gave him my approval, the process after that was
19 generally out of my hands.

20 **Q So if it was the broker's customer**
21 **that was looking to re-sell their note, would it be**
22 **his responsibility to then place that re-sell?**

23 A That's not a responsibility, but the
24 way that compensation system worked was that if a
25 broker had one of his clients sell the note, he

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1 DAVID SMITH
2 wouldn't receive compensation any longer. It's kind
3 of an accepted practice.
4 So there would be certainly times
5 when it was in the broker's interest to help
6 facilitate the sale for his client. I mean, he
7 really had two motivations. His client was
8 requesting something and he was trying to facilitate
9 that. It would be helpful to his client. And at the
10 same time if he can maintain his sale and he has
11 another client, a lot of times prior to the
12 difficulty, there was a large demand. I mean, it
13 wasn't a problem. So he'd have clients that were
14 interested.
15 MR. NEWMAN: Did McGinn Smith
16 require -- or let me rephrase that. Did
17 the LLCs require in the situation where
18 a customer wanted to redeem prior to
19 maturity that they were required -- they
20 or the broker were required to have
21 another investor to fill their shoes?
22 THE WITNESS: No.
23 MR. NEWMAN: That wasn't a
24 requirement?
25 THE WITNESS: Not a

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1 DAVID SMITH
2 requirement.
3 MR. NEWMAN: Was there ever a
4 situation you are aware of where a
5 customer in the LLCs redeemed prior to
6 maturing and there was not a replacement
7 investor?
8 THE WITNESS: Certainly, yeah.
9 MR. NEWMAN: How often did
10 that happen?
11 THE WITNESS: I don't think
12 very often but it happened.
13 MR. NEWMAN: In terms of the
14 new investment, the replacement
15 investment, was that treated as a new
16 investment for purposes of determining
17 whether the LLC investment had more than
18 35 non-accredited investors?
19 THE WITNESS: Yes. I mean, it
20 would be -- you know, we would have to
21 get a new subscription document from
22 that client, a new questionnaire from
23 that client, unless -- well, I think we
24 even -- even if it was a client who was
25 already in the notes, I think we got a

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1 DAVID SMITH
2 new subscription document. I am not
3 absolutely certain about that, but
4 certainly if it was a new client, we got
5 a new subscription.
6 BY MS. SMITH:
7 **Q And as far as tracking those changes**
8 **on the re-sells, is that something, again, that Patty**
9 **Sicluna would be in charge of including the**
10 **Subscription Agreements?**
11 A Correct.
12 **Q Who is responsible for monitoring the**
13 **minimum and maximum offering amounts?**
14 A Well, I, again, had the ultimate
15 responsibility to break escrow. Again, that's an
16 activity that I think I have stated several times was
17 done primarily by Patty or Mr. Guzzetti. He was
18 aware of it on a daily basis. As the offering wound
19 down or consumed, or whatever, as more and more
20 people bought it, and the level of availability
21 decreased, we basically published that every day in
22 an e-mail from Mr. Guzzetti.
23 So I was -- I had access to that
24 information. I was reading it at the same time.
25 Once a minimum was broken, you know, we would

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1 DAVID SMITH
2 generally break escrow.
3 **Q And the tracking, again, of let's say**
4 **the maximum amount, is that something that -- who was**
5 **responsible for the tracking of the maximum offering**
6 **amount?**
7 A Patty tracked those, but, again, you
8 know, the ultimate responsibility would be mine. I
9 mean, if, you know, they went over or were still
10 under, or whatever, you know, I would be made aware
11 of it.
12 **Q Why is it important to not exceed the**
13 **maximum offering amount?**
14 A Well, because the prospectus called
15 quite specifically that we would not offer more than,
16 case of First Independent Income Notes, \$20 million
17 worth of notes. So it was -- it was not a
18 permissible activity of the operating company to, in
19 effect, after two years go out and raise another \$10
20 million.
21 It was a set amount of dollars and
22 that was, of course, designed to not basically have
23 different impacts at different times for different
24 investors.
25 MR. RATTINER: How did that

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1 DAVID SMITH
2 work with respect to rollovers?
3 THE WITNESS: Rollover was
4 part of the original capital. We were
5 not to exceed the original capital
6 amount. And in fact, within each
7 tranche you had -- you had to maintain
8 whatever dollars were allocated to that
9 tranche, which the traditional LLC, it
10 was 5 million, and the senior, 5 million
11 and senior subordinate, and 10 million
12 in the junior.

