

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 III

12 INVESTIGATIVE TESTIMONY OF

13 DAVID SMITH

14 WOODBRIDGE, NEW JERSEY

15 FEBRUARY 3, 2010

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19

20 ATKINSON-BAKER, INC.

21 COURT REPORTERS

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25 FILE NO.: A400C31

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 3, 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

FINRA

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Representing Witness.

ALSO PRESENT:
JOSEPH CARR

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DAVID SMITH

DAVID SMITH, Having been previously sworn, Continues to
testify:

EXAMINATION

BY MR. NEWMAN:

Q Back on the record.

**Mr. Smith is here for the
continuation of his testimony that we started a
couple of days ago.**

**Is there any -- are there any issues,
loose ends we need to discuss before we start the
examination?**

A Don't have any.

**Q Okay. Couple of things I want to go
over from the last couple of days. The first thing
is, there was a reference to an upcoming arbitration
or trial that you are involved with.**

A Yes.

Q Can you explain what that is?

A I will do my best. It's a bit of a
bizarre theory of law, but I guess that's what we all
seek to remedy.

Sometime ago, certainly within, I
think it was 2009, we received a -- I guess a

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1 DAVID SMITH

2 complaint or suit, whatever, from the Bankruptcy
3 Court of CCI, which is Caribbean Club. That's an
4 investment that you have seen in the LLCs. And
5 Caribbean Club was a development project in the
6 Caribbean, as the name implies. It was headed by an
7 investment banker and broker by the name of Mark
8 Casolo. I will try to make this short. Casolo moved
9 on in '05, continued with that project and --

10 MR. FRANCESKI: "Moved on"
11 meaning?

12 THE WITNESS: Moved on to
13 another brokerage firm. Excuse me.
14 Transferred his license to a firm by the
15 name of Westrock Securities. And
16 somewhere after leaving us, joining
17 Westrock, I am thinking '07, basically
18 after a series of finances and what have
19 you, it went into bankruptcy.

20 Bankruptcy trustee is -- I
21 guess the best way I can describe it is
22 he's attempting to recover the placement
23 fees that McGinn Smith received in
24 raising some capital on the theory that
25 Casolo, who well after the placement

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1 DAVID SMITH

2 took place, in an effort to basically
3 right the ship or give more guidance to
4 it, was appointed an officer and
5 chairman of the board.

6 And the theory in the
7 bankruptcy court is, I guess, that he
8 was then in a dual role, and so that any
9 -- so that he should have been raising
10 the capital and not McGinn Smith. The
11 fact is McGinn Smith had already raised
12 it, been sold by brokers, they were paid
13 commissions and the court is now
14 attempting to lay a claim to those
15 commissions, so...

16 Doesn't seem to have much
17 logic to me, but then again that's where
18 we are at. They've come back. I think
19 they started out with some -- Joe could
20 maybe help me, but about 700,000,
21 they've offered to settle for, I think,
22 three times in the last month. So that
23 will suggest their case isn't that good.
24 But I believe it is scheduled for
25 somewhere around the 20th of this month.

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1 DAVID SMITH

2 BY MR. NEWMAN:

3 **Q Is there another arbitration you're**
4 **participating in?**

5 A There's an arbitration scheduled for
6 March 1st.

7 **Q Who is the customer?**

8 A [REDACTED]

9 **Q [REDACTED] was an investigator in**
10 **the LLC investments?**

11 A I think he has some LLCs. The bulk
12 of his dollars that I think the complaint revolves
13 around is in the CCI with Casolo. Casolo was his
14 broker. And they had a number of private placements.
15 The LLCs were to some degree, but I think most of the
16 money and most of the complaint revolves around CCI.

17 **Q Do you have anything else scheduled**
18 **in the way of upcoming hearings or arbitrations?**

19 A No. Between now and March 1st, you
20 mean?

21 **Q In the next six months?**

22 A In the next six months, yeah, um,
23 there's -- there is one in May. I think there's
24 literally one in every month. There is one in May,
25 there is one in June, I think July. There's about

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1 DAVID SMITH

2 eight arbitrations out there. And I think they have
3 scheduled maybe three or four.

4 **Q Are those the arbitrations that you**
5 **referred to on Monday that have been filed by the**
6 **attorney in Albany?**

7 A Yes.

8 **Q Tim O'Connor?**

9 A Tim O'Connor, yes.

10 **Q Your personal bank accounts -- you**
11 **said M&T Bank is where you maintain your personal**
12 **account?**

13 A That is correct.

14 **Q How long have you maintained an**
15 **account at M&T?**

16 A M&T and its predecessor, which was
17 Union National Bank, I think as long as I've been
18 downtown with McGinn Smith, which would probably be,
19 you know, 29 years.

20 **Q Is it an account in your name or is**
21 **it a joint account?**

22 A It's in my name.

23 **Q Other than that account, have you**
24 **held any other bank accounts over the last seven**
25 **years?**

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1 **DAVID SMITH**
2 A Just in my name?
3 **Q Yes.**
4 A I don't think so.
5 **Q How about in joint name with your**
6 **wife?**
7 A Yeah, I think I've, at some time, had
8 a joint account with her. I don't know when or
9 where. I think generally her account is used to pay
10 bills. I think it was joint, maybe it's not -- it's
11 not joint now. It's just in her name.
12 **Q So her bank account is used to pay**
13 **your family expenses?**
14 A Right.
15 **Q Personal expenses?**
16 A Right.
17 **Q Is that account at M&T Bank too?**
18 A No. I think it's Bank of America.
19 **Q How long has it been at Bank of**
20 **America?**
21 A Probably since we have been in
22 Saratoga, which is six years.
23 **Q Is that your primary family bank**
24 **account?**
25 A Yes.

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1 **DAVID SMITH**
2 **Q And you use that account to pay your**
3 **own personal expenses?**
4 A Yes.
5 **Q Do you have any investment accounts**
6 **in your name?**
7 A I don't think so. I did years ago.
8 It was small. May still be existing. There's no
9 meaningful investments in it or dollars.
10 **Q Does your wife have any investment or**
11 **brokerage accounts in which you have a beneficial**
12 **interest or control?**
13 A No.
14 **Q That would apply for the last seven**
15 **years?**
16 A Yes.
17 **Q I want to ask a couple more questions**
18 **about the LLC offerings. The First Independent**
19 **Income Notes LLC Private Placement is dated**
20 **September 15, 2003.**
21 **Do you know when in reference to that**
22 **date the concept -- let me rephrase that.**
23 **When in reference to September 15,**
24 **2003 you determined to raise funds for that entity;**
25 **when you first decided to create that entity?**

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1 **DAVID SMITH**
2 A I believe I testified yesterday the
3 thought was sometime in the spring of that year. I
4 believe I met with Gersten Savage, spring-summer and
5 initiated the offering in September, as you pointed
6 out.
7 **Q First Excelsior is dated January 16,**
8 **2004.**
9 **Same question: When in reference to**
10 **that date did you first decide to raise funds through**
11 **that entity?**
12 A It would have been -- actually, I
13 thought it was in November of '04. I'm obviously
14 wrong.
15 The thought came after the completion
16 or probably near-completion of First Independent
17 Income Notes. I testified yesterday, would do so
18 again today, that that offering was quite successful
19 and there was a demand for some -- you know,
20 continuing the concept.
21 So the thought would have come -- I
22 believe First Independent Income Note sold out within
23 a couple of months. So I would guess that you're
24 talking at the end of November then that First
25 Excelsior, the thought came to. And I thought we

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1 **DAVID SMITH**
2 initiated it then, but definitely not until January.
3 **Q Third Albany Income Notes, the PPM is**
4 **dated November 1st, 2004. Same question for that**
5 **offering.**
6 A Basic same answer as First Excelsior:
7 Was ultimately completed, continued interest. And I
8 don't know exactly when we started putting those
9 thoughts together, but probably in September '04,
10 maybe August '04.
11 **Q Last one is First Advisory, which is**
12 **dated October 1, 2005. Same question for that.**
13 A Probably had thoughts, you know,
14 three months earlier, so summer of '05.
15 **Q Did any of these four LLCs go on**
16 **simultaneously?**
17 **Were there any occasions when**
18 **interests were being sold in more than one of the**
19 **LLCs at the same time?**
20 A Not for the original subscription, I
21 don't believe.
22 **Q There was no overlapping investments**
23 **for the original --**
24 A No.
25 **Q -- investments?**

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1 **DAVID SMITH**

2 A No. There might have been secondary
3 sales, but not at the original subscription.

4 MR. MCCARTHY: I just want to
5 make sure I understand a couple of
6 questions.

7 We are going to go back to
8 where Mike just started. Mike was
9 asking about your personal bank
10 accounts, yourself and your wife. I
11 want to clarify: Any other bank
12 accounts, including trusts, where you're
13 the trustee or the beneficiary or have a
14 beneficial interest?

15 THE WITNESS: There is --
16 there's an irrevocable trust. I believe
17 the trustee is Thomas Urbelis.
18 Beneficiaries, I believe, are my
19 children.

20 MR. MCCARTHY: Where is that
21 trust held?

22 THE WITNESS: "Held" meaning,
23 the account?

24 MR. MCCARTHY: The account's
25 held.

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1 **DAVID SMITH**

2 THE WITNESS: The account is
3 held at NFS.

4 MR. MCCARTHY: Any others?

5 THE WITNESS: There was a QTIP
6 Trust that was formed through some
7 estate planning a few years ago. It
8 turned out it was not funded properly.
9 I don't -- I am not that familiar with
10 exactly the tax laws, but ultimately we
11 had to unfund it, unwind it. I don't
12 think it exists anymore. But maybe QTIP
13 trusts don't have a way of dying.
14 There's no funds in it, but it may still
15 exist.

16 There's a life insurance
17 trust, and I think that's in the name of
18 my wife. I don't -- I think the kids
19 are beneficiaries. I possibly would be
20 the beneficiary.

21 MR. MCCARTHY: What firm is
22 that held with?

23 THE WITNESS: I don't think
24 it's any firm. I think it's just -- I
25 think it's a life insurance trust, you

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1 **DAVID SMITH**

2 know, for life insurance policies, stuff
3 like that.

4 MR. MCCARTHY: There would be
5 a company that issued the policy.

6 THE WITNESS: Oh, yeah. I
7 think it is Lutheran Brotherhood,
8 something like that.

9 MR. MCCARTHY: Any others?

10 THE WITNESS: That's all I can
11 think of at the moment.

12 MR. MCCARTHY: What about
13 offshore?

14 THE WITNESS: No offshore
15 accounts.

16 MR. MCCARTHY: There are no --

17 THE WITNESS: No.

18 MR. MCCARTHY: -- offshore?

19 THE WITNESS: No.

20 MR. MCCARTHY: What about bank
21 accounts for corporations that you are
22 a -- have a substantial interest in,
23 outside of the McGinn Smith entities?

24 THE WITNESS: Outside the
25 McGinn Smith entities, referring, Bob,

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1 **DAVID SMITH**

2 to the four that we have been talking
3 about?

4 MR. MCCARTHY: Talking
5 affiliated companies with McGinn Smith,
6 personally affiliated, outside the
7 brokerage business.

8 THE WITNESS: Well, I guess
9 there's a long list. There's things
10 like M&S Partners. That is a bank
11 account at M&T. There is -- McGinn
12 Smith Capital Holdings has a bank
13 account. I suspect M&S -- M&S Holdings
14 has a bank account. TDM, which we've
15 talked about over the last couple of
16 days, has an operating account. I am
17 not sure where that is. It may be North
18 Carolina for a bank that we used to do
19 business with. Or maybe at M&T.

20 You know, I have -- there's a
21 list, to make life easy for both of us,
22 that Brian Cooper produces every day
23 that has all the operating accounts.
24 Some of them are that I have involvement
25 in, and some of them are entities that

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1 DAVID SMITH
 2 have been formed and continue to
 3 operate.
 4 If I had access to that, it
 5 would make both of our lives easier. If
 6 you would like to get that, I would do
 7 that for you.
 8 MR. MCCARTHY: Okay. Let's do
 9 that.
 10 But aside from that, outside
 11 that list that you're going to produce.
 12 THE WITNESS: No. I've given
 13 you all that I can think of.
 14 MR. NEWMAN: Are there any
 15 accounts which you have signatory
 16 authority that would not be included on
 17 that list in terms of an entity or
 18 corporate account?
 19 THE WITNESS: No.
 20 MR. MCCARTHY: Would the same
 21 hold true for any non-bank accounts,
 22 brokerage accounts, any types of
 23 accounts?
 24 THE WITNESS: That would, yes.
 25 MR. FRANCESKI: Let me say

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1 DAVID SMITH
 2 this for the record. I believe we
 3 provided -- not we, McGinn Smith,
 4 provided some of that information in
 5 various forms in response to various
 6 information requests up until now. And
 7 Mr. Smith is going by recollection today
 8 and should not be held against him if
 9 his recollection doesn't -- isn't
 10 complete as to all those accounts.
 11 MR. MCCARTHY: No problem.
 12 Okay.
 13 MR. RATTINER: Who is [REDACTED]
 14 [REDACTED]?
 15 THE WITNESS: [REDACTED]
 16 is an attorney out of Boston, long-time
 17 friend of mine. I have known him since
 18 the seventh grade.
 19
 20 EXAMINATION
 21 BY MR. RATTINER:
 22 Q Any of the four LLCs paid Mr.
 23 Urbelis?
 24 A No.
 25 Q Okay.

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1 DAVID SMITH
 2 A I don't even pay Mr. [REDACTED]
 3 Q Did he invest in any of the four
 4 LLCs?
 5 A Yes, I think his IRA had an
 6 investment. He's been a client of mine for 30 years.
 7 Q What is the status of his investment?
 8 A Status of his investment is, he's --
 9 the only investment that I -- I shouldn't say that.
 10 I think he has two investments
 11 remaining: One in Pine Street Capital Partners, and
 12 he was an investor in SAI International.
 13 Q Did he invest at any point in time in
 14 LLC?
 15 A Yes.
 16 Q Did he redeem those?
 17 A He redeemed those.
 18 Q Okay. We discussed a little bit
 19 yesterday -- I believe it was yesterday, if not,
 20 Monday, alsoT IP.
 21 How much money was loaned to alsoT
 22 IP; do you recall?
 23 A I believe it was in the 7 or 8
 24 million dollar range, notwithstanding accrued
 25 interest. I think the accrued interest now has

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1 DAVID SMITH
 2 brought the total investment up to the 9 to 10
 3 million dollar range.
 4 MR. FRANCESKI: Were you
 5 asking Chris about loans -- when you
 6 said "loans," did you mean loans by the
 7 LLCs?
 8 MR. RATTINER: Correct.
 9 BY MR. RATTINER:
 10 Q And what is the current account
 11 condition of alsoT IP?
 12 A It's still operating. It has --
 13 since January '09, in my judgment, has lost most of
 14 its current possibilities. January of '09, they were
 15 still seriously negotiating and had a strong interest
 16 from Fortress for \$100 million financing.
 17 Prior to that, in end of '07, which
 18 was when we thought the fortunes were best going to
 19 be served, they were in very serious negotiations
 20 with Goldman Sachs to provide a \$500 million line of
 21 credit -- credit facility.
 22 Since January of '09, the Fortress
 23 deal seems to have escaped them and their activities
 24 are very, very limited. As far as I know, they are
 25 still trying to operating within the concept of

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1 DAVID SMITH
2 getting financing, but they have not been successful
3 to date.

4 **Q And have they come to you, elseT --**
5 **come to you or McGinn Smith or the LLCs for**
6 **additional funding in 2009?**

7 A There was an additional financing
8 provided for them outside of the LLCs. And I can't
9 remember if that -- I don't think it was in '09. I
10 think it was in '08. It's a thing called IP Partners
11 or something of that nature. Didn't raise a lot of
12 money. Raised -- well, that's always relative, I
13 guess. I think they raised maybe four, five, six
14 hundred thousand dollars.