13 MR. RATTINER: And how about
14 with regards to a re-sell?

15 THE WITNESS: Same thing. I
16 mean, if there was a re-sell, if they
17 were moving from tranche to tranche,
18 they could only move from tranche to
19 tranche if, in fact, it didn't violate
20 those levels.

21 So you couldn't have -- just
22 to use an absurd example -- somebody
23 sell 5 million of the juniors and buy 5
24 million of the seniors. Now, the senior
25 would be a 10 and the junior would be a

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1 DAVID SMITH
2 5 and that would be unacceptable.
3 MR. RATTINER: So I guess the
4 seniors capped at 5 million?
5 THE WITNESS: Yes.
6 MR. RATTINER: And everything
7 is sold, there is a re-sell, does that
8 re-sell go above the 5 million or is
9 that subtracted? How is that worked on?

10 THE WITNESS: You say a
11 re-sell of a senior note?

12 MR. RATTINER: Correct, to a
13 new investor.

14 THE WITNESS: And the new
15 investor would be buying the senior
16 note?

17 MR. RATTINER: Correct.

18 THE WITNESS: So that there
19 would be an offset. I mean, there would
20 be a hundred thousand out and a hundred
21 thousand in, the balance of the seniors,
22 if you will, would remain at \$5 million.

23 MR. RATTINER: Okay. That's
24 what I was going for.

25 BY MS. SMITH:

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1 DAVID SMITH
2 Q Did any of the LLCs ever exceed the
3 maximum offering amount?
4 A Not at the offering period. I
5 think there was -- there may have been one or two
6 times when an immaterial amount, there may have been,
7 you know, instead of 5 million, it was 5,025,000, you
8 know. There might have been something less than
9 that, but not with any regularity. But I think -- I
10 think there may have been a time when, as I said, not
11 a material amount but that's just logistics trying to
12 get people to balance it, so.

13 Q So you are saying \$25,000 is an
14 immaterial amount? Is that basically the threshold?

15 A I don't know if there is any
16 threshold. But I would say 25,000 out of 20 million
17 is immaterial, yes.

18 MR. NEWMAN: Why don't we go
19 through each of the four offerings,
20 briefly, and you can tell us how much
21 was raised in each offering.

22 THE WITNESS: Well, the first
23 two, First Independent and First
24 Excelsior, were both \$20 million
25 offerings. The tranches were the same,

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1 DAVID SMITH
2 5 in the senior, 5 in the senior
3 subordinate, and 10 in the junior.
4 Third Albany was a little larger
5 offering. That was \$30 million.

6 MR. FRANCESKI: Which one is
7 that again?

8 THE WITNESS: Third Albany
9 Income Notes. That was 30 million, and
10 there you had 7.5 million in each of the
11 senior and the senior subordinate, and
12 15 million in the junior.

13 And finally First Advisor
14 Income Notes, I think, was the only
15 offering that we did not fully subscribe
16 for. I think -- my recollection was is
17 we subscribed somewhere between 16 and
18 18 million, and I can't tell you what
19 the specific tranches were in terms of
20 dollars in that one.

21 MR. NEWMAN: Which, if any, of
22 the offerings was there an excess amount
23 raised, an amount over the maximum
24 amount?

25 THE WITNESS: I don't believe

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1 DAVID SMITH
 2 there was ever a time when we raised an
 3 excess amount of the offering. As I
 4 said, there may have been a time when
 5 there was between these resales that
 6 didn't quite match up, and one of the
 7 categories got a little more or
 8 something.
 9 MR. NEWMAN: Wait a minute.
 10 So I thought you testified before that
 11 when there was a re-sell, that was
 12 treated as a new investment for purposes
 13 of computing the investment amount?
 14 MR. FRANCESKI: He's
 15 distinguishing at the time of offering
 16 versus after offering. No time of
 17 offering ever exceeded the maximum, but
 18 the re-sell.
 19 MR. NEWMAN: Well, is the
 20 maximum amount specified in the offering
 21 memorandum for each offering, says how
 22 much can be raised for each offering?
 23 THE WITNESS: Right.
 24 MR. NEWMAN: Now, is there a
 25 time limit on that from your

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1 DAVID SMITH
 2 perspective?
 3 THE WITNESS: I think where
 4 the confusion is, maybe it's confusion
 5 on my end, as often the case, to the
 6 best of my recollection, the times that
 7 this happened, and I don't believe it
 8 was many times, was within the tranches.
 9 In other words, to use the example of
 10 First Independent where it is 5 million
 11 senior, 5 million senior subordinate and
 12 10 million of the junior --
 13 MR. NEWMAN: Right.
 14 THE WITNESS: -- there may
 15 have been a time, if my memory serves
 16 me, that there was a time in an
 17 immaterial amount that instead of 5
 18 million in the senior subordinate, maybe
 19 there was 4 million 750, and there was 5
 20 million 250 in the junior. I think
 21 that's an exaggeration of the amounts,
 22 but to use the example, that's what I am
 23 referring to.
 24 MR. NEWMAN: And which
 25 offering was that?

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1 DAVID SMITH
 2 THE WITNESS: I have no idea.
 3 MR. NEWMAN: How was that
 4 handled?
 5 THE WITNESS: I don't think
 6 there was any action taken if it was an
 7 immaterial amount. If it was a material
 8 amount, adjustments were made, people
 9 had to basically not accept the order.
 10 MR. NEWMAN: Well, again, I
 11 don't know, are you talking
 12 hypothetically or reality? What
 13 happened in this instance?
 14 THE WITNESS: I am talking
 15 more hypothetically because I can't
 16 remember specifically. You're asking me
 17 what would happen, and I think that's
 18 what we would do.
 19 MR. NEWMAN: When you say
 20 material amounts, what was your measure
 21 of materiality?
 22 THE WITNESS: I think probably
 23 a couple hundred thousand dollars, you
 24 know, 1 percent.
 25 MR. NEWMAN: 1 percent --

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1 DAVID SMITH
 2 something within excess of 1 percent,
 3 then it was material in terms of the
 4 offering amount?
 5 THE WITNESS: Yeah. I didn't
 6 have any written number that I dealt
 7 with. I am trying to respond to your
 8 question.
 9 MR. NEWMAN: Right.
 10 THE WITNESS: Where I am
 11 sitting here today and that would be a
 12 number that I would start to look at.
 13 MR. NEWMAN: From a standpoint
 14 of what?
 15 THE WITNESS: From the
 16 standpoint that the tranches are out of
 17 balance, you know. We have got
 18 1 percent more in one tranche than the
 19 other, then I would have wanted to see
 20 something.
 21 MR. NEWMAN: Well, did you
 22 understand as the compliance officer for
 23 McGinn Smith that you had a legal
 24 obligation to ensure that the offering
 25 terms were complied with?