15 **Q Is that in addition to the 7 to 8**
16 **million?**

17 A Yes. That was outside of the LLCs.

18 **Q What was their liability at that**
19 **point during that raise of the 400, 500?**

20 A It was still strong. They were still
21 negotiating -- they still had the -- if my dates are
22 correct, it was either the Fortune negotiation was
23 still going on or the Goldman Sachs thing was still
24 alive.

25 They were actually taking a new

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1 DAVID SMITH
2 business tack in an attempt to get operating
3 revenues, and they were going to focus on litigation
4 IP. And it was primarily used to fund that.

5 They had probably half a dozen
6 letters of interest, commitment at that time. But
7 whether it's lack of funding or lack of credit
8 availability, probably a little of both, it's been
9 difficult for them to move forward.

10 **Q How is the agreement -- we saw the**
11 **agreement for elseT that was provided by the firm.**
12 **And it mentioned that it was a credit agreement.**

13 **Do you recall?**

14 A It was initially a credit agreement
15 that was drawn up by their counsel, David Goldstein
16 of White & Case. Basically provided for facility --
17 sort of a grid line of credit. Although my
18 recollection is there was no amount stipulated
19 that -- I think the language of it was McGinn Smith
20 or their affiliates. It was never meant to go to
21 McGinn Smith, obviously. I think that was sort of an
22 error in drafting from White & Case.

23 But basically, the financing was done
24 on a quarterly basis. They submitted budgets. The
25 intent always was that it was going to be basically,

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1 DAVID SMITH
2 you know, a three- to six-month transaction from
3 the -- right from the initiation. There looked to be
4 very promising funding opportunities.

5 The original funding that they
6 developed and intended was a fund, if you will, that
7 they were going to sell to institutional investors,
8 generally one or two institutional investors. It was
9 patterned after the Pharma Fund, which was a
10 billion-dollar fund or \$500 million fund that had
11 been successfully raised in which White & Case had
12 been the counsel. That's how elseT arrived at using
13 White & Case. And it was designed to basically --
14 with those dollars -- and they would be take-down
15 dollars. But nonetheless it would be a \$500 million
16 fund. Provide credit facilities to some Pharma, but
17 their focus was going to be on technology and to
18 basically use the IP, intellectual property, which
19 is: copyrights, patents, trademarks, whatever it
20 might be, to support the loans.

21 Generally those companies have cash
22 flow ongoing. They have a business. And the
23 question is, for them to get financing, what do they
24 use? And they use future cash flows from the
25 technology. Risk always says technology can become

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1 DAVID SMITH
2 obsolete. This is where the elseT Group brought
3 their expertise.

4 Two of the leading players in that
5 group, a gentleman by the name of David Kennedy, a
6 gentleman by the name of Stephen Willis, both had
7 experience in evaluating IP, and more importantly
8 what the future cash flows would be. So that was
9 their whole purpose.

10 **Q What was your understanding of the**
11 **use of funds that are being loaned by the LLCs to**
12 **elseT, the 8 million or so dollars?**

13 A It was quite specific. They had a
14 budget, presented me a budget every quarter. And it
15 was, you know, initially -- well, really never
16 changed. I mean, the bulk of their expenses were
17 administrative salary and legal, as they were putting
18 the transactions together. There was marketing
19 costs. They had -- I believe they had two
20 facilities. They had a facility in Chicago and they
21 had a facility in Atlanta.

22 Am I talking too much?

23 MR. FRANCESKI: It would be
24 easier if you let him go after what he's
25 after rather than going over the whole

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1 DAVID SMITH

2 transaction.

3 BY MR. RATTINER:

4 **Q The loans that are made by the LLCs**
5 **were to fund the operating expenses of alseT?**

6 A Yes.

7 **Q What was Mr. Livingston's position at**
8 **the time the loans were made at alseT?**

9 A I think there was -- there were
10 different time periods. Mr. -- just answer the
11 question.

12 MR. FRANCESKI: Whatever he
13 asked -- he will get there quicker.

14 THE WITNESS: Mr. Livingston
15 initially had no position, and at some
16 point became an officer and, I believe,
17 president of the enterprise.

18 BY MR. RATTINER:

19 **Q Okay. How was alseT introduced to**
20 **McGinn Smith?**

21 A Through Mr. Livingston.

22 **Q What was his connection to alseT at**
23 **that time?**

24 A Well, alseT hadn't been formed. His
25 connection was -- is that -- I think as early as

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1 DAVID SMITH

2 2001, maybe 2002, he had been working with Mr.
3 Willis; and they had talked about the concept for
4 some period of time -- excuse me. And ultimately
5 they put the concept together. And ultimately it was
6 brought to our attention for -- our attention,
7 meaning the LLCs, for funding possibilities.

8 **Q Based on current day, does the**
9 **investment have any chance of being repaid?**

10 A I would say it's very small. Very
11 small.

12 **Q Has it been written off yet?**

13 A No. Because in '09, as I indicated a
14 few moments ago, we were still quite hopeful that the
15 Fortress deal would take place. I met with their
16 investment banker, Heather Smith from Deutsche Bank.
17 She was quite encouraged by it. But I think by the
18 summer of '09 that seemed to have diminished. And I
19 haven't heard anything encouraging since.

20 **Q Does alseT have any revenues at this**
21 **point?**

22 A I don't believe they have any
23 revenues. I think -- I know they haven't closed the
24 deal. And I haven't seen any litigation revenues, so
25 I don't believe so.

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1 DAVID SMITH

2 **Q Is Mr. Livingston still affiliated**
3 **with alseT?**

4 A He's not.

5 MR. NEWMAN: Some questions
6 about alseT. According to the
7 information we have, Quicken records,
8 there's over \$8 million that was
9 invested in alseT by the LLCs
10 cumulatively.

11 Does that sound accurate?

12 MR. FRANCESKI: Objection.
13 You may answer.

14 THE WITNESS: I may answer?

15 MR. FRANCESKI: Yes. I object
16 to the form of the question.

17 THE WITNESS: Yeah. That
18 sounds about right, yes.

19 MR. NEWMAN: Over what period
20 of time was this \$8 million invested?

21 MR. FRANCESKI: Same
22 objection.

23 THE WITNESS: I would -- to
24 the best of my recollection, funding
25 probably started in '04, '05, continued

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1 DAVID SMITH

2 through -- certainly maybe '07. So it
3 was maybe a three-year period, two-year
4 period -- two-and-a-half, three-year
5 period.

6 MR. NEWMAN: Whose decision
7 was it to invest these funds in this
8 entity?

9 MR. FRANCESKI: Same
10 objection.

11 THE WITNESS: Well, the
12 management of the LLCs, which was
13 primarily during those years myself, but
14 certainly that was the one of the
15 projects that Mr. Livingston was
16 obviously intimately involved with.

17 MR. NEWMAN: Was it your
18 decision to invest this money?

19 THE WITNESS: Yes.

20 MR. FRANCESKI: Meaning?
21 "Your" meaning?

22 MR. NEWMAN: You personally.
23 Did you decide that that was a good
24 investment?

25 THE WITNESS: No. It was --

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1 DAVID SMITH
 2 representing MS Advisors, yes. I was a
 3 managing member of MS Advisors, yes.
 4 MR. NEWMAN: Why was it a good
 5 investment? Let me back up. At the
 6 time this money was initially invested,
 7 elseT was a startup company with no
 8 revenues --
 9 THE WITNESS: That is correct.
 10 MR. NEWMAN: -- is that
 11 correct?
 12 When had it been established
 13 versus when the initial funding was made
 14 by the LLCs?
 15 THE WITNESS: It could have
 16 been established for probably three to
 17 six months, I am not certain.
 18 MR. NEWMAN: And what sort of
 19 due diligence did you do to determine
 20 that this was a good investment for the
 21 LLCs?
 22 THE WITNESS: Extensive.
 23 MR. NEWMAN: Can you explain
 24 what that was?
 25 THE WITNESS: We interviewed

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1 DAVID SMITH
 2 the management. We checked the
 3 backgrounds. We did exhaustive study on
 4 intellectual property opportunities. We
 5 thought it was the most exciting capital
 6 -- new capital-raising opportunity that
 7 I have seen, ever.
 8 I think it will ultimately
 9 prove to be a major part of the way
 10 companies finance themselves going
 11 forward. We thought we would be -- we
 12 thought funds would have the opportunity
 13 to be on the cusp of a new financing,
 14 have a pipeline of financing opportunity
 15 for years and years to come. Quality of
 16 the players in the space were all major
 17 finance players; major investment banks,
 18 ranging from Goldman Sachs to Bear
 19 Sterns to Lehman. All rest in peace.
 20 So it was a -- you know, there
 21 were hundreds of articles written on it,
 22 lots of major players in the space. And
 23 we thought it was a great opportunity.
 24 MR. NEWMAN: So in terms of
 25 the actual due diligence, who performed

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1 DAVID SMITH
 2 the due diligence on behalf of the LLC
 3 -- I'm sorry, the advisor?
 4 THE WITNESS: Mr. Livingston
 5 did the bulk of the due diligence.
 6 MR. NEWMAN: What was your
 7 involvement in the due diligence?
 8 THE WITNESS: I basically
 9 reviewed the due diligence that Mr.
 10 Livingston gathered.
 11 MR. NEWMAN: At the time Mr.
 12 Livingston was doing this due diligence,
 13 what was his connection, affiliation,
 14 involvement with elseT, if any?
 15 THE WITNESS: I don't believe
 16 he had any.
 17 MR. NEWMAN: At what point did
 18 Mr. Livingston become president of
 19 elseT?
 20 THE WITNESS: I believe it was
 21 about a year later, but I am not
 22 absolutely certain.
 23 MR. NEWMAN: So between the
 24 time he performed the due diligence and
 25 the time he became president, did he

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1 DAVID SMITH
 2 have any interim connection or
 3 involvement with -- direct involvement
 4 with elseT during that time period?
 5 THE WITNESS: He was basically
 6 working the concept, I mean, on behalf
 7 of MS Advisors; you know, trying to
 8 review or do the due diligence on the
 9 proposals that they have made.
 10 So when you say "involvement,"
 11 he was interfacing with, you know,
 12 Willis, Kennedy, ultimately a gentleman
 13 by the name of Larry Rosenberg;
 14 interfacing with David Goldstein, the
 15 attorney for White & Case. So his
 16 involvement was extensive, yes.
 17 MR. NEWMAN: But in terms -- I
 18 think you explained he was involved in
 19 the due diligence. What I am getting at
 20 is, what involvement or role did he have
 21 with elseT directly, if any?
 22 THE WITNESS: I don't believe
 23 he had any direct involvement with elseT
 24 until he ultimately joined the firm as
 25 an officer.

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1 DAVID SMITH
 2 MR. NEWMAN: So approximately
 3 a year after the initial investment is
 4 made by one or more of the LLCs, Mr.
 5 Livingston joins -- becomes an officer
 6 of alseT?
 7 THE WITNESS: That's to the
 8 best of my recollection.
 9 MR. NEWMAN: AlseT was a
 10 corporation?
 11 THE WITNESS: I believe it was
 12 a C corp, yes.
 13 MR. NEWMAN: Did Mr.
 14 Livingston own any shares or interest in
 15 alseT prior to becoming an officer?
 16 THE WITNESS: I think it was
 17 contemporaneously. I am not sure.
 18 MR. NEWMAN: It's possible he
 19 may have had an ownership interest prior
 20 to becoming president?
 21 MR. FRANCESKI: Objection.
 22 THE WITNESS: I don't think
 23 so.
 24 MR. NEWMAN: So once he
 25 becomes president, are there further

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1 DAVID SMITH
 2 monies invested by the LLCs in alseT?
 3 THE WITNESS: Yes.
 4 MR. NEWMAN: Approximately how
 5 much was invested -- approximately how
 6 much was invested by the LLCs with alseT
 7 after the point in time Mr. Livingston
 8 became president?
 9 THE WITNESS: Well, the budget
 10 started out at about 200,000 a month.
 11 And then I think that budget was intact
 12 for the first year. And then it grew to
 13 300 and maybe 400 a month, so -- as they
 14 added staff, et cetera. So taking the
 15 medium point, it could have been half of
 16 that, 4 million.
 17 MR. NEWMAN: Did it concern
 18 you as the principal with the investment
 19 advisor who is making investment
 20 decisions on behalf of these LLCs that
 21 you were investing in an entity in which
 22 one of the officers of that entity was a
 23 member of McGinn Smith?
 24 THE WITNESS: It concerned me
 25 from the standpoint that we had -- we

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1 DAVID SMITH
 2 had unfortunately got a sunk cost and
 3 the -- as I mentioned earlier, when that
 4 investment was started, the sense was --
 5 is that the principals were within a
 6 quarter or two quarters at most of
 7 getting their funding. That's how it
 8 was represented. And there were
 9 negotiations going on.
 10 MR. FRANCESKI: Let me stop
 11 you there. I don't think Mr. Newman
 12 asked you whether generally the idea
 13 concerned you. He was asking --
 14 THE WITNESS: No, it didn't.
 15 MR. FRANCESKI: -- did it
 16 concern you that Livingston was
 17 associated with alseT?
 18 THE WITNESS: No, it didn't.
 19 MR. NEWMAN: You weren't
 20 concerned about the potential conflict
 21 of interest?
 22 THE WITNESS: Not in a
 23 material way, no.
 24 MR. NEWMAN: What does that
 25 mean?

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1 DAVID SMITH
 2 THE WITNESS: It was not a
 3 major concern of mine.
 4 MR. NEWMAN: Did you have any
 5 concerns about it?
 6 THE WITNESS: I really -- no.
 7 Because I really looked to the
 8 principals of Kennedy & Willis as the
 9 driving bus. Those were the critical
 10 parties to the transaction.
 11 MR. NEWMAN: Mr. Livingston,
 12 what was his equity stake when he became
 13 an officer of alseT?
 14 THE WITNESS: It was about
 15 18 percent.
 16 MR. NEWMAN: Did that change
 17 at any point in time?
 18 THE WITNESS: Changed in late
 19 '07 or early '08.
 20 MR. NEWMAN: In what respect?
 21 THE WITNESS: Went to zero.
 22 MR. NEWMAN: Why is that? He
 23 sold his interest.
 24 THE WITNESS: No. There was a
 25 major dispute between the principals.