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1 DAVID SMITH
2 THE WITNESS: The offering
3 terms were complied with. I am talking
4 post-offering. The offering terms were
5 always complied with.
6 MR. NEWMAN: So, again, you
7 know, this is a -- when you give a
8 customer a prospectus saying we are
9 going to raise X amount of dollars and X
10 amount in each of the tranches, did you
11 believe there was a time limit on that
12 disclosure?
13 MR. FRANCESKI: I think, Mike,
14 I hear him -- wait, wait, wait. I hear
15 him saying he tolerated non-material
16 variations from the offering, and you
17 can make what you want of it but I think
18 that's what he's telling you.
19 THE WITNESS: Post-offering.
20 I think there's a critical difference.
21 MR. NEWMAN: That's what I am
22 trying to understand. When you say
23 post-offering, explain the difference
24 between the offering and the
25 post-offering. As far as we can see,
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1 DAVID SMITH
2 there's an offering memorandum that says
3 we are going to raise X amount of
4 dollars in X amount in each of these
5 tranches.
6 MR. FRANCESKI: Objection.
7 Asked and answered but explain it to him
8 once again.
9 MR. NEWMAN: So it hasn't been
10 explained.
11 MR. FRANCESKI: Yeah, it has,
12 twice.
13 MR. NEWMAN: Again, we will
14 have to agree to disagree on that.
15 MR. FRANCESKI: Just I am
16 willing to admit mistakes and you
17 aren't. Go ahead. Explain it to him
18 again.
19 THE WITNESS: What the
20 distinction that I am referring to is
21 that in the offering, the initial
22 offering period, we are offering \$20
23 million, we are offering 5, 5, and 10.
24 MR. NEWMAN: Right.
25 THE WITNESS: It's my belief
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1 DAVID SMITH
2 and recollection that in all four LLCs,
3 that was followed to the letter, that at
4 the end of the offering period when the
5 offering was complete, fully subscribed
6 for.
7 MR. NEWMAN: Okay.
8 THE WITNESS: It was 5, 5, 10.
9 MR. NEWMAN: Okay.
10 THE WITNESS: At some time
11 during the end of the subscription
12 period, over the next two or three
13 years, there may have been individuals
14 in one tranche that, in effect, sold
15 their senior subordinate, and there may
16 have been another investor who, as
17 orders came in they didn't all match up,
18 bought a little more of the other
19 tranche.
20 I just have a recollection of
21 seeing that at some point, not on a
22 material basis, not anything -- not as
23 McGinn Smith, now I am in effect the
24 manager of the LLC, and that doesn't, in
25 my judgment, have any impact, impairment
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1 DAVID SMITH
2 on either how I manage the assets or the
3 impact that it has on the existing note
4 holders.
5 MR. NEWMAN: Are you familiar
6 with SEC Rule 10b-9.
7 THE WITNESS: Not by
8 designation.
9 MR. NEWMAN: You are not
10 familiar with that rule? You are not
11 familiar with that rule?
12 THE WITNESS: Not by
13 designation. I may be familiar with the
14 rule. I don't --
15 MR. NEWMAN: Okay. Just so I
16 understand.
17 THE WITNESS: You are not
18 going to tell me, huh?
19 MR. NEWMAN: Not yet. No, I
20 am not going to tell you. I am going to
21 ask you a question. At the time of the
22 offering, it's your testimony that for
23 all four offerings, each of the tranches
24 was -- except for the last offering --
25 excuse me. Let me rephrase that. For
Page 580

1 DAVID SMITH
 2 three of the four offerings, each of the
 3 tranches was fully subscribed during the
 4 offering period?
 5 THE WITNESS: That's my
 6 recollection.
 7 MR. NEWMAN: Okay. So in a
 8 situation where -- let me rephrase that.
 9 I'm sorry. For each of those three
 10 offerings, were there instances after
 11 the offering had been fully subscribed
 12 where a customer had redeemed prior to
 13 maturity date by finding another
 14 investor, or a broker had found another
 15 investor, did that happen in all three
 16 of the offerings?
 17 THE WITNESS: I don't know.
 18 I'm not able to process that much
 19 information over seven years.
 20 MR. FRANCESKI: The answer is
 21 you don't know. You don't have to
 22 apologize for not knowing. Say you
 23 don't know, move on.
 24 MR. NEWMAN: But there were
 25 instances you were aware of where that

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1 DAVID SMITH
 2 practice happened after the offering had
 3 been fully subscribed where a customer
 4 had redeemed prior to maturity date and
 5 another investor was found?
 6 THE WITNESS: There were
 7 instances of that, yes.
 8 MR. NEWMAN: So in those
 9 instances every one of those instances
 10 would be a situation where the maximum
 11 amount within each tranche had been
 12 exceeded?
 13 THE WITNESS: No. No,
 14 absolutely not.
 15 MR. NEWMAN: Can you explain
 16 to me why I am wrong?
 17 THE WITNESS: Because if an
 18 investor redeemed, we now have less
 19 dollars, as far as subscribers are
 20 concerned, and in your example it was
 21 re-sold, I think that was --
 22 MR. NEWMAN: Right, prior to
 23 maturity date.
 24 THE WITNESS: -- you're
 25 description, the equivalent amount would

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1 DAVID SMITH
 2 now be added to the total subscription.
 3 It wouldn't exceed the subscription at
 4 all.
 5 MR. NEWMAN: I thought you
 6 told us earlier, when you testified,
 7 that in those circumstances that was
 8 treated as a new investment, where it
 9 comes from a redeemed -- prior to
 10 maturity date, and another customer
 11 filled that person's shoes?
 12 THE WITNESS: No, it's not a
 13 new investment in terms of additional
 14 dollars. It's a new investor and
 15 therefore he was entitled to a
 16 prospectus, and we got a subscription
 17 agreement as opposed to some places in
 18 secondary sales and private placements,
 19 they treat it as simply a secondary
 20 market, and they process it as a ticket.
 21 We did not treat it that way.
 22 We treated it that we wanted a
 23 new subscription agreement, and a new
 24 questionnaire, and he was given a
 25 prospectus. That is the distinction.