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1 DAVID SMITH
 2 And as a part of the negotiations,
 3 Mr. Livingston forfeited his stake.
 4 MR. NEWMAN: Was there -- was
 5 there litigation that resulted?
 6 THE WITNESS: There was no
 7 litigation, no.
 8 MR. NEWMAN: Do you know how
 9 much compensation Mr. Livingston
 10 received from alseT while he was an
 11 officer of that entity, approximately
 12 how much money he received?
 13 THE WITNESS: I would -- this
 14 is really approximate, probably seven --
 15 six, seven hundred thousand dollars.
 16 MR. NEWMAN: And the source of
 17 those funds were monies that had been
 18 invested by the LLCs in alseT?
 19 THE WITNESS: I believe so,
 20 yes.
 21 MR. NEWMAN: Did that concern
 22 you, again, from a conflict-of-interest
 23 standpoint?
 24 THE WITNESS: It did not,
 25 because I was aware of the total

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1 DAVID SMITH
 2 management contract of all the parties
 3 and what was required.
 4 MR. NEWMAN: This is -- as I
 5 understand it, correct me if I am wrong,
 6 this entity never earned any revenues?
 7 THE WITNESS: It never earned
 8 any revenues because it never got its
 9 funding. It was absolutely critical
 10 that it get substantial funding. And it
 11 never got its funding; and of course, as
 12 we got into '07 and '08, the
 13 possibilities of getting funding
 14 diminished greatly.
 15 MR. NEWMAN: Mr. Livingston's
 16 involvement in McGinn Smith during this
 17 time was what? What was his position
 18 with McGinn Smith?
 19 THE WITNESS: He held a
 20 position of senior vice president. He
 21 worked in the syndicate area. But most
 22 of his efforts -- or good deal of his
 23 time was devoted to alseT once he became
 24 an officer of alseT.
 25 MR. NEWMAN: Did he continue

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1 DAVID SMITH
 2 to work and physically work in the
 3 offices of McGinn Smith?
 4 THE WITNESS: He did.
 5 MR. NEWMAN: Did that apply
 6 during the time period we are talking
 7 about for -- while the money is being
 8 invested by the advisor and alseT?
 9 THE WITNESS: Yes. Yes.
 10 BY MR. RATTINER:
 11 **Q Did alseT sublease space from 45**
 12 **Broadway?**
 13 A I don't believe they sublet it. We
 14 provided space for them. I don't think there was any
 15 actual compensation. There were offices for one
 16 party, which was Mr. Rosenberg, who was domiciled in
 17 New York. The other gentleman were not domiciled in
 18 New York. So space was made available to Rosenberg
 19 for -- and he'd probably come in three, four days a
 20 week.
 21 **Q So in his case he didn't have to move**
 22 **because the offices were in the same location as Mr.**
 23 **Livingston?**
 24 A Mr. Livingston worked out of Albany.
 25 **Q Oh, I apologize.**

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1 **DAVID SMITH**
 2 A That's all right.
 3 **Q So he remained in Albany?**
 4 A He remained in Albany.
 5 MR. NEWMAN: All right. So
 6 the initial investment in alseT is
 7 approximately how much?
 8 THE WITNESS: 300,000.
 9 MR. NEWMAN: At the time that
 10 money is invested, what is your
 11 expectation as the investment advisor as
 12 to when alseT is going to be generating
 13 the return for the limited liability
 14 companies?
 15 THE WITNESS: Three to six
 16 months.
 17 MR. NEWMAN: So after six
 18 months there was no return, correct?
 19 THE WITNESS: There was no
 20 return.
 21 MR. NEWMAN: And further
 22 dollars are invested by you as the
 23 advisor on behalf of the limited
 24 liability companies and alseT?
 25 THE WITNESS: That is correct.

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1 DAVID SMITH

2 MR. NEWMAN: At what point did
3 you become concerned that you're
4 investing millions of dollars of these
5 investment funds in an entity that's not
6 generating any returns for the advisor
7 or the LLCs?

8 THE WITNESS: Well, I am
9 always concerned, from day one. But the
10 opportunities that were being discussed
11 and were indicated to me were close to
12 fruition were numerous, and they seemed
13 to always be within 30 days of a
14 closing. And so one of the more
15 difficult propositions for a money
16 manager is once one crosses the Rubicon,
17 there's a subcost and you're always
18 attempting to weigh whether you cut the
19 cord or whether you continue to fund to
20 protect your costs. I think that's
21 probably one of the most difficult
22 decisions one ever makes. And it's
23 never an easy one.

24 In our case, because the
25 promises of funding were so, in our

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1 DAVID SMITH

2 judgment, real and available and within
3 our grasp, that we continued to make
4 that decision. And, of course, every
5 time one makes that decision, the next
6 time it becomes more difficult, because
7 you're sunk cost has gone up, the
8 capital you have committed.

9 So in answer to your question,
10 which again, I do it at more length than
11 my attorney would like, it was always a
12 concern. But each and every quarter
13 that went by we believed on the basis of
14 the representations from the individuals
15 of alseT and the people that they were
16 talking to; and we had conversations
17 with those people that funding was going
18 to happen.

19 And, unfortunately, it did not
20 happen. And as I said, in December of
21 '07, when we were sort of at the
22 crossroads, that was when we thought we
23 finally had put it to bed with Goldman
24 Sachs, we had a letter from Goldman
25 Sachs, they had representation.

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1 DAVID SMITH

2 Mr. Goldstein was negotiating with
3 Goldman Sachs for \$500 million, which
4 would have taken us totally out, and we
5 would have -- I would no longer have had
6 those concerns. That did not happen.

7 MR. NEWMAN: So the funding
8 was done on a quarterly basis?

9 THE WITNESS: Yes.

10 MR. NEWMAN: And that started
11 in '03 and continued through '0 --

12 THE WITNESS: I don't think it
13 started in '03. I don't think I said
14 that.

15 MR. NEWMAN: '04.

16 THE WITNESS: I think it was
17 in the '04, '05 area.

18 MR. NEWMAN: And continued
19 through '07?

20 THE WITNESS: I don't know
21 exactly when we basically finally made
22 that decision that just said -- my guess
23 is, we -- best of my recollection, I had
24 actually reduced the budget
25 dramatically. Did still provide some

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1 DAVID SMITH

2 funding with the hope that that Goldman
3 Sachs deal would go through. I think
4 subsequent to that, as we got into '08,
5 we -- we terminated funding. And that's
6 when we attempted to make an outside
7 transaction, just again, to get him
8 through the period when we can get this
9 closing. And I think we raised
10 another -- outside of funds, I think we
11 raised another 5 or 6 thousand dollars.

12 MR. NEWMAN: Where was that
13 raised from?

14 THE WITNESS: It was raised
15 from McGinn Smith.

16 MR. NEWMAN: Meaning McGinn
17 Smith made that investment directly?

18 THE WITNESS: No, meaning --

19 MR. NEWMAN: Or as an
20 offering?

21 THE WITNESS: It was an
22 offering, yes.

23 MR. NEWMAN: How many
24 investors were there in that offering?

25 THE WITNESS: I don't think a

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1 DAVID SMITH
2 lot. Nine or ten is a number that comes
3 to mind.
4 MR. NEWMAN: Were they
5 accredited investors?
6 THE WITNESS: Yes.
7 MR. NEWMAN: When was that
8 offering?
9 THE WITNESS: I am thinking it
10 was in the spring to June, July of '08.
11 MR. NEWMAN: Was there a
12 private placement memorandum?
13 THE WITNESS: Yes, there was.
14 MR. NEWMAN: Did that private
15 placement memorandum discuss the
16 operating history of alseT?
17 THE WITNESS: Yes.
18 MR. NEWMAN: And the rest of
19 the investment?
20 THE WITNESS: Yes.
21 MR. NEWMAN: How risky did you
22 consider this investment to be at the
23 time it was made on behalf of the LLCs?
24 THE WITNESS: Well, as a
25 startup it had risk. But again, the

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1 DAVID SMITH
2 company or the group had moved well
3 along in terms of the formation, their
4 business plan and discussions with
5 funding sources. So as I have
6 indicated, there was the belief that
7 those -- that that funding commitment
8 was going to take place immanently.
9 In fact, when we made the
10 first commitment, to the best of my
11 recollection, was that they had already
12 formed an offering document, a mutual --
13 or a limited partnership offering
14 document called alseT IP Fund, or
15 something of that nature. It was --
16 again, to the best of my recollection,
17 it was a \$500 million offering. And
18 they were talking to people like the
19 Teachers Retirement of Ontario, Canada;
20 Probata, out in California. And they
21 had substantial interest from Deutsche
22 Bank and people of -- you know, serious
23 people in the capital-raising side.
24 And then it didn't happen.
25 And they moved on to some other form.

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1 DAVID SMITH
2 And from that point, it was
3 quarter-by-quarter of "Let's get this
4 thing closed."
5 MR. NEWMAN: Now, these
6 conversations you testified you were
7 having with representatives of alseT
8 concerning the status of the investment
9 and the entity, were those documented
10 through e-mails, letters, memos, at any
11 time?
12 THE WITNESS: If there's any
13 letters, they would be documented. Most
14 of the conversations by -- were
15 telephonically. And no, I didn't write
16 things up. I think -- I'm certain
17 there's some e-mails. I think I've seen
18 some e-mails between me and Kennedy --
19 myself and Kennedy.
20 MR. NEWMAN: Who is Kennedy?
21 THE WITNESS: Kennedy was one
22 of the principals of alseT, really the
23 business guy behind the enterprise.
24 MR. NEWMAN: Did -- did you
25 maintain a file, a due diligence file,

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1 DAVID SMITH
2 or any other file for alseT -- for the
3 alseT IP investment?
4 THE WITNESS: I did.
5 MR. NEWMAN: Is that file
6 still at McGinn Smith?
7 THE WITNESS: It is.
8 MR. NEWMAN: And what is in
9 that file, generally speaking?
10 THE WITNESS: It's extensive.
11 I mean, it is a drawer, includes -- I
12 haven't looked at it in a while. It
13 includes the budget proposals. It
14 includes articles on the industry.
15 Includes previous transactions done in
16 that same space. But also includes, I
17 am sure, some privileged things between
18 them and their attorney. But it's an
19 extensive file. It's long, it's a
20 drawer.
21 MR. NEWMAN: The Staff will
22 request a copy of that. We will confirm
23 that in writing, but we are going to
24 request a copy of that file.
25 THE WITNESS: Okay.

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1 DAVID SMITH
 2 MR. NEWMAN: Now, what
 3 efforts, if any, have you made -- has
 4 the investment advisor made on behalf of
 5 the LLCs to recover any of the monies
 6 that were invested by the LLCs in alseT
 7 IP?
 8 THE WITNESS: We continue to
 9 think the best way to recover is to in
 10 effect have the business plan work. And
 11 so as I've said, as late as spring of
 12 '09, there was still discussions with
 13 them and their investment banker. They
 14 were negotiating directly at that time
 15 with Fortress, which is a large hedge
 16 fund. Fortress was talking about
 17 providing funding in the hundred million
 18 dollar range.
 19 We have conversed with them
 20 through probably the summer, fall of
 21 '09, seen what their status was. They
 22 were at that time attempting to change
 23 their business plan to get some
 24 immediate revenues. And that was a
 25 business plan that was going to involve
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1 DAVID SMITH
 2 representing litigants in IP lawsuits.
 3 And I don't believe at this point
 4 they've had any revenue. So shortly we
 5 were planning on having a discussion to
 6 see if, in fact, they -- what the level
 7 of their funding source is; what they're
 8 going to do personally, and then see
 9 what the consequences are going to be.
 10 MR. NEWMAN: Have you, on
 11 behalf of the advisor and the LLCs, made
 12 any demand, filed any legal action, made
 13 any legal claim to recover any of the
 14 monies that were invested?
 15 THE WITNESS: No. Because
 16 when you do that you basically eliminate
 17 any opportunity to ever get any funding.
 18 The minute you file any sort of legal
 19 action, you can basically remove any
 20 opportunity to get funding. And so that
 21 is a step that, in my judgment, you
 22 don't take until you absolutely have
 23 written the enterprise off and there's
 24 no possibility of success.
 25 MR. NEWMAN: You still think
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1 DAVID SMITH
 2 that four years later there's still a
 3 possibility of success with alseT?
 4 MR. FRANCESKI: Objection.
 5 That question is argumentative.
 6 MR. NEWMAN: Do you still
 7 think there's a possibility of success
 8 four years after the fund?
 9 THE WITNESS: Yes.
 10 MR. NEWMAN: Did -- have you
 11 made any attempt to recover any of the
 12 money that Mr. Livingston was paid in
 13 connection with alseT IP?
 14 THE WITNESS: I have not.
 15 MR. NEWMAN: And why is that?
 16 THE WITNESS: When that would
 17 take the form of litigation, which I
 18 just spoke about, I don't think it's in
 19 the best interest of the LLCs until such
 20 time as one decides that there is no
 21 other action to take.
 22 Number two, I'm not a lawyer,
 23 but that was salary that was paid to Mr.
 24 Livingston as part of alseT. And my
 25 unprofessional and uninformed assumption
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1 DAVID SMITH
 2 would be that would be very difficult to
 3 gather.
 4 MR. NEWMAN: Have you had a
 5 discussion with him or asked him to
 6 return any of the money he received from
 7 alseT?
 8 THE WITNESS: I have not.
 9 MR. NEWMAN: Do you know what
 10 he did to earn \$700,000 for a non
 11 income-producing startup company?
 12 THE WITNESS: He acted on
 13 behalf of alseT. He was the president
 14 of the company, and carried out those
 15 duties.
 16 MR. NEWMAN: While he was
 17 registered with McGinn Smith?
 18 THE WITNESS: That is correct.
 19 MR. NEWMAN: Did you, either
 20 individually or through any of the
 21 affiliated entities you are involved
 22 with, receive any monies, payments,
 23 funds, loans from alseT IP?
 24 THE WITNESS: No.
 25 MR. NEWMAN: How about Mr.
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1 DAVID SMITH
2 Livingston, in connection with this
3 litigation?
4 THE WITNESS: Did Mr.
5 Livingston receive any?
6 MR. NEWMAN: No. Did Mr.
7 Livingston pay you --
8 THE WITNESS: No.
9 MR. NEWMAN: Based on the
10 investment that was made in alseT, did
11 you receive any monies, funds or loans
12 from Mr. Livingston?
13 MR. FRANCESKI: "You" meaning?
14 MR. NEWMAN: You,
15 individually, or through any of your
16 companies?
17 THE WITNESS: No.
18 MR. PAULSEN: Was MS Advisors'
19 decision to terminate funding to alseT
20 the source of the dispute between
21 Livingston and the firm and alseT
22 itself?
23 THE WITNESS: No. The
24 decision -- no. No.
25 MR. PAULSEN: Can you

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1 DAVID SMITH
2 elaborate on the dispute itself?
3 THE WITNESS: And that
4 dispute --
5 MR. PAULSEN: Between alseT
6 and Livingston.
7 THE WITNESS: Yes.
8 MR. FRANCESKI: The answer to
9 that is yes or no.
10 THE WITNESS: Yes.
11 MR. PAULSEN: Would you do so,
12 please.
13 THE WITNESS: Certainly. In
14 December of '07, maybe a little later
15 than that, I believe it was
16 December '07, it came to my attention
17 that there was evidently -- had been an
18 ongoing dispute between Livingston and
19 the other members of alseT. And without
20 going into detail that I am not familiar
21 with, I would characterize that as --
22 that the other principals of alseT felt
23 that Livingston was going to be an
24 impediment to the funding from Goldman
25 Sachs.

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1 DAVID SMITH
2 They articulated the position.
3 And I never received confirmation of
4 this other than through Willis and
5 Kennedy. But their position was that
6 Goldman Sachs, as one of the conditions
7 in making the funding, was that they
8 felt that Livingston was not additive --
9 value additive to the process any
10 longer.
11 Livingston, of course, had a
12 different point of view. Livingston's
13 point of view, I think, would be best
14 characterized as saying "I basically
15 developed the concept," which he did.
16 "I brought the parties together," which
17 he did. "I found the principals and the
18 expertise; did the great deal of due
19 diligence; made contact with the law
20 firm; I was the driving force." And in
21 a nutshell, it was his position that now
22 that all of that had been accomplished
23 and that they were on the cusp of an
24 enormous success, which a \$500 million
25 funding from Goldman Sachs would have

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1 DAVID SMITH
2 ensured enormous success, that -- that
3 they were basically looking to force him
4 out. He was not prepared to do that,
5 and threatened litigation against those
6 individuals.
7 MR. FRANCESKI: Let me stop
8 you there. I don't mind you giving
9 these details. But please make clear
10 when you are talking about firsthand
11 knowledge or knowledge gained through
12 somebody else, so they can understand
13 the credibility of what you are saying.
14 THE WITNESS: Okay. Fair
15 enough. I, as someone who stood in the
16 middle, got some of these thoughts that
17 I am giving to you from both sides. So
18 you must take that into consideration,
19 as I did.
20 There's always something in
21 the middle. Everybody has an agenda.
22 So I reached out to Kennedy and Willis.
23 In fact, I met with them in New York.
24 Obviously I got Livingston's side of the
25 story.

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1 DAVID SMITH

2 I was terribly concerned from
3 the standpoint of the LLCs that this was
4 our best and last chance to get
5 basically our money back and continue to
6 have the opportunities that I thought
7 were going to be enormous for the LLCs.

8 And so I was agitated, to say
9 the least, at the position that Mr.
10 Livingston was taking. I am not saying
11 anything out of school, he's well aware
12 of it.

13 I implored him to reach a
14 settlement. I did my best, and Mr.
15 McGinn was also involved, to bring the
16 parties together. I had numerous
17 conversations with David Goldstein from
18 White & Case who was their counsel,
19 numerous conversations with Mr. Kennedy,
20 Mr. Rosenberg and Mr. Willis. And,
21 obviously, numerous conversations with
22 Mr. Livingston.

23 I believe the question you
24 asked, the dispute between Mr.
25 Livingston and myself, and so with that

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1 DAVID SMITH

2 background you can assume that there was
3 some friction between the two of us and
4 there were, you know, some heated
5 exchanges between the two of us. I felt
6 that at that point Mr. Livingston needed
7 to sacrifice whatever personal gain he
8 might make for the good of the LLCs,
9 that it was not -- I think the word I
10 used was brinkmanship. I didn't
11 appreciate pushing the envelope right to
12 the edge to in effect see if he was
13 going to prevail or not. Because the
14 consequences of my judgment were
15 draconian. I mean, they were just
16 enormous.

17 And I know, having been in
18 this business for 30 years, how fickle
19 funding is; that you have a very small
20 window to get funding done. And people
21 like Goldman Sachs, if you don't dance
22 to their tune, they don't hang around.
23 They got lots of opportunities. And in
24 my judgment that's exactly what
25 happened. But at any rate at some

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1 DAVID SMITH

2 point, and I believe it was January,
3 after Mr. Livingston had engaged
4 separate counsel, I, as the managing
5 member of the LLC, fashioned an
6 agreement that would give Mr. Livingston
7 some compensation going forward, not
8 immediate, but only if they had some
9 success and only after the LLCs were
10 entirely paid out. You know, ultimately
11 he signed off on that. He resigned from
12 elseT. And I guess with some passage of
13 time our passions subsided. And Tom and
14 I worked together again for some period
15 of time. But that is the genesis of it.

16 MR. PAULSEN: So if I
17 understand you correctly, his
18 consideration of filing suit against
19 elseT, as you said it, would have
20 compromised the last chance, as you
21 stated, to get the money back on behalf
22 of the LLCs?

23 THE WITNESS: People who were
24 providing funding --

25 MR. PAULSEN: Is that a yes or

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1 DAVID SMITH

2 a no?

3 THE WITNESS: Yes.

4 MR. PAULSEN: So I guess that
5 would have been in early 2008, I believe
6 you said?

7 THE WITNESS: The question
8 again, Mike?

9 MR. PAULSEN: When he left --
10 or the dispute between Livingston and
11 elseT was late '07 or early 2008?

12 THE WITNESS: Well, that is
13 when it came to my attention.

14 MR. PAULSEN: Okay.

15 THE WITNESS: The principals
16 of elseT told me that the origin
17 started, I think, that summer.

18 MR. PAULSEN: Of '07?

19 THE WITNESS: Of '07.

20 MR. PAULSEN: So when did you
21 come to the agreement -- or when did you
22 and Livingston agree or discuss that
23 agreement, as you just referenced, kind
24 of shook hands, if you will. And at
25 that point in time there may have still

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1 DAVID SMITH
 2 been an opportunity -- I guess in your
 3 mind there was still potential to
 4 recouping monies back from the LLCs?
 5 THE WITNESS: Yeah. As I
 6 indicated -- well, to answer your
 7 question, that took place, to the best
 8 of my recollection, December '07,
 9 January '08.
 10 MR. PAULSEN: Okay.
 11 THE WITNESS: The
 12 opportunities for alseT continued
 13 through -- the last real serious
 14 negotiation took place as late as
 15 January through March of '09. That was
 16 with Fortress. The Goldman Sachs
 17 opportunity faded sometime in '08. I
 18 don't know exactly when.
 19 MR. PAULSEN: I guess I'm
 20 curious at what point, as Mike Newman
 21 was asking earlier, do you say that the
 22 likelihood of recouping any monies for
 23 the LLCs is just not there and perhaps
 24 you consider filing suit to get some of
 25 that money back?

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1 DAVID SMITH
 2 THE WITNESS: I mean, you just
 3 -- at some point it may come to that.
 4 You just don't know. The fact is, is
 5 that -- my experience, and maybe it's
 6 not that extensive, but in the few times
 7 that we have, in fact, gone that route
 8 for the funds against an individual,
 9 we've never recovered.
 10 MR. FRANCESKI: May I ask --
 11 I'm sorry. May I ask a clarifying
 12 question?
 13 MR. PAULSEN: Sure.
 14 MR. FRANCESKI: Are you
 15 finished?
 16 THE WITNESS: I'm finished.
 17 MR. FRANCESKI: Dave, if you
 18 filed suit on behalf of the LLCs, as Mr.
 19 Paulsen and Mr. Newman have asked you,
 20 who would have paid the attorneys' fees
 21 involved in that suit?
 22 THE WITNESS: Well, the
 23 limited liability companies.
 24 MR. FRANCESKI: The LLCs?
 25 THE WITNESS: The LLCs.

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1 DAVID SMITH
 2 MR. FRANCESKI: That's all.
 3
 4 EXAMINATION
 5 BY MR. NEWMAN:
 6 **Q Do you know how much the limited**
 7 **liability companies have paid in legal fees,**
 8 **approximately?**
 9 A To date?
 10 **Q To date.**
 11 A I believe the only fees that they
 12 have paid were in the lawsuit against Pali Capital.
 13 And I don't think they were extensive. Maybe
 14 \$30,000. Easy for me to say.
 15 **Q So you are not including the amount**
 16 **that was paid in the end -- or, excuse me, January of**
 17 **this year, \$200,000 in legal fees?**
 18 A No. Those monies -- \$200,000 in
 19 legal fees were fees that were directed to McGinn
 20 Smith to pay. They weren't considered legal fees of
 21 the funds.
 22 **Q They were paid out of the LLC pot of**
 23 **money?**
 24 MR. NEWMAN: You're shaking
 25 your head.

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1 DAVID SMITH
 2 MR. FRANCESKI: Go ahead and
 3 finish your question.
 4 BY MR. NEWMAN:
 5 **Q I believe the legal fees were paid**
 6 **out of the operating accounts of the LLCs, the**
 7 **\$200,000 in legal fees that were paid?**
 8 A Yes.
 9 **Q What other legal fees have been paid**
 10 **by the LLCs?**
 11 A I don't believe any.
 12 **Q That question goes to monies that**
 13 **were in the operating accounts?**
 14 A Right. Do I need to clarify that?
 15 As far as I know Pali Capital and the \$200,000. I
 16 don't think there's any -- I am not aware of any
 17 others.
 18
 19 EXAMINATION
 20 BY MR. RATTINER:
 21 **Q Are you defining -- if I can clarify.**
 22 **Are you defining legal fees as going**
 23 **after a company for monies owed to you?**
 24 A I don't believe Mike delineated that
 25 question.

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1 DAVID SMITH

2 **Q I am just trying to figure out how --**
3 **you are saying only -- not only, but \$200,000 in**
4 **legal fees were, I guess, from the funds through**
5 **McGinn Smith to the attorney?**

6 A Right.

7 **Q Are there other legal fees that have**
8 **been taken from the funds and passed through whatever**
9 **entities to eventually end up in a law firm or to pay**
10 **for the legal expenses?**

11 MR. FRANCESKI: Let me object.

12 It's not a pass-thru. And don't know
13 whether you mean anything pejorative
14 about pass through.

15 MR. RATTINER: No.

16 MR. FRANCESKI: The LLCs have
17 obligations to certain entities. They
18 satisfy those obligations. The entities
19 have then used the funds to satisfy
20 those obligations to pay their
21 obligations.

22 MR. RATTINER: These
23 obligations are specific to the legal
24 fees that were due, not the underwriting
25 fees. We are not talking about the

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1 DAVID SMITH

2 BY MR. RATTINER:

3 **Q The source of the funds that were**
4 **paid to Mr. Francheski's firm were from where, the**
5 **original funds?**

6 MR. FRANCESKI: Source of
7 funds. Money is fungible. But I think
8 what you need to know is who wrote the
9 check.

10 MR. RATTINER: No, I am not
11 asking who wrote the check.

12 MR. FRANCESKI: We can argue
13 about that later.

14 MR. NEWMAN: The question
15 was -- and I think the witness
16 understood and answered it. And we can
17 go back over it again. But funds, legal
18 fees that were paid out of the LLC
19 operating funds.

20 MR. FRANCESKI: No. That is
21 what I am saying.

22 THE WITNESS: No. We better
23 go back over it.

24 MR. FRANCESKI: Yeah. Be
25 clear about it, Dave.

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1 DAVID SMITH

2 underwriting fee or the administrative
3 fee.

4 THE WITNESS: The only other
5 fee -- I think what you're talking
6 about, Chris, as I've testified, that I
7 can recall, is fees that went to Gersten
8 Savage on behalf of recovering monies
9 from Pali Capital.

10 BY MR. RATTINER:

11 **Q Okay. And we discussed Shutts &**
12 **Bowen. For instance, we showed that \$260,000.**
13 **Is that being classified differently**
14 **than this context?**

15 A That Shutts & Bowen didn't come from
16 the LLCs.

17 **Q I'm sorry. Correct.**

18 MR. FRANCESKI: Nor did the
19 \$200,000. That was paid by the LLCs to
20 the people who received it. It's not --

21 MR. RATTINER: There's a
22 disconnect between you and your client.

23 MR. FRANCESKI: I don't know
24 whether there's a disconnect between me
25 and my client or between him and you.

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1 DAVID SMITH

2 THE WITNESS: Give me a
3 chance. Lots of guys are firing at me.

4 I testified yesterday, and I
5 will re-clarify for any purposes. We
6 have indicated that there are a number
7 of fees due to McGinn Smith and McGinn
8 Smith entities. We are all clear on
9 that.

10 At some point yesterday -- and
11 I was following up, I think, to Mike's,
12 under the same vein, is that recently
13 some of those funds, to your point,
14 source of funds, were paid. And then
15 somebody yesterday, or the day before,
16 asked me "What were those funds used
17 for?" And I said, "They were used to
18 pay our legal fees." I don't know if
19 one can be any clearer.

20 Now, from the actual
21 obligation to your point of the funds
22 using legal fees to recover monies or
23 something like that, my answer is: The
24 only one that I can recall is Pali
25 Capital, which was paid to Gersten

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1 DAVID SMITH
 2 Savage. And to the best of my
 3 knowledge, it was in the \$30,000 range,
 4 but I don't know.
 5 BY MR. RATTINER:
 6 **Q So the legal fees that were recently**
 7 **paid in January of 2009 were -- you utilized the**
 8 **underwriting income that you accrued to pay those**
 9 **fees?**
 10 A That's correct.
 11 **Q So you no longer owed that**
 12 **underwriting income?**
 13 A That is correct.
 14 MR. FRANCESKI: Can we take a
 15 short break? I've got a case going on
 16 back in Philadelphia.
 17 MR. NEWMAN: Let's go off the
 18 record.
 19 (Whereupon a recess is taken.)
 20 MR. NEWMAN: Back on the
 21 record.
 22 THE WITNESS: Would you play
 23 back the entire exchange regarding the
 24 fees discussion that we had with Chris
 25 and maybe Mike and maybe -- maybe both

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1 DAVID SMITH
 2 Mikes. I am concerned that it's -- I
 3 want to make sure that everybody has an
 4 exact set of facts.
 5 The last five minutes of the
 6 exchange, seems to be some discrepancy
 7 as to what was conveyed; and I don't
 8 want to leave here not knowing that what
 9 was conveyed was the truth.
 10 MR. NEWMAN: Okay. That's
 11 fine. I think we wanted to know what
 12 legal fees have been paid by the LLCs.
 13 That was the general question.
 14 THE WITNESS: Right.
 15 MR. NEWMAN: Do you want --
 16 THE WITNESS: I would like to
 17 hear what was said so I know the record
 18 reflects the truth.
 19 MR. NEWMAN: Okay.
 20 (Whereupon record is read
 21 back.)
 22 THE WITNESS: I believe I'm
 23 clear. Is anyone else unclear?
 24 MR. NEWMAN: I think we
 25 understand what you are testifying to.

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1 DAVID SMITH
 2 THE WITNESS: Fees were paid
 3 to McGinn Smith which were owed, which
 4 were then -- the source of those funds
 5 were the -- of the LLCs. But they were
 6 paid to McGinn Smith who then paid their
 7 legal fees. Not paid by the funds.
 8 That is the critical point I want to
 9 make sure that nobody has any confusion
 10 about.
 11 BY MR. RATTINER:
 12 **Q How does that differ from the**
 13 **October 2008 letter where it says that the funds will**
 14 **no longer pay fees; however, they will pay legal**
 15 **expenses?**
 16 A Because it differs. They didn't pay
 17 legal fees on behalf of the funds in that instance.
 18 Those fees, again, were paid to McGinn Smith. They
 19 were owed to McGinn Smith. They were owed prior to
 20 the letter. And that's what they are used for.
 21 **Q Going forward, is it the fund's**
 22 **intention to use excess revenues, excess monies to**
 23 **pay legal fees?**
 24 A If it's on behalf of the funds, yes.
 25 If it's on behalf of the funds.

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1 DAVID SMITH
 2 **Q Let's take the arbitration for Mr.**
 3 **██████, the \$805,000, assuming it's due and owed?**
 4 A That is a fee that is incurred at
 5 McGinn Smith.
 6 **Q And it would be paid by who?**
 7 A Paid by McGinn Smith.
 8 **Q By reimbursement of the LLCs?**
 9 A If they are entitled to money, yes.
 10 The other clarification I would like
 11 to make -- I don't think it's material, but the -- in
 12 terms of the inclusion of all fees, there were I'm
 13 certain organizational expenses at the time these
 14 LLCs were formed. Gersten Savage I'm certain billed
 15 me and, obviously, the LLCs paid those fees. I was
 16 not thinking of those at the time I gave my answer.
 17 **Q I can't recall off the top of my head**
 18 **other law entities that he used.**
 19 **Were there other law firms that these**
 20 **four notes or the LLCs would have used other than**
 21 **Gersten Savage?**
 22 A Actually that is a good point. I did
 23 forget. Yes. There were when they represented
 24 certain loan transactions, yes. Roemer & Mano is one
 25 that comes to mind. I can't think of any others.

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1 DAVID SMITH
 2 That's a good point. We have at times used law firms
 3 to close transactions, yes.
 4 MR. FRANCESKI: Chris, to your
 5 question about -- generally about LLC
 6 obligations that you've asked about
 7 before, I don't know if this is of any
 8 interest to the staff, but just so you
 9 all recognize this, all of the investors
 10 in the LLCs, in their subscription
 11 agreements, agreed to indemnify the LLCs
 12 for any misrepresentations or breach of
 13 warranties that they made in those
 14 subscription agreements. And I don't
 15 think the LLCs have resolved what to do
 16 about those representations of
 17 warranties. But, certainly, if I were
 18 counseling the LLCs, I would suggest the
 19 LLCs look closely about what to do about
 20 those representations and warranties.
 21 BY MR. RATTINER:
 22 **Q How would payments be made -- more**
 23 **payments made to Matt McGinn from the LLCs?**
 24 A I don't know. Matt McGinn is an
 25 associate counsel. Might have done some limited work

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1 DAVID SMITH
 2 on behalf of the LLCs. I am not -- would have been
 3 under Mr. Carr's direction. So I am not sure.
 4 **Q Would that be classified as legal**
 5 **expense?**
 6 A If he's acting on behalf of the LLCs,
 7 yes.
 8 **Q Would that be included as part of --**
 9 **in terms of -- I know they say Gersten Savage.**
 10 **The other entity's Roemer?**
 11 A It would. I can't recall exactly
 12 what work he did, but it would be, yes.
 13 **Q With regard to alseT, did alseT**
 14 **borrow any money from McGinn Smith?**
 15 A I don't believe so.
 16 **Q The only funding that you are aware**
 17 **of is the \$8 million or -- the plus \$8 million that**
 18 **was loaned from the LLCs?**
 19 A While in addition to the follow-on
 20 offering, yes.
 21 **Q Correct. Okay.**
 22 MR. NEWMAN: I have one more
 23 question, that was a debt investment by
 24 the LLCs?
 25 THE WITNESS: Yes.