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1 DAVID SMITH
 2 MR. NEWMAN: Okay. So but in
 3 terms -- then what you're saying in
 4 terms of determining whether or not the
 5 maximum offering amounts had been
 6 exceeded, that was not -- in those
 7 circumstances where a new customer was
 8 brought on to buy the share a customer
 9 who had redeemed prior to maturity, that
 10 wasn't considered for purposes of
 11 determining the maximum offering amount
 12 as a new investment?
 13 THE WITNESS: Absolutely not.
 14 MR. FRANCESKI: Are you really
 15 not understanding what he's saying or
 16 are you just playing with us here?
 17 MR. NEWMAN: You can make all
 18 the comments you want to make, but I
 19 don't -- I don't understand what the
 20 witness is saying. So I am entitled to
 21 ask questions so I have that
 22 understanding.
 23 MR. FRANCESKI: Well, I will
 24 be object, asked and answered, but you
 25 may do what you like. I am really

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1 DAVID SMITH
 2 querying whether you don't understand
 3 what he's saying because he's been very
 4 clear three times.
 5 MR. NEWMAN: I don't
 6 understand what he's saying. That's why
 7 I'm asking the question.
 8 MR. FRANCESKI: Objection,
 9 asked and answered. Do we have a
 10 question?
 11 MR. NEWMAN: Yeah, we do have
 12 a question. I am trying to determine --
 13 earlier you testified when a customer
 14 redeemed prior to maturity, that was
 15 considered to be new investment. Was
 16 that your earlier testimony?
 17 THE WITNESS: That may have
 18 been but your interpretation of new
 19 investment is quite wrong. It's a new
 20 investor. I think that is quite clear.
 21 We get a new subscription document, a
 22 new questionnaire, he's a new investor.
 23 On the other hand, it's not an
 24 additive dollar amount to the original
 25 subscription. If one sells and one buys
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1 DAVID SMITH
 2 in equal amounts, the amount has not
 3 increased. So there's still \$20
 4 million. So there's no -- to your
 5 point, you seem to be suggesting, that
 6 we have somehow now, because simply a
 7 new body has come in, despite the fact
 8 he's replacing an old body, that the
 9 total subscription amount now exceeds
 10 the \$20 million.
 11 That's not -- there's no logic
 12 to that line.
 13 MR. NEWMAN: Did you ever get
 14 a legal opinion on that?
 15 THE WITNESS: No.
 16 MR. NEWMAN: Okay.
 17 BY MS. SMITH:
 18 **Q So you had said that there could be**
 19 **times where the tranche maximum may have been**
 20 **exceeded within each one of the different LLCs?**
 21 A Yeah. I think that's -- there may
 22 have been an instance of that, yeah.
 23 **Q How about the overall maximum**
 24 **investment in the notice?**
 25 A I don't believe so. I can't tell
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1 DAVID SMITH
 2 you -- I am not going to respond that never, never
 3 happened but I don't believe it happened.
 4 MS. SMITH: I would like to
 5 introduce Exhibit 12. This is an e-mail
 6 sent from Patty Sicluna to David Smith
 7 on April 18, 2007, with a printout of
 8 the attached First Excelsior Income
 9 Note, Excel spreadsheet dated
 10 March 23rd, 2007. Staff has numbered
 11 and circled pages for ease of reference.
 12 The exhibit is 14 pages long.
 13 THE WITNESS: Fire away.
 14 (Whereupon Exhibit 14 is
 15 Marked.)
 16 BY MS. SMITH:
 17 **Q Do you recall receiving this e-mail?**
 18 A I don't, but it certainly was
 19 addressed to me so I have no reason to believe it's
 20 not mine.
 21 **Q And what was the purpose of this**
 22 **e-mail?**
 23 A I don't know the purpose. It appears
 24 to simply list all the investors and their
 25 investments, and it's all four LLCs, (Reviewing). I
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1 DAVID SMITH
 2 guess this is just for First Excelsior Income Notes.
 3 It appears to be the investors, and I don't know if
 4 it has segregated by tranche or not. I have to look
 5 a little harder.
 6 MR. FRANCESKI: I just want to
 7 interpose an objection on the record.
 8 The e-mail would suggest that the
 9 attachment was to be for the four LLCs,
 10 and the attachment we have here is only
 11 for FEIN. I don't know what to make on
 12 that but I simply put an objection on
 13 the record just because perhaps this
 14 isn't the correct or full attachment.
 15 MS. SMITH: I have the
 16 remainder of the remaining three notes
 17 printed out and the attachments if you
 18 would like to see those, but we are not
 19 going to be referencing them here.
 20 MR. FRANCESKI: No, I don't
 21 care how the staff uses the exhibit, but
 22 the e-mail cover suggested there was
 23 more attached than there is.
 24 MR. NEWMAN: That is correct.
 25 There is more. For purposes of this
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1 DAVID SMITH
 2 line of questioning, we are only
 3 including part of the attachment.
 4 MR. FRANCESKI: That's all I
 5 need.
 6 MR. NEWMAN: If the witness
 7 would like to see the entire attachment,
 8 we will make that available.
 9 MR. FRANCESKI: Thanks.
 10 THE WITNESS: Go ahead..
 11 BY MS. SMITH:
 12 **Q If you can turn to Page 13 and look**
 13 **at the line called totals, and you can see it looks**
 14 **as though the First Excelsior Note has exceeded the**
 15 **\$20 million maximum offering by at least \$275,000.**
 16 MR. FRANCESKI: Objection, but
 17 you may answer.
 18 BY MS. SMITH:
 19 **Q Can you explain this?**
 20 A I guess it would be consistent with
 21 my testimony that my recollection was there was a
 22 time that that occurred.
 23 MR. FRANCESKI: Let me caution
 24 the witness. What you have on Page 13
 25 are two totals. She posed the question

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1 DAVID SMITH
 2 that those totals lead to a particular
 3 conclusion. Do you know that from
 4 looking at the document? Have you
 5 looked at the document carefully enough
 6 to know whether her construction of the
 7 total is correct?
 8 MR. NEWMAN: Now we are going
 9 beyond an objection to --
 10 THE WITNESS: -- coaching.
 11 MR. NEWMAN: Coaching, yes,
 12 thank you.
 13 MR. FRANCESKI: Well, I am not
 14 coaching but I think it is a fair
 15 objection to the question. If the
 16 question was posed to suggest one thing,
 17 and I am not sure the witness took the
 18 time to --
 19 MR. NEWMAN: The witness has
 20 answered the question.
 21 MR. FRANCESKI: But aren't you
 22 interested in the correct record, Mr.
 23 Newman? And if he answered the question
 24 with the misunderstanding of the
 25 material in front of him, that would not

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1 DAVID SMITH
 2 be a correct answer. I thought we were
 3 interested in the truth here and not
 4 tricking the witness into giving an
 5 answer --
 6 MR. NEWMAN: And we certainly
 7 on, the witness indicated any confusion
 8 about the question, he answered it. So
 9 we will accept his answer as what's on
 10 the record.
 11 MR. FRANCESKI: Well, but
 12 witnesses sometimes don't look over 13
 13 pages of documents in probably
 14 30 seconds. Well, maybe they should.
 15 That is what happened here. And all I
 16 was suggesting to the witness is he take
 17 his time and look and make sure he
 18 agrees with her characterization.
 19 MR. NEWMAN: Why don't you ask
 20 the next question.
 21 MR. FRANCESKI: So I object to
 22 that question and move to strike it, and
 23 answer.
 24 MR. NEWMAN: The record will
 25 speak for itself.