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1 DAVID SMITH
 2 MR. NEWMAN: How is that
 3 documented or memorialized? What
 4 documents show that the --
 5 THE WITNESS: There's a loan
 6 agreement --
 7 MR. NEWMAN: Was there a loan
 8 document?
 9 THE WITNESS: Best of my
 10 recollection, there was a line of credit
 11 document. I think we provided that to
 12 FINRA.
 13 MR. NEWMAN: Do we have that?
 14 Do we have the line of credit agreement?
 15 MR. RATTINER: I am going to
 16 introduce Exhibit Number 22.
 17 (Whereupon Exhibit 22 is
 18 marked.)
 19 MR. RATTINER: I only have one
 20 for counsel. I didn't make additional
 21 copy for counsel. Except I can't see
 22 it.
 23 BY MR. RATTINER:
 24 **Q Mr. Smith, in front of you is the**
 25 **private placement memorandum for First Independent**

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1 DAVID SMITH
 2 **Income Notes. And it's identified by Bates stamp MGS**
 3 **0014648. And it continues through MGS 0014691.**
 4 **Do you recognize this document?**
 5 A I do.
 6 **Q Was this document the one we**
 7 **previously discussed created by Gersten Savage?**
 8 A Yes.
 9 **Q What was your input with this**
 10 **document? Or maybe I will rephrase.**
 11 **Did you approve this document?**
 12 A Yes.
 13 **Q And prior to approving it, did you**
 14 **review it?**
 15 A Yes.
 16 **Q Where are the fees disclosed on**
 17 **page -- let's stick with the first page here**
 18 **identified by the last four numbers of the Bates**
 19 **stamp 4648.**
 20 **What does that tell us towards the**
 21 **bottom part of the document in a grid form?**
 22 A Document shows that of the initial
 23 offering price, there is a 2 percent placement agent
 24 fee for that initial subscription.
 25 **Q And how does that reflect the fees**

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<p>1 DAVID SMITH</p> <p>2 that you previously identified to us?</p> <p>3 Is that the same as the underwriting</p> <p>4 fee?</p> <p>5 A That is the same as the -- part of</p> <p>6 the underwriting fee. It's then indicated that that</p> <p>7 fee is an annual fee in addition to other fees that</p> <p>8 we are talking about, the advisory fee and the</p> <p>9 trustee fee.</p> <p>10 Q So what is the difference between the</p> <p>11 private agent -- placement agent commission fee and</p> <p>12 the underwriting fee?</p> <p>13 A Nothing.</p> <p>14 Q Okay. Where on this page does it say</p> <p>15 this 2 percent is an annual fee?</p> <p>16 A I don't believe it says it on that.</p> <p>17 That's designed to indicate how much money is coming</p> <p>18 out of the initial offering. Then the LLCs incur</p> <p>19 additional expenses which are discussed and disclosed</p> <p>20 in the memorandum.</p> <p>21 Q And on this page does it identify</p> <p>22 that you will be investing in affiliate entities from</p> <p>23 the first page?</p> <p>24 A First page is silent to what -- other</p> <p>25 than the form of investments of any investments.</p> <p style="text-align: right;">Page 863</p>	<p>1 DAVID SMITH</p> <p>2 Bates stamp 4654.</p> <p>3 A I am there.</p> <p>4 Q And the business section, where in</p> <p>5 that section does it say that you will make</p> <p>6 investments in affiliated entities? Or does it say?</p> <p>7 A It says "We may acquire such</p> <p>8 investments directly or from our managing member or</p> <p>9 affiliate of us or managing member that has purchased</p> <p>10 the investment," et cetera, et cetera.</p> <p>11 Q That would be an investment that's</p> <p>12 held?</p> <p>13 A It's investments held in -- that</p> <p>14 there will clearly have the ability to commence loans</p> <p>15 and investments in those entities.</p> <p>16 Q Where is that clearly?</p> <p>17 A That is my interpretation. That's my</p> <p>18 counsel's interpretation. And that is evidently the</p> <p>19 interpretation of everyone but yourself.</p> <p>20 Q What sentence were you specifically</p> <p>21 reading from?</p> <p>22 A I was reading from the end of the</p> <p>23 fourth sentence. We may acquire such investments</p> <p>24 directly or from our manage member or an affiliate of</p> <p>25 us -- of our managing member. There's purchase of</p> <p style="text-align: right;">Page 865</p>
<p>1 DAVID SMITH</p> <p>2 Q Okay. And we are going to continue</p> <p>3 on.</p> <p>4 This offering was available to both</p> <p>5 accredited and non-accredited investors?</p> <p>6 A Non accredited to the limited extent</p> <p>7 of 35 non-accredited, 506 of Reg D.</p> <p>8 Q Can you turn to Bates stamp number</p> <p>9 ending in 4657.</p> <p>10 Are you there?</p> <p>11 A Hm-hm.</p> <p>12 Q 4657, the second sentence states that</p> <p>13 "Subscriptions will be accepted only from accredited</p> <p>14 investors as that term is defined in Reg D</p> <p>15 promulgated under the Securities Act."</p> <p>16 How does that differ from your</p> <p>17 previous testimony?</p> <p>18 A Because I believe Reg D gives an</p> <p>19 exemption for 35 non-accredited investors.</p> <p>20 Q So you're saying that in this</p> <p>21 case you're basing it on a Reg D exemption not by the</p> <p>22 fact that it says accredited investors only here?</p> <p>23 A Absolutely. That's always been part</p> <p>24 of the exemption that there's 35. It's well known.</p> <p>25 Q If we can turn back a few pages to</p> <p style="text-align: right;">Page 864</p>	<p>1 DAVID SMITH</p> <p>2 the investment. If the investment is purchased -- if</p> <p>3 it is purchased, suggesting there's others -- from</p> <p>4 the managing member or any affiliate, we will not pay</p> <p>5 above the price paid by our managing member or such</p> <p>6 affiliate of the investment, other than to reimburse</p> <p>7 our managing member or such affiliate for its costs,</p> <p>8 discounts received by virtue of a special arrangement</p> <p>9 or relationship. In other words, through purchase</p> <p>10 and investment from our managing member or any</p> <p>11 affiliate, we will pay the same price that we would</p> <p>12 have paid had we directly purchased the investment.</p> <p>13 We also may purchase securities from</p> <p>14 issuers in offerings in which McGinn Smith & Company</p> <p>15 is acting as underwriter or placement agent, for</p> <p>16 which McGinn Smith & Company will receive a</p> <p>17 commission.</p> <p>18 We may retain the investments beyond</p> <p>19 the term of the notes, sell such investments during</p> <p>20 the term of the notes, or offer the notes to</p> <p>21 preferred investors.</p> <p>22 Q Thank you.</p> <p>23 A That's basically it.</p> <p>24 Q How does that relate to the loans</p> <p>25 that we're discussing, however? This is regarding --</p> <p style="text-align: right;">Page 866</p>

<p>1 DAVID SMITH</p> <p>2 in the way it's read and the way you've read it, it's</p> <p>3 regarding the investments that are made in other</p> <p>4 entities. You can buy those investments from those</p> <p>5 entities.</p> <p>6 I don't see the verbiage where it was</p> <p>7 discussed the loans that are made in affiliates?</p> <p>8 A Well, I think without trying to parse</p> <p>9 the words of my attorneys who drafted this, the clear</p> <p>10 intent was that investment and loans are analogous.</p> <p>11 We repeatedly talked about that. And I generally try</p> <p>12 to correct myself. This was an operating company</p> <p>13 with a -- the primary goal of its business was to</p> <p>14 make loans. I think the term "investments" is</p> <p>15 maybe -- is used sometimes as a substitute. But that</p> <p>16 is the clear intent of ourselves and counsel when</p> <p>17 they drafted it.</p> <p>18 MR. NEWMAN: Does it say</p> <p>19 anywhere in the private placement</p> <p>20 memorandum what you just stated; that</p> <p>21 the primary purpose of this entity was</p> <p>22 to act as an operating company that was</p> <p>23 going to be making loans?</p> <p>24 THE WITNESS: I don't know</p> <p>25 without reading it. But that's</p> <p style="text-align: right;">Page 867</p>	<p>1 DAVID SMITH</p> <p>2 security. It's "securitized."</p> <p>3 THE WITNESS: Securitized.</p> <p>4 Thank you.</p> <p>5 -- "cash flow instruments and</p> <p>6 any other investments that may add value</p> <p>7 to our portfolio."</p> <p>8 Word "loans" is in the third</p> <p>9 line.</p> <p>10 BY MR. RATTINER:</p> <p>11 Q Under "bridge loans"?</p> <p>12 A That is correct.</p> <p>13 Q Not loans by itself?</p> <p>14 MR. FRANCESKI: I am going to</p> <p>15 object.</p> <p>16 MR. NEWMAN: It says what it</p> <p>17 says.</p> <p>18 MR. FRANCESKI: It says what</p> <p>19 it says.</p> <p>20 MR. NEWMAN: Okay. Is there</p> <p>21 anything -- I am not going to ask you.</p> <p>22 THE WITNESS: I mean, I can</p> <p>23 read the rest of it, Mike if you want,</p> <p>24 if it's going to be helpful.</p> <p>25 MR. NEWMAN: No. I am not</p> <p style="text-align: right;">Page 869</p>
<p>1 DAVID SMITH</p> <p>2 certainly what was conveyed to</p> <p>3 investors.</p> <p>4 MR. NEWMAN: Can you take a</p> <p>5 second and look through the private</p> <p>6 placement memorandum and tell us if you</p> <p>7 find language like that.</p> <p>8 MR. FRANCESKI: We are talking</p> <p>9 about a very long document. If you want</p> <p>10 him to read every page, Mike, he</p> <p>11 certainly will do that.</p> <p>12 THE WITNESS: Let's start on</p> <p>13 page 1.</p> <p>14 MR. NEWMAN: Okay.</p> <p>15 THE WITNESS: "It has been</p> <p>16 formed to identify and acquire various</p> <p>17 public and/or private investments, which</p> <p>18 may include, without limitation: Debt</p> <p>19 securities, collateralized debt</p> <p>20 obligations, bonds, equities securities,</p> <p>21 trust preferreds, collateralized stock,</p> <p>22 convertible stock, bridge loans, leases,</p> <p>23 mortgaged equipment leases, security</p> <p>24 cash flow instruments and any" --</p> <p>25 MR. FRANCESKI: You said</p> <p style="text-align: right;">Page 868</p>	<p>1 DAVID SMITH</p> <p>2 going to ask you to read through the</p> <p>3 whole private placement memorandum.</p> <p>4 Maybe you can just take a look</p> <p>5 at the summary. I see in the business</p> <p>6 description it has the same -- looks</p> <p>7 like the same description that's on the</p> <p>8 first page of the document which you</p> <p>9 just read.</p> <p>10 Other than that, is there</p> <p>11 anything else in the summary that</p> <p>12 relates to your statement that this was</p> <p>13 going to be -- the primary purpose of</p> <p>14 this entity was to be an operating</p> <p>15 company that was going to be making</p> <p>16 loans?</p> <p>17 THE WITNESS: Summary is on</p> <p>18 what page?</p> <p>19 MR. NEWMAN: Begins on Bates</p> <p>20 14654. Continues through 14657.</p> <p>21 THE WITNESS: (Reviewing).</p> <p>22 Page 14655 under "Security."</p> <p>23 Once again, word "loans" is referenced.</p> <p>24 (Reviewing). I don't see</p> <p>25 anymore under there.</p> <p style="text-align: right;">Page 870</p>

1 DAVID SMITH
 2 Risk factors.
 3 (Reviewing).
 4 Page 60, under "We will be
 5 adversely affected when investments are
 6 pre-paid or defaulted."
 7 MR. FRANCESKI: I think Mr.
 8 Newman only asked about the summary.
 9 You're beyond the summary.
 10 MR. NEWMAN: That's fine. We
 11 can spend a few more minutes if he
 12 thinks there are other sections that
 13 address that topic. That's fine.
 14 THE WITNESS: Page 8 says "May
 15 default." Certainly the word "default"
 16 is associated with loans.
 17 (Reviewing).
 18 Again on page 9, "Use of
 19 proceeds." Where loans is mentioned.
 20 Same page under "Business," mentioned
 21 again.
 22 MR. NEWMAN: What is your
 23 understanding of the term "Bridge loan"?
 24 THE WITNESS: Bridge loan is
 25 generally a loan that is provided until
 Page 871

1 DAVID SMITH
 2 such time as it can be repaid through
 3 another financing, which would include
 4 equity, recapitalization, restructuring.
 5 Page 10, "Description of the
 6 notes." It's basically the same
 7 language, but it's again repeated on
 8 page 10 in the third paragraph.
 9 (Reviewing).
 10 Page 12, "Securities"
 11 mentioned again.
 12 That completes my review of
 13 the memorandum.
 14 MR. NEWMAN: Did Gersten
 15 Savage actually prepare the private
 16 placement memorandums for all four of
 17 the offerings?
 18 MR. FRANCESKI: Objection.
 19 Asked and answered.
 20 THE WITNESS: Best of my
 21 knowledge.
 22 MR. NEWMAN: This wasn't a
 23 situation where they prepared the
 24 initial private placement memorandum and
 25 then for the subsequent ones McGinn
 Page 872

1 DAVID SMITH
 2 Smith just took those and made the
 3 revisions to the names of the entity and
 4 any other changes?
 5 THE WITNESS: I don't believe
 6 so. Pay a fee every time.
 7 MR. NEWMAN: I have a question
 8 on page 17, under "Suitability
 9 requirements." It states that "Each
 10 investor must represent in writing that
 11 it qualifies as an accredited investor."
 12 THE WITNESS: Where are we,
 13 Mike?
 14 MR. NEWMAN: On page 17 under
 15 "Suitability requirements."
 16 THE WITNESS: Hm-hm.
 17 MR. NEWMAN: It says, "Each
 18 investor must represent in writing that
 19 it qualifies as an accredited investor."
 20 MR. FRANCESKI: Question is?
 21 MR. NEWMAN: Question is: We
 22 have already discussed that there were
 23 non-accredited investors in this
 24 offering, correct?
 25 THE WITNESS: That is correct.
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1 DAVID SMITH
 2 MR. NEWMAN: How do you
 3 reconcile that fact with this language?
 4 MR. FRANCESKI: Objection;
 5 asked and answered.
 6 But you can answer again.
 7 THE WITNESS: The writing that
 8 we're referring to is the questionnaire.
 9 Language in the questionnaire clearly
 10 defines what is an accredited investor.
 11 And again under Reg D, the exemption
 12 applies in these instances to 35 -- you
 13 can accept 35 non-accredited investors.
 14 BY MR. RATTINER:
 15 **Q We are going to turn to page Bates**
 16 **stamped as 14656.**
 17 **You see "Use of proceeds"?**
 18 **What does that represent? Is that**
 19 **only based on the initial raise?**
 20 **A Yes.**
 21 **Q And if we go down below you will see**
 22 **"Plan of Distribution," second paragraph, what does**
 23 **that represent? Is that 2 percent -- what would that**
 24 **2 percent be?**
 25 **A That 2 percent fee is the initial**
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1 DAVID SMITH
 2 plan of distribution, that's covered on the front
 3 cover, yes.
 4 **Q And that's equivalent to the**
 5 **underwriting fee?**
 6 A That's equivalent to the underwriting
 7 fee, yes.
 8 **Q Where does it say here that it's an**
 9 **annual fee?**
 10 MR. FRANCESKI: Objection;
 11 asked and answered.
 12 MR. RATTINER: Not with regard
 13 to this section.
 14 MR. FRANCESKI: He says it is
 15 the same language, same idea.
 16 MR. NEWMAN: I don't think
 17 it's been asked an answered.
 18 THE WITNESS: The annual fee
 19 is mentioned several times throughout.
 20 It's not on this page.
 21 MR. RATTINER: Okay.
 22 MR. NEWMAN: Why wouldn't that
 23 be included in the summary of the
 24 offering?
 25 THE WITNESS: Because this is

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1 DAVID SMITH
 2 a -- generally the offering costs are
 3 identified, which -- the initial
 4 2 percent fee, which is deducted from
 5 the proceeds, is what is asked for and
 6 is identified both here and on the front
 7 page.
 8 After that, there are ongoing
 9 expenses of the LLCs which are then
 10 identified in other parts of the
 11 prospectus. They include the trustee
 12 fee, which is not identified here. They
 13 include additional annual commission
 14 fees, which is not identified here but
 15 is identified in several sections; and
 16 the advisory fee.
 17 MR. NEWMAN: I guess we are
 18 wondering why that information -- these
 19 other -- those other fees that you just
 20 referenced, including the annual
 21 2 percent fee you testified to, are not
 22 included in the initial cover page or
 23 the memorandum or in the summary of the
 24 offering?
 25 MR. FRANCESKI: Objection.