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1 DAVID SMITH
 2 MR. FRANCESKI: Indeed.
 3 MS. SMITH: Staff would like
 4 to introduce Exhibit Number 13, an
 5 e-mail from Patty Sicluna --
 6 THE WITNESS: We are getting
 7 hungry over here.
 8 MS. SMITH: -- to David Smith
 9 on August 11th, 2008. E-mail provides a
 10 summary of invested funds for each of
 11 the four Income Notes and the exhibit is
 12 one page.
 13 (Whereupon Exhibit 13 is
 14 Marked.)
 15 MR. FRANCESKI: You're
 16 entitled to request a break for food or
 17 whatever you like. It's up to the staff
 18 to grant the request. But if you're
 19 hungry, just tell the staff that.
 20 THE WITNESS: I am hungry.
 21 You guys got to be hungry.
 22 MR. NEWMAN: Why don't we do
 23 this exhibit and we will take a lunch
 24 break. That's fine.
 25 MR. FRANCESKI: Is that okay

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1 DAVID SMITH
 2 with you?
 3 THE WITNESS: Yeah, that's
 4 fine.
 5 BY MS. SMITH:
 6 **Q Do you recall receiving this e-mail?**
 7 A I don't. I don't dispute its
 8 authenticity.
 9 **Q Can you describe what this e-mail is,**
 10 **the information contained in the e-mail?**
 11 A Looks like a breakdown of the three
 12 separate tranches and the four separate LLCs that we
 13 have been discussing.
 14 **Q And for the First Excelsior Note, the**
 15 **last note listed?**
 16 A Yes.
 17 **Q The e-mail there is 20,065,000?**
 18 A That is correct.
 19 **Q Which exceeds the \$20 million maximum**
 20 **offering amount. This e-mail is dated a year and a**
 21 **half after the last exhibit, and it looks as though**
 22 **the Excelsior note exceeded the \$20 million amount**
 23 **for over a year and a half.**
 24 A Well, I don't think you could draw
 25 that conclusion, with all due respect. There is

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1 DAVID SMITH
 2 fluctuating amounts during that period of time.
 3 You're concluding that at point A was exceeding and
 4 point B was exceeding, but we don't know what might
 5 happen in-between. But I don't dispute the fact that
 6 at this particular date the fines were in excess of
 7 the overall amount by \$65,000.
 8 MR. NEWMAN: At what point did
 9 you understand that FEIN offering to be
 10 fully subscribed approximately?
 11 THE WITNESS: I believe that
 12 offering was in November.
 13 BY MS. SMITH:
 14 **Q Excuse me. This is FEIN?**
 15 MR. NEWMAN: FEIN.
 16 THE WITNESS: FEIN.
 17 MR. NEWMAN: When was that
 18 fully subscribed?
 19 THE WITNESS: I believe it was
 20 fully subscribed somewhere between
 21 December '03 and maybe February '04. My
 22 recollection is the offering came in
 23 November of '03 and more likely than not
 24 took two months, three months to fully
 25 subscribe.

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1 DAVID SMITH
 2 MR. NEWMAN: How about the
 3 other ones?
 4 THE WITNESS: First
 5 Independent Income Notes, again, to the
 6 best of my recollection, was September
 7 of '03. I believe it was probably fully
 8 subscribed within a couple of months so
 9 we are talking October/November of '03.
 10 Third Albany Income Notes was
 11 sometime in '04, and I think First
 12 Advisory was late '04. I don't have the
 13 exact dates on the top of my head.
 14 MS. SMITH: I would like to
 15 introduce Exhibit Number 14. This is an
 16 Excel spreadsheet prepared by Staff in
 17 review of the Charter One Bank escrow
 18 statements for the First Independent
 19 Income Note for the period of
 20 September 2003 through August 2004.
 21 MR. FRANCESKI: Wait a minute.
 22 I thought we were taking a break after
 23 the last document? That's what the
 24 staff offered to the witness.
 25 MR. NEWMAN: Right. Just one

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1 DAVID SMITH
 2 exhibit left in this line of questioning
 3 so we thought just to get it over, we
 4 will do it, and this is going to be
 5 brief.
 6 MR. FRANCESKI: Is it
 7 basically one exhibit or is it one
 8 exhibit?
 9 MR. NEWMAN: It's one exhibit.
 10 MR. FRANCESKI: Are you okay
 11 with that?
 12 THE WITNESS: That's fine.
 13 MS. SMITH: The exhibit is one
 14 page.
 15 (Whereupon Exhibit 14 is
 16 Marked.)
 17 BY MS. SMITH:
 18 **Q I do have the supporting bank escrow**
 19 **statements if you would like to review those, as**
 20 **well?**
 21 MR. FRANCESKI: I'm sorry.
 22 What is Exhibit 14 purporting to be?
 23 BY MS. SMITH:
 24 **Q This is an Excel spreadsheet prepared**
 25 **by Staff reviewing the Charter One Bank escrow**

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1 **DAVID SMITH**

2 **statement for the First Independent Income Note for**
3 **the period of September 2003 through August 2004.**

4 MR. FRANCESKI: Thanks.

5 (Reviewing).