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 2 You may answer.
 3 THE WITNESS: Because when you
 4 do an offering and you are trying to
 5 identify what the net dollars are going
 6 to be at the time the offering is
 7 subscribed for and concluded, you don't
 8 list -- I've never seen it listed --
 9 ongoing fees. I mean, this is basically
 10 saying that we are raising \$20 million,
 11 we are taking 2 percent of it, and so
 12 initially \$19.6 million is going to be
 13 accredited to the LC.
 14 Subsequent to that, the LLC
 15 incurs all sort of expenses. They incur
 16 organizational expenses; they include
 17 the advisory fees that we talked about.
 18 They are going to include legal fees
 19 when they close loans. I mean, those
 20 are operating costs of the LLC. This
 21 is -- my understanding is that this is
 22 trying to reflect and properly so the
 23 offering costs at the time of
 24 subscription.
 25 BY MR. RATTINER:

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 2 **Q If we can turn to page 14 of 60.**
 3 MR. FRANCESKI: Do you mind if
 4 I ask a follow-up question?
 5 Mr. Smith, as far as you're
 6 concerned, is the disclosure process you
 7 described with respect to underwriting
 8 fees versus ongoing expenses, is the way
 9 this private placement memorandum deals
 10 with it, as far as you understand,
 11 custom and practice in the industry?
 12 And did you do this under advice of
 13 counsel?
 14 A Yes.
 15 BY MR. RATTINER:
 16 **Q Just so the record is clear, and we**
 17 **discussed this before, just so it's in the same**
 18 **question, is this PPM substantially similar to the**
 19 **other three PPMs --**
 20 A Yes.
 21 **Q -- the other three LLCs?**
 22 **Are there any other notable**
 23 **differences other than --**
 24 **(Pause in the proceedings.)**
 25 THE WITNESS: I believe it is,

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2 with the one exception that we have
3 chatted about a couple of times, and
4 that was the senior subordinate.

5 MR. FRANCESKI: Please note my
6 objection, "Asked and answered" but I
7 got it in late.

8 BY MR. RATTINER:

9 **Q Okay. We will turn to page 14660.**
10 **And four paragraphs down, are these**
11 **the fees you have been referencing?**

12 A (Reviewing).

13 MR. FRANCESKI: The ongoing
14 fees?

15 MR. RATTINER: Correct.

16 THE WITNESS: You are talking
17 about under the risk factors of subtitle
18 "We may be unable to finance our
19 operations"?

20 BY MR. RATTINER:

21 **Q Correct?**

22 A Then they're talking about cash
23 liquidity; talking about incentive commissions at
24 2 percent annually over the term of the notes.

25 **Q Let's stay there. Is that your**

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1 DAVID SMITH

2 **Q Are the salesmen paid an incentive**
3 **commission of 2 percent?**

4 A It is -- not exactly that. There are
5 modifications.

6 **Q And those are --**

7 A The seniors were paid at a rate of
8 1 percent. This is -- now, you are talking about --
9 maybe I am parsing words.

10 Are you talking about the gross
11 commission or are you talking about the net
12 commission? I should have asked that. The gross
13 commission is, in fact, 2 percent, yes.

14 **Q But the salesmen aren't getting**
15 **that --**

16 A That's correct.

17 **Q -- the way it's worded?**

18 A That's correct.

19 **Q So the salesmen are actually**
20 **getting --**

21 A Yeah. That's what I was trying to
22 get at.

23 That suggests that the salesmen is
24 getting the entire amount. And in our industry, I
25 think it's -- you think in terms of commissions in

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1 DAVID SMITH

2 **underwriting fee?**

3 A That is our underwriting -- well no,
4 that is not an underwriting fee, I guess. It is what
5 it says it is: It's to the managing members
6 salesman, so...

7 **Q That's an additional fee?**

8 A That's -- it says it's an incentive
9 commission. And I guess the underwriting fee would
10 be reflective of the 2 percent the first year. This
11 is identified as an incentive commission.

12 **Q Yesterday we discussed there's total**
13 **fees of 3.25 percent ongoing for the term, I guess**
14 **four or five years, depending on which LLC?**

15 A That is correct.

16 **Q Where does this fall in with that**
17 **3.25 percent? Or does it?**

18 A It does fall. We talked about the
19 2 percent commission, which is the language
20 identified here. We are talking about the management
21 fee of 1 percent, which is the second line. And the
22 third line is the administration fee of .25 percent.

23 **Q What is the last .25 percent?**

24 A That's in there. It's never been
25 paid. Never been accrued. Damn.

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2 terms of gross, but that isn't what they put in their
3 pocket, so...

4 **Q So the house keeps a percentage?**

5 A The house keeps a percentage.

6 **Q What does the rep actually get out of**
7 **that?**

8 A Well, it varies.

9 **Q Over the three tranches?**

10 A No -- well, yes, yes.

11 **Q And then varies per rep?**

12 A Per rep, yes.

13 **Q What's this, a typical pay out?**

14 A Yes. The --

15 MR. FRANCESKI: Was there a
16 typical at McGinn Smith; is that what
17 you mean?

18 MR. RATTINER: I don't care
19 about everybody else.

20 THE WITNESS: The payout plan
21 was, is that the -- for the senior
22 tranche, the salesmen got 1 percent, and
23 then at whatever payout he was at. And
24 that varied with different parties.

25 MR. FRANCESKI: I think --

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1 DAVID SMITH

2 BY MR. RATTINER:

3 **Q As an example, if Lex, for instance,**
4 **is at an 80 percent payout, he'd get 80 percent of**
5 **1 percent?**

6 A That is correct.

7 MR. FRANCESKI: Chris was
8 asking, is there a typical rep payout;
9 is that --

10 MR. RATTINER: With regard to
11 these.

12 What we are saying is
13 2 percent is the gross paid to the
14 broker-dealer. The broker-dealer --
15 does the broker-dealer have a typical
16 payout of that 2 percent to the brokers
17 that they employ.

18 So I think we are on the same
19 page.

20 THE WITNESS: I think so.

21 MR. FRANCESKI: In other
22 words, is there a percentage typically
23 paid to brokers?

24 THE WITNESS: Right. With
25 some differences. The vast majority of

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2 them received anywhere between 50 and
3 60 percent payout, depending on when
4 they were hired, what their compensation
5 was.

6 BY MR. RATTINER:

7 **Q If we are going to that number**
8 **specifically, what was the number based on?**
9 **So 1 percent was for the seniors?**

10 A Right.

11 **Q And then the individual broker?**

12 A Right. Got his respective payout,
13 whatever he was -- had been agreed upon.

14 And then the senior subordinate
15 tranche and the third tranche, the junior tranche was
16 also at 2 percent.

17 **Q 2 percent. So the full payout, their**
18 **percent of 2 percent?**

19 A Okay, now, we -- seniors got a
20 1 percent gross. Senior subordinates got 2 percent
21 gross. Junior's got 2 percent gross. Off of those
22 gross, each respective rep gets whatever payout he
23 may have been in agreement with.

24 **Q Understood.**

25 **And that's for the term of the note,**

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1 DAVID SMITH

2 **the four years, five years, respectively?**

3 A That is correct.

4 MR. FRANCESKI: Let me object
5 to that. It's not Mr. Smith. One of
6 the LLCs did not pay for the entire term
7 of the note? Or am I wrong about that?
8 It was a five-year note but only paid
9 four years. If I am wrong I am wrong.

10 THE WITNESS: No. That was --
11 the broker himself, I think, was -- only
12 got for four years, but not the firm.

13
14 EXAMINATION

15 BY MR. ROWEN:

16 **Q The incentive commissions that we**
17 **spoke of, those incentive commissions are specific to**
18 **this one offering and no other offerings or no other**
19 **raises?**

20 A No. They are specific to any
21 subscription by an investor that's in place. So if
22 -- you're -- are we talking about what's going to go
23 to the reps? Or are we talking about gross? I guess
24 we need --

25 **Q I am trying to understand what is**

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1 DAVID SMITH

2 **disclosed here.**

3 A What this -- what this references is
4 the percentage of the value of the cost value of the
5 notes at the time.

6 **Q The notes specific to this private**
7 **placement memorandum?**

8 A That is correct.

9 **Q Okay. Since -- and this private**
10 **placement memorandum was specific to one offering.**
11 **Why -- why would this line -- this**
12 **disclosure of the incentive commissions not be**
13 **displayed in either the offering summary or on the**
14 **page that is Bates stamped 14654 on the summary**
15 **section specific to the offering; why instead is it**
16 **on the third page of risk factors?**

17 MR. FRANCESKI: Objection.
18 Asked and answered.

19 THE WITNESS: I guess I am not
20 sure I totally understand the question,
21 Steve; would you repeat it.

22 BY MR. ROWEN:

23 **Q This incentive commission is specific**
24 **to the offering.**

25 **Why would it not be disclosed in the**

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2 offering summary as opposed to the third page of risk
3 factors?

4 MR. FRANCESKI: Objection.

5 THE WITNESS: I believe the
6 answer was, when we are talking about
7 the summary we are talking about the
8 summary of the offering as it is made
9 and until it's completed. And I have
10 then indicated that subsequent to that
11 there are expenses that are incurred by
12 the LLC, and those are disclosed because
13 they're, you know, I guess conflict
14 disclosures, what have you.

15 And then from a risk
16 standpoint, it is obviously suggesting
17 that -- and informing. Not suggesting,
18 but it's informing the investor that his
19 own liquidity can be impacted by the
20 fact that there are fees payable on
21 expenses payable. And that is a
22 legitimate risk factor.

23 BY MR. ROWEN:

24 Q So you agree though that the
25 incentive commissions as related to this offering --

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2 THE WITNESS: I've answered
3 the best way I can. I think you're
4 reaching for legal conclusions that I am
5 not prepared to answer. You know. I
6 think this is an expense. It's been
7 disclosed. Whether it's -- to meet your
8 definition, I am not in a position to
9 answer that, Steve. So I will have to
10 take a pass.

12 EXAMINATION

13 BY MR. RATTINER:

14 Q To follow-up on Steve's point, why is
15 this labeled as a risk and not a fee?

16 MR. FRANCESKI: Objection.

17 THE WITNESS: It's labeled as
18 a risk because as I just suggested to
19 Steve if, in fact, you are trying to
20 determine what various risk might arise
21 so that an investor might not get a
22 timely payment or get a payment at all,
23 there are going to be potential expenses
24 ahead of him. And it will impair the
25 ability to get paid. One of them is

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2 MR. FRANCESKI: Objection.

3 MR. NEWMAN: What is the
4 objection?

5 MR. FRANCESKI: Again, he's
6 arguing with the witness. He's trying
7 to throw in the words "related to this
8 offering." Mr. Smith has explained to
9 him that commissions that fall out of
10 the total proceeds of the offering upon
11 closing are disclosed on page 1 and
12 expenses later on, which -- I don't even
13 use the term related to the offering,
14 but it doesn't change the answer. The
15 expenses that come out later on are
16 disclosed elsewhere. That's all. It is
17 what it is. We will argue about whether
18 it should be on page 1 or --

19 MR. NEWMAN: I'm asking if
20 this is an offering expense to be paid
21 at a later date? Or is this a separate
22 expense away from the offering? That's
23 what I am trying --

24 MR. FRANCESKI: He answered
25 that.

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2 these fees. And that, I think, is a
3 risk factor and certainly one that's
4 appropriately disclosed, especially as
5 it relates to the affiliate parties that
6 are involved. It's generally what you
7 are trying to do.

8 MR. NEWMAN: What guidance, if
9 any, did the firm give its sales force
10 regarding the description and disclosure
11 of fees as they were presenting these
12 investments to prospective investors?

13 THE WITNESS: The fees were
14 all disclosed.

15 MR. FRANCESKI: The question
16 was what guidance did you give to the
17 salesmen about how to talk about the
18 fees?

19 Is that what you are asking,
20 Mike?

21 MR. NEWMAN: Right.

22 THE WITNESS: Okay. That's
23 what I was about to say.

24 We disclosed to the brokers
25 what the level of fees were, that they

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1 DAVID SMITH
 2 were to be translated to the clients. I
 3 mean, the fees are what they were. I
 4 mean, I don't know if there was an
 5 extensive discussion other than "This is
 6 what it is going to cost. This is going
 7 to be the impact on the LLCs every year
 8 in terms of its carrying cost," which
 9 include -- you know, we repeatedly
 10 talked about our cost of capital being
 11 in the eleven-and-three-quarter-percent
 12 range. And that would be a reflection
 13 of the average rate -- weighted average
 14 rate of the three classes of notes,
 15 which approximate somewhere about a
 16 eight-and-a-half-percent level if you
 17 weight the ten and a quarter and the
 18 approximately five to six and the seven,
 19 seven and a half, you know, whatever the
 20 rates were, you are going to arrive at a
 21 weighted rate of about eight-and-a-half
 22 percent. If you add another
 23 three-and-a-quarter percent, which is
 24 the two, the one, the quarter --
 25 notwithstanding that I missed that other

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1 DAVID SMITH
 2 quarter percent that was available --
 3 you come to around
 4 eleven-and-three-quarters percent. And
 5 that was what was conveyed to the sales
 6 force, that's our cost to capital. So
 7 that's our bogie, to use the term, that
 8 that's basically -- when you're -- which
 9 really begs the question in terms of
 10 risk, everyone understood, you know,
 11 with that bogie, you are making loans,
 12 you are making capital commitments and
 13 credit facilities with that bogie in
 14 mind. And that was -- to answer your
 15 question, that's what was conveyed.
 16 MR. NEWMAN: Eleven and
 17 three-quarters.
 18 THE WITNESS: At the time
 19 that's what it was, yes.
 20 MR. NEWMAN: What did the LLCs
 21 generate in the way of income, returns
 22 on a percentage basis annually from 2000
 23 -- 2003 through 2006, approximately?
 24 THE WITNESS: I believe three
 25 of the four were profitable. I think

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1 DAVID SMITH
 2 FAIN was not the first year, but I don't
 3 know the numbers. I would have to, you
 4 know, go back.
 5 MR. NEWMAN: What is the
 6 approximate percentage we are talking
 7 about?
 8 THE WITNESS: Approximate
 9 percentage was that they were covering
 10 their expenses and had some profit, but
 11 I don't -- that's all -- that's what it
 12 was basically designed to do.
 13 MR. NEWMAN: Was there ever --
 14 let me rephrase that.
 15 Did the LLCs ever earn
 16 sufficient investment returns to pay the
 17 required interest payments and the
 18 expenses of the LLCs?
 19 THE WITNESS: Absolutely.
 20 MR. NEWMAN: And that applied
 21 throughout the 2003 through 2006 time
 22 period.
 23 THE WITNESS: Best of my
 24 recollection, they did. As I said, I
 25 believe there was one of the funds the

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1 DAVID SMITH
 2 first year, organizational costs, what
 3 have you; but, yes.
 4 MR. NEWMAN: Again, my asking
 5 that question, I'm not talking about
 6 giving people back what they invested in
 7 principal, I am talking about actual
 8 returns?
 9 THE WITNESS: Correct.
 10 Income, is what you would be looking at.
 11 MR. NEWMAN: Right.
 12 BY MR. RATTINER:
 13 **Q I asked you yesterday that there was**
 14 **an indenture.**
 15 **How many customers requested the**
 16 **indenture, that you recall?**
 17 A I don't know.
 18 **Q Who were they requesting an indenture**
 19 **from?**
 20 A MS Advisors.
 21 **Q And do you recall if any were**
 22 **requested?**
 23 A I believe one or two. But I don't
 24 know if it came directly from a customer, attorney.
 25 And are you talking at time of

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1 DAVID SMITH
 2 purchase? Are you talking any time --
 3 **Q Throughout the life of the loan.**
 4 A Maybe one or two, but I couldn't tell
 5 you who.
 6 MR. ROWEN: How about at time
 7 of purchase?
 8 THE WITNESS: I don't think
 9 any.
 10 BY MR. RATTINER:
 11 **Q How about representatives, were they**
 12 **provided with the indenture?**
 13 A I don't believe so. It was
 14 available, but it was not passed out to them.
 15 **Q Did any representative request an**
 16 **indenture?**
 17 A Not to my recollection.
 18 MR. ROWEN: Did any ask
 19 questions about the indenture?
 20 THE WITNESS: I don't recall.
 21 I mean, they were told -- hopefully they
 22 would know if they were told, there's an
 23 indenture with a bond offering, so...
 24 But I don't recall specifically if
 25 anybody asked any questions.

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1 DAVID SMITH
 2 MR. ROWEN: You said they were
 3 told that there was an indenture with
 4 the bond offering?
 5 THE WITNESS: I said I would
 6 hope that salesmen in the securities
 7 business would understand with a bond
 8 offering there's an indenture. And I
 9 don't recall any broker to your specific
 10 question asking me either questions,
 11 which I think was your last question, or
 12 requesting it. I have no recollection
 13 of any of that happening.
 14 BY MR. RATTINER:
 15 **Q If we can turn to page 14669, Bates**
 16 **stamp.**
 17 MR. FRANCESKI: It's almost
 18 five to 12:00, gentlemen. I want to
 19 give everybody a heads up, we are
 20 concluding at 12:00. You guys tend to
 21 always want to ask questions too after
 22 we've tell you we've expired. Today we
 23 are not going to give you that.
 24 MR. RATTINER: Once the
 25 expiration happens.

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1 DAVID SMITH
 2 MR. FRANCESKI: Correct. So
 3 if there is something you really want to
 4 know in the next six minutes, please...
 5 THE WITNESS: Page 16, did you
 6 say?
 7 BY MR. RATTINER:
 8 **Q Yes, page 16.**
 9 **What did this form of compensation**
 10 **represent?**
 11 **We see a \$400,000 total commission**
 12 **with a footnote of one and the reimbursement of**
 13 **expenses of \$50,000?**
 14 A The total commissions represent the
 15 2 percent of the 20 million. The \$50,000 I would
 16 have to -- I wouldn't assume. I do know. I don't
 17 know if it was exact, but the legal costs and the due
 18 diligence costs associated with the preparation of
 19 the memorandum, printing of that sort, I think the
 20 50,000 was designed to, you know, cover that;
 21 although, I do think Gersten's fee was pretty much
 22 \$50,000 the first year. That's my recollection.
 23 **Q And this is, again, the -- only the**
 24 **onset fees described here?**
 25 A That is correct.

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1 DAVID SMITH
 2 **Q Where is that stated?**
 3 MR. FRANCESKI: Where is what
 4 stated?
 5 BY MR. RATTINER:
 6 **Q That this is only the initial fee?**
 7 MR. FRANCESKI: Are the words
 8 there? Yes or no: Are the words there?
 9 THE WITNESS: (Reviewing).
 10 No.
 11 MR. NEWMAN: Let's go off the
 12 record for one minute.
 13 (Whereupon a recess is taken.)
 14 MR. RATTINER: Back on the
 15 record.
 16 MR. MCCARTHY: I just want to
 17 go back and clarify the yearly costs.
 18 You mentioned, and please correct me if
 19 I am wrong, eleven and a quarter
 20 percent?
 21 THE WITNESS: No. I think I
 22 used eleven and three-quarters.
 23 MR. MCCARTHY:
 24 Eleven-and-three-quarters percent. That
 25 was what you would need to earn to cover

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1 DAVID SMITH
 2 costs; to pay out the --
 3 THE WITNESS: For the income,
 4 yeah. That's your bogie.
 5 MR. MCCARTHY: And that eleven
 6 and three-quarters is on the par value;
 7 is that correct?
 8 THE WITNESS: That is correct.
 9 MR. MCCARTHY: So since you
 10 are not getting the full par value right
 11 off the top, you are taking 2 percent
 12 off, that figure is going to start to go
 13 up, correct?
 14 THE WITNESS: If you divide it
 15 by .98, I guess it would have some
 16 impact, yeah.
 17 MR. MCCARTHY: As the funds
 18 decreased in value -- you testified
 19 yesterday that at some point in 2007 and
 20 2008 they were worth 80 percent,
 21 70 percent. So, again, that yearly
 22 percentage to try to break even is going
 23 higher and higher and higher?
 24 THE WITNESS: Not necessarily.
 25 Because the value of the underlying

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1 DAVID SMITH
 2 investment may in effect have gone down,
 3 but the income that it's generating may
 4 have stayed the same. To your point, if
 5 there are impaired or defaulted
 6 investments or investments that are not
 7 accruing anymore, yes, then your
 8 argument is correct. That means --
 9 MR. MCCARTHY: Argument?
 10 THE WITNESS: Well, your
 11 thesis would suggest that other
 12 investments would have to pay more.
 13 And, in fact, that's an excellent point,
 14 because that's exactly why when people
 15 manage these types of funds -- and I
 16 mentioned this in my testimony
 17 yesterday, anyone that goes into a
 18 company, such as this -- I mean, banks
 19 don't expect to make a hundred percent
 20 returns on their loans, they always
 21 expect to have some default rates. And
 22 they are lending to presumably AAA
 23 credits.
 24 So as you go down the
 25 credit-worthiness trail, if you will,

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1 DAVID SMITH
 2 you are going to have expectations of
 3 disappointments. And so therefore, if
 4 you are going to be -- if you look at
 5 the portfolio of loans, a great number
 6 of the loans yielded far in excess of
 7 eleven-and-three-quarters percent.
 8 You know, generally, the
 9 lowest coupon was for what was in the
 10 12 percent range; but there was
 11 14 percent coupons, 15 percent coupons.
 12 The things that we invested in the
 13 private placement entities that were
 14 offered with InCaps and DeKania were
 15 returning on an income basis 24 percent
 16 in the first years.
 17 So you had -- you always, you
 18 know, are looking to -- to your point,
 19 is what was the fixed bogie? And then
 20 if you had disappointments, yes, you
 21 would presumably need to get income
 22 elsewhere. Well, that's why you had
 23 investments that were returning higher
 24 rates of return.
 25 MR. MCCARTHY: It would seem

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1 DAVID SMITH
 2 to me in looking through the balance
 3 sheet that there were more
 4 disappointments than higher returns; is
 5 that correct?
 6 MR. FRANCESKI: What are you
 7 referring to --
 8 THE WITNESS: I guess that's
 9 why we are here, isn't it?
 10 You know, what if I had
 11 invested in all preferred stock of
 12 Citicorp, Wachovia, General Motors,
 13 Lehman Brothers, Bear Stearns, how would
 14 we be doing? Would we be sitting here?
 15 We'd have the same record, the same
 16 record for the investors, but my guess
 17 is we wouldn't be sitting here.
 18 You guys wouldn't have called
 19 me in if I invested in those entities,
 20 and the results would have been worse.
 21 So... Yes, we have had a lot of
 22 disappointments, Bob, and nobody feels
 23 it more than me. A lot of people that
 24 feel it.
 25 MR. MCCARTHY: Just one

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1 DAVID SMITH
 2 last -- and I just want to make sure
 3 that our figures are accurate, Palisades
 4 Pictures, total investment of the funds
 5 of about 13.9 million. Is a big chunk
 6 of that still outstanding?
 7 THE WITNESS: About 6 million
 8 is outstanding, yes -- maybe 7 million,
 9 I think.
 10 MR. MCCARTHY: And the
 11 prospects of paying back that 6 or 7
 12 million?
 13 THE WITNESS: Prospects of
 14 that is that they have been in the queue
 15 for approximately two years to do a
 16 public offering. They had an engagement
 17 with Laidlaw. Never got off the ground.
 18 We actually started in '07 with those
 19 discussions. Obviously, as we got to
 20 '08, had no -- still -- I talked to
 21 Mr. Roberti just before I arrived here,
 22 tells me he's still in negotiations,
 23 still talking with Laidlaw, still
 24 expects to do it later this year. And
 25 we are negotiating on behalf of the LLCs

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1 DAVID SMITH
 2 as to how and what form that might be
 3 and why that -- how that would result in
 4 total return of the LLC's capital.
 5 THE WITNESS: I have one
 6 question.
 7 MR. FRANCESKI: Yes.
 8 THE WITNESS: Have we gotten
 9 any of the Stockholm syndrome yet?
 10 Nobody is familiar with the Stockholm
 11 syndrome?
 12 MR. RATTINER: None of us have
 13 it.
 14 THE WITNESS: None of us have
 15 it. Well, that's too bad from my point.
 16 Thank you.
 17 MR. NEWMAN: That will
 18 conclude our questioning. But we are --
 19 we are going to reserve the right to
 20 have you back again for more testimony.
 21 There's still some outstanding 8210
 22 requests and there are a couple of
 23 issues we haven't had a chance to go
 24 through today. So we still -- we do
 25 want you to come back. So we need to

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1 DAVID SMITH
 2 come up with a date in the next couple
 3 of weeks and -- your coming back today
 4 for a few hours has made a difference in
 5 terms of the time we are going to spend
 6 with you next time. We appreciate you
 7 coming back for a few hours this
 8 morning.
 9 And at this point, if counsel
 10 has anything else they want to add, we
 11 will go off the record, otherwise...
 12 MR. FRANCESKI: Yeah. Let's
 13 go off the record.
 14 MR. NEWMAN: Okay. Off the
 15 record.
 16 (Whereupon testimony adjourned
 17 for the day at 1:00 p.m..)
 18
 19
 20
 21
 22
 23
 24
 25

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1 I, S. Arielle Santos, C.S.R., a Registered Professional
 2 Reporter, Certified Shorthand Reporter, Certified LiveNote
 3 Reporter do hereby certify:
 4 That prior to being examined, the witness named in the
 5 forgoing deposition, was by me duly sworn to testify the
 6 truth, the whole truth, and nothing but the truth.
 7 That said deposition was taken before me at the time and
 8 place set forth and was taken down by me in shorthand and
 9 thereafter reduced to computerized transcription under my
 10 direction and supervision, and I hereby certify the foregoing
 11 deposition is a full, true and correct transcript of my
 12 shorthand notes so taken.
 13 I further certify that I am neither counsel for nor
 14 related to any party to said action nor in anywise interested
 15 in the outcome thereof.
 16
 17 _____
 18 S. Arielle Santos
 19 Registered Professional Reporter
 20 Certified Shorthand Reporter - #2116
 21 Certified LiveNote Reporter
 22 Notary Exp. 4/2011
 23
 24
 25

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1 FINANCIAL INDUSTRY
2 REGULATORY AUTHORITY
3 CASE NO. 2009-017-9845

4 IN RE)
5 THE MATTER OF:)

6 DAVID L. SMITH)
7)
8 -----)

9
10
11 INVESTIGATIVE TESTIMONY OF

12 DAVID L. SMITH

13 VOLUME IV, PAGES 907-1091

14 WOODBRIDGE, NEW JERSEY

15 FEBRUARY 12, 2010
16
17
18

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24 CSR NO. XI01807

25 FILE NO.: A401438

FINANCIAL INDUSTRY
REGULATORY AUTHORITY
CASE NO. 2009-017-9845

IN RE)
THE MATTER OF:)
)
DAVID L. SMITH)
)
)
)
)

Investigative testimony of DAVID L. SMITH,
taken on behalf of FINRA, District 9 at 581 Main
Street, 7th Floor, Woodbridge, New Jersey,
commencing at 9:50 a.m., February 12, 2010, before
Jill A. Praml-Bussanich, CSR No. XI01807.

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A P P E A R A N C E S

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I N D E X

Witness: DAVID L. SMITH

Examinations	Page
BY MR. ROWEN	911
BY MR. RATTINER	1022

E X H I B I T S

Number	Description	Page
23	List	913
24	Confidential Private Placement Memorandum	1050
25	E-Mail	1056
26	E-Mail	1060
27	Letter dated February 2, 2010	1075

EXHIBITS NOT ATTACHED
INFORMATION REQUESTED
Page Line

QUESTIONS INSTRUCTED NOT TO ANSWER
Page Line

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DAVID L. SMITH,

having first been duly sworn, was
examined and testified as follows:

MR. ROWEN: We're on the record at
approximately 9:50 on February 12, 2010.
This is a continuation of the on-the-record
interview of Davis Smith, which had adjourned on
February 3, 2010.

E X A M I N A T I O N

BY MR. ROWEN:

Q. What is RTC Trust?

A. RTC was a grantor trust that was
formed for the purpose of financing through the
collateralization and securitization of alarm
contracts.

I believe RTC specifically referred to a
monitoring station somewhere. I can't tell you what
the exact moniker stands for.

Q. Who are the owners of RTC Trust?

A. If there is any, it's a grantor trust.
I'm not sure there are any real owners.

The owners are, in effect, the note holders
that finance it. If there is a residual ownership,

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1 it stays in the trust, and the trustee I think was
2 more likely than not McGinn Smith Capital Holdings.
3 That's generally the case.

4 I don't know that for certain, but that's
5 generally the case.

6 **Q. What is your role with RTC?**

7 A. The only role I would have as
8 principal -- if, in fact, McGinn Smith Capital
9 Holding was the trustee, I don't remember that
10 specifically. If that was the case, I am an owner
11 and principal in McGinn Smith.

12 **Q. What roles did you perform for RTC?**

13 A. The trustee, if that is in fact -- if
14 that's what the evidence shows, the trustee
15 generally monitors the payments, both coming in,
16 distributions out and sees to it the affairs of the
17 trust are conducted according to the indenture and
18 prospectus.

19 **Q. Does your broker-dealer raise funds
20 for RTC?**

21 A. Yes.

22 **Q. How much?**

23 A. I don't remember.

24 **Q. When was that?**

25 A. Well, it was prior to 2003. That's

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1 all I can tell you.

2 MR. ROWEN: Can I have this marked as
3 Exhibit 23.

4 (List was received and marked FINRA
5 Exhibit 23 for identification.)

6 **Q. BY MR. ROWEN: I'm handing you
7 Exhibit 23 in this matter. It's a total of
8 five pages.**

9 These were provided to FINRA by the
10 broker-dealer as documentation of First Advisory
11 income notes use of customer proceeds.

12 First two pages stamped MGS 0020096 and 97
13 are copies of a registry report of transactions
14 between First Advisory income notes and RTC. Of the
15 last three pages stamped MGS 0020098 through MGS
16 0020100 are copies of a grid note between First
17 Advisory income notes and RTC.