6 BY MS. SMITH:

7 **Q If you would just take a look at the**
8 **deposit amount, you will see that within that time**
9 **frame of September '03 through August 2004, the**
10 **amount exceeded the 20 million?**

11 A Yeah, but I think the -- and
12 obviously I am not privy to the analysis but I think
13 it's flawed because this offering was fully
14 subscribed for long before 8-31-2004.

15 So some of those deposits may very
16 well have been either resales, which to Mr. Newman's
17 point, I think we've hopefully put that aside, or as
18 I indicated earlier, and again, I have no certainty
19 of this, but I did actually raise it, that -- that
20 escrow account may have been used, you know, as an
21 operating account even.

22 But I can tell you that that offering
23 was long fully subscribed for and closed before
24 8-31-2004. So what you have is you have the \$20
25 million, let's say I am correct, and it was

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1 **DAVID SMITH**

2 actually -- because this is FIIN, and my recollection
3 was is that FIIN was fully subscribed for by October
4 or November of '03.

5 Okay. Subsequent to that if somebody
6 sold their unit and made a withdrawal and you made
7 another deposit, you shouldn't be adding that to the
8 original subscription amount because it is a net --
9 it is a net zero.

10 And clearly once escrow was broken,
11 and whether it was October/November/December '03, I
12 don't really remember which, but I know it didn't go
13 beyond December because the fact was is that one of
14 the leading reasons that we came forth with another
15 offering in First Excelsior was because there was an
16 interest and a demand for more product because First
17 Independent Income Notes had, in fact, been fully
18 subscribed for.

19 So you can't add deposits that are
20 taking place in May of '04 and adding it to the total
21 subscription amount. That's just flawed thinking.
22 It doesn't work.

23 **Q What is the purpose of the escrow**
24 **account, again, because this is specifically for**
25 **FIIN?**

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1 **DAVID SMITH**

2 A It is. And I believe once the escrow
3 account is broken, that the investment is fully
4 subscribed for -- we kept the escrow account up
5 because we are not allowed to have a bank record, and
6 that provided us with a bank record. But once escrow
7 is broken, it is no longer really operating as an
8 escrow account.

9 The issue is fully subscribed for,
10 the money has been disbursed to, in this case, the
11 LLC. The LLC is operating, making investments, and
12 any subsequent investments would not be added to the
13 subscription amount. You have to take a net basis in
14 and out. So as I said, I haven't seen -- I know your
15 staff is very competent, but I think there's a flawed
16 thinking here.

17 **Q So what you are saying is that within**
18 **a one-year time frame, actually less than a one-year**
19 **time frame, when this escrow account was established**
20 **for FIIN monies coming in exceeded the 20 million**
21 **showing here \$20,837,133 due to resales?**

22 A What I am saying is one of two
23 things. That is a possibility. Seems highly
24 unlikely but it is a possibility. Or potentially the
25 account was used as other deposits came in as an

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1 **DAVID SMITH**

2 operating account initially. Shouldn't have been but
3 it may have. I mean, the only way you could
4 determine whether this was oversold was to look at
5 the investor list every single month from 9-30-2003
6 to 8-31-2004, the records kept by Miss Sicluna, and
7 if, in fact, it went over within that time of actual
8 dollars, then I would buy in to your theory, but my
9 guess is you are not going to find that.

10 MR. PAULSEN: Would the
11 records in the database maintained by
12 Miss Sicluna reflect the amounts and the
13 dates the amounts were deposited to the
14 escrow account and identify the party
15 for which they were deposited for?

16 THE WITNESS: I believe so.

17 MR. PAULSEN: So then in
18 theory we can match the deposits to this
19 account to specific investors?

20 THE WITNESS: Yeah. I mean, I
21 think it is easier than that, Mike. You
22 could ask, from our records, you know,
23 pick your dates, want to use the ending
24 date of every month and see what the
25 subscriptions were in each of those

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