18 Please take a minute to review that.

19 A. Yes.

20 **Q. Turn to the final page of the exhibit
21 Bates stamped finishing 100.**

22 Does this refresh your memory about who the
23 trustee of RTC Trust is?

24 A. I'm sorry. Where are we looking?

25 **Q. Final page, stamped finishing 100.**

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1 A. Yes.

2 **Q. It is, in fact, McGinn Smith Capital
3 Holding who is the trustee?**

4 A. Correct.

5 **Q. What is your involvement with the
6 loans documented in this exhibit?**

7 A. I believe for First Advisory they
8 picked up an income stream as evidenced by the grid
9 note, which was designed to provide sufficient
10 credit on an ongoing basis to provide for the
11 operating deficiency that was occurring in the RMR,
12 the recurring monthly revenues, of the monitoring
13 contracts.

14 We can see virtually every month there
15 was -- there was an advance to cover that underneath
16 the grid note. And the collateral was ongoing
17 contracts, which would be in somewhat perpetuity.

18 **Q. Why is First Advisory income notes
19 providing a line of credit to a company?**

20 A. Because that's the business they are
21 in. They are in the business of providing credit
22 facilities.

23 So, this was both a business that we knew
24 and a business that, again, as we have indicated in
25 earlier testimony, had no ongoing risk for First

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1 Advisory, because the note itself was secured by the
2 pledge of the fees. And it provided a facility and
3 a means to provide income to the LLC, which is the
4 business purpose of the LLC.

5 **Q. I'm confused by what you refer to as
6 pledging the fees.**

7 I believe it was your earlier testimony
8 that it was investments in affiliates of which
9 McGinn Smith or any McGinn Smith entity or someone
10 personally was a 20 percent owner in the entity,
11 correct?

12 A. Basically entity or affiliate we
13 deemed to have a conflict in the case of a RTC -- as
14 I indicated a few moments earlier, the ownership
15 really rests until the residual ownership is
16 concluded. Then the residual ownership rests in the
17 trustee, which McGinn Smith Capital Holding is an
18 affiliate of us.

19 **Q. Were there other similar entities
20 where there was no personal ownership, but which
21 McGinn Smith Capital Holdings was the trustee that
22 were also had their transaction with one of the four
23 funds or four LLCs collateralized?**

24 A. There might be. There was some
25 discretion used with this.

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Specifically with RTC, the feeling was at the time that this was not a new loan. This was a facility that was being provided to in effect address a deficiency. And that because of that deficiency, we wanted to remove any concern of conflict.

If it was a brand new loan, that may not be considered under those circumstances. But, under these circumstances, the original RTC had run into a deficiency in terms of its income. And to sort of be above any criticism, that was something that we considered.

Q. Was there a list of entities which --

A. Yes.

Q. Who maintained that list? Is there a list of entities that had their loans with one of the four LLCs collateralized by fees due by the LLCs?

A. There is a schedule of those entities that qualify for that, yes.

Q. Who maintains that list?

A. Brian Cooper.

MR. RATTINER: Is that list different from the schedule of fees?

THE WITNESS: Same.

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MR. NEWMAN: When did you start maintaining that list?

THE WITNESS: Oh, you know, I don't really know. Sometime ago.

We've always known from the 2004, 2005 that any entity would in effect over the 20 percent qualify for that.

MR. NEWMAN: When approximately did you start maintaining that list?

THE WITNESS: I don't know. Brian Cooper keeps that list.

MR. NEWMAN: Within the last year or two?

THE WITNESS: I really don't know.

MR. NEWMAN: You have no idea?

THE WITNESS: No. We've known whose on the list. And it's been in the last really since 2008, I guess that we've had a focus on these considerations, because basically in January of 2008 when the funds went into deficiency or default or whatever we want to refer to it as, those became more critical in terms of discovery and knowing what was pledged and what wasn't.

MR. NEWMAN: Why is that?

THE WITNESS: Well, for the simple

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reason we were trying to make sure that those entities that we were, in fact, covered by the pledge would not be -- there would be sufficient funds to do that.

And then if there were any other advances that would fall under those circumstances, we wanted to make sure we didn't go over and above it.

MR. NEWMAN: Did you have any concerns in maintaining this list that someone would accuse McGinn Smith or you have a conflict of interest in terms of these loan transactions?

THE WITNESS: Actually, quite the opposite.

You know, the fact is is that the LLCs had a need to put money out. One of their main objectives was not to be caught in a negative arbitrage situation where they had cash.

If opportunity came up that allowed us to do that, and if, in fact, they had involvement with entities where we in fact had some sort of involvement, in this case the 20 percent, it was more important to us that those, in fact, be attributed, those fees would be protected so we wouldn't be accused of a conflict of interest.

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If there was no real plan or real ability to pay back the loan, then, in fact, the criticism you're raising would, in fact, be real. But as long as there were funds to pay it back, philosophically we were comfortable with that.

MR. NEWMAN: You didn't have concerns about a conflict of interest or being accused of having a conflict of interest?

THE WITNESS: I don't see where there is a conflict. I would take exactly the opposite position.

MR. NEWMAN: I want to make sure we're clear. You didn't have any concern about having a conflict of interest?

MR. FRANCESKI: I'm not sure, Dave, you're understanding what Mike is asking.

Mike is asking whether your concern -- whether it was a concern of the conflict that motivated you to set up this collateralization idea.

Isn't that what you're asking?

MR. NEWMAN: That's fine. That's a fine question, too.

THE WITNESS: Okay. In that context, flipping it, yes. The concern was that we be above criticism for conflict for those entities that there

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1 might be a question as to how we would repay the
2 loan or what was the source of repayment, and we
3 wanted to have, in fact, a good source of repayment.
4 So, that's why we pledged the fees.

5 MR. NEWMAN: We talked about this
6 agreement during your earlier testimony here.

7 Have you had a chance to see if you
8 have a copy of that agreement?

9 THE WITNESS: I have. I've not been
10 able to find it.

11 I have one other source I'm looking
12 to, which is our former counsel. And I've yet to --
13 she's no longer with us. See if she has it.
14 I've yet to find it.

15 MR. NEWMAN: So I'm clear, we talked
16 about several transactions that were subject to this
17 security collateralization agreement involving
18 different multiple transactions.

19 Was this -- can you describe the
20 agreement in more detail? Was this an omnibus
21 agreement or was there an agreement for each of the
22 transactions where there deemed to be a potential
23 conflict?

24 THE WITNESS: No. It was an -- to use
25 your term omnibus or overall sort of credit

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1 agreement, if you will, basically covering those
2 companies where the potential for conflict might
3 arise.

4 MR. NEWMAN: When was this agreement
5 actually formulated?

6 MR. FRANCESKI: Asked and answered.

7 THE WITNESS: Best of my recollection,
8 it was 2004 or 2005.

9 MR. NEWMAN: Who are the parties to
10 that agreement?

11 MR. FRANCESKI: Objection. Asked and
12 answered.

13 THE WITNESS: Parties are McGinn Smith
14 & Company. Let me correct that. Alter that answer.

15 The parties are those parties that
16 have fees coming to them from the four LLCs that
17 have been the subject of this inquiry.

18 MR. NEWMAN: Parties that have fees
19 coming to them from -- the parties who are the
20 recipients of money from one of the LLCs?

21 THE WITNESS: Right. I'm trying to
22 qualify that, because when I state those three
23 parties which are McGinn Smith & Company, McGinn
24 Smith Advisors and McGinn Smith Capital Holdings,
25 their -- it was not a blanket guarantee, but those

Page 921

1 three, but only to the extent that they had pledged
2 the fees that were coming from the LLCs so that
3 McGinn Smith & Company was not guaranteeing those
4 notes.

5 McGinn Smith Advisors was not
6 guaranteeing those notes or the loans, I guess. Nor
7 was McGinn Smith Capital Holdings. But, rather, the
8 fees that were due to them from the four LLCs were,
9 in fact, pledged to cover those.

10 MR. NEWMAN: One of the those -- any
11 of those three entities were eligible to receive
12 fees or entitled to receive fees from the LLCs based
13 on the offering terms were -- were subject or party
14 to that agreement?

15 THE WITNESS: Were party to.

16 MR. NEWMAN: The agreement itself,
17 since we don't have a copy of it, is it signed by
18 those three different entities?

19 THE WITNESS: Well, my recollection
20 was, and we have not been able to find the document,
21 what I explicitly remember is drafting, personally
22 drafting, writing, discussing it with Mr. McGinn.

23 I don't know if it's been signed by
24 those entities, because I can't find it. I don't
25 know if it got beyond the draft stage. I thought it

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1 had, but obviously I haven't been able to locate it
2 yet.

3 I did have the discussion. We had
4 lost our attorney at that time. So maybe I --
5 that's why I'm going back to her to see if it's in
6 her records.

7 We are without an attorney from
8 basically 2003 to 2007. So, whether it got to the
9 next stage or not, I can't remember.

10 MR. NEWMAN: Sitting here today, it's
11 possible this agreement was never finalized? Is
12 that what you're telling us?

13 THE WITNESS: It was finalized,
14 because the agreement was finalized by agreement by
15 the parties that control those three entities; so.

16 MR. NEWMAN: I mean in terms of
17 actually having a completed signed executed written
18 agreement?

19 THE WITNESS: That could be the case,
20 yes.

21 MR. NEWMAN: This may have been
22 something that wasn't actually completed in terms of
23 a written document?

24 THE WITNESS: In terms of a written
25 document, correct.

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1 MR. NEWMAN: Besides the -- to the
2 extent this -- there was a draft of this agreement?

3 THE WITNESS: Yes. That I remember
4 doing.

5 MR. NEWMAN: As far as what -- who
6 the -- you understand obviously as a businessman
7 entering into a lot of agreements, there are
8 multiple parties, one or more parties, involved in
9 the agreement.

10 What I want to find out is who were
11 the participants in this agreement as it was drafted
12 besides the three entities that you referred to?

13 Was there anyone else?

14 THE WITNESS: The only two parties
15 that I am aware of were myself and Mr. McGinn.

16 MR. NEWMAN: How come based on the way
17 you described this, how come the LLCs were not
18 participants to this agreement?

19 THE WITNESS: I guess because the
20 people that represent the LLCs were parties to the
21 agreement.

22 MS Advisors is really the party that
23 represents the LLCs. MS Advisors were pledging the
24 fees. They clearly were part of the agreements.

25 MR. NEWMAN: Shouldn't the LLCs been

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1 parties to the agreement?

2 MR. FRANCESKI: Objection.
3 You can answer.

4 THE WITNESS: They were through their
5 agent or through their managing member, MS Advisors.
6 There isn't anyone else. That is, in fact, who
7 manages the LLCs is MS Advisors. There is no one
8 else.

9 So, the fact is that they were a party
10 to the agreement.

11 MR. NEWMAN: Who is acting on behalf
12 of the LLCs, MS Advisors?

13 THE WITNESS: That's correct.

14 MR. NEWMAN: MS Advisors is you and
15 Mr. McGinn?

16 THE WITNESS: And Mr. Livingston.

17 MR. NEWMAN: Who is acting on behalf
18 of the three entities who are eligible to receive
19 fees pursuant to the LLC offering? That's you
20 again?

21 THE WITNESS: Same parties.

22 MR. NEWMAN: You're wearing multiple
23 hats in at least preparing an agreement where you're
24 essentially on both sides of the transaction, if I
25 understand the way you're describing this?

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1 THE WITNESS: I don't think I would
2 describe it as both sides of the transaction.

3 In affect what's happening is that
4 fees that are contractually obligated to those
5 entities that we just talked -- mentioned, are in
6 effect not receiving anything in return. All they
7 are doing is forfeiting fees.

8 It's not really a negotiation. It's
9 not like one party has an advantage over the other
10 party. There is no advantage to MS Advisor, McGinn
11 Smith & Company and McGinn Smith Capital Holdings.
12 There was no quid pro quo. We took the position to
13 sort of stay above potential criticism was that we
14 needed to in effect support through this credit
15 facility, through this credit guarantee, whatever
16 you want to refer to it as, moneys that were
17 contractually due to us.

18 So, I don't -- when you say we're
19 wearing two hats, maybe we have, but there is only
20 one hat. There is only one party that is really
21 benefitting, that is the LLCs.

22 MR. NEWMAN: Let me cover that point.
23 You're -- are you aware of the term fiduciary duty?

24 THE WITNESS: Yes.

25 MR. NEWMAN: What is your general

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1 understanding?

2 THE WITNESS: As a fiduciary you're to
3 represent the best interest of that entity that you
4 represent.

5 MR. NEWMAN: You, as an investment
6 advisor, were the fiduciary for the four LLC
7 offerings?

8 THE WITNESS: That's correct.

9 MR. NEWMAN: When you were making
10 investment decisions, lending decisions, you were
11 responsible under the laws as a fiduciary that makes
12 decisions in the best interest of the LLCs?

13 THE WITNESS: I think that's fair to
14 say, yes.

15 MR. NEWMAN: Are you familiar with any
16 general requirements concerning conflict of interest
17 in terms of your fiduciary duties as an investment
18 advisor?

19 MR. FRANCESKI: Objection.

20 You can answer.

21 THE WITNESS: In general, I'm -- but,
22 again, I don't see this as a conflict of interest.
23 I see this was a one-way street.

24 This is an agreement that basically
25 only benefits the LLCs. It has no conflict or

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benefit to MS Advisors, McGinn Smith Capital Holdings or McGinn Smith & Company.

In fact, if the credit facility doesn't work out or it gets impaired or goes into default, there is only one party that is harmed, and that is the harm that comes to those that are giving up the fees to support the underlying credit.

I just respectfully disagree it's a conflict. It's a one-way street.

MR. NEWMAN: Did you have any concerns, we've gone through several transactions over the last two or three days of testimony, did you have any concerns when you're entering into multiple transactions in which you individually or through different entities are receiving fees, finance benefits from investments and loans made by the LLCs, did you have any concerns that there was a conflict of interest in terms of those transactions given your role as an investment advisor for the LLC.

You, as investment advisor from what we can see, and there is multiple examples of this, we're going through some today and gone through some over the other days, you're making a decision to lend or invest in entities that you have some direct

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or indirect financial interest.

Would you agree with that statement?

MR. FRANCESKI: Let me object. I don't know who the "you" is in that. There are a lot of yous in there.

MR. NEWMAN: Investment advisor, MS. The investment advisor for the LLC.

You were the one personally on behalf of the advisor making the financial decisions, generally speaking?

THE WITNESS: MS Advisors is making it.

MR. NEWMAN: Are you --

THE WITNESS: Part of MS Advisors.

To answer the question, the whole reason for the pledge of the fees was to, in effect, address that issue.

If you're -- if there is an entity that you have in our case the 20 percent, which I would agree may have been considered arbitrary and both it was, but that was the threshold we thought was critical, because there is too many other things where there is nominal interest that you might draw the same conclusion, that we wouldn't agree with that, which is exactly why this, in fact, policy was

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put in place.

Did I have an awareness of it and concern, yeah. I think that's why we implemented the policy we did.

MR. NEWMAN: The policy being the security agreement?

THE WITNESS: This pledge of fees. Whatever we want to call it.

MR. NEWMAN: From your standpoint, I want to make sure we understand this correctly, this agreement was an important component from your standpoint in terms of dealing with any potential conflict of interest that may be perceived from the relationship between the investment advisor and the different entities that were being selected for investments or loans?

THE WITNESS: That is true. I think it went beyond that. It became part of the whole decision-making process, is that, you know, if, in fact, this facility is going to be provided, the first and foremost thing you always are concerned with is how are you going to be repaid or how are you going to get a return on your investment. This became a way of giving us more comfort.

Aside from the conflict of interest,

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it was also a part of the investment process or investment decision process.

MR. NEWMAN: This was an important document in terms of that issue, why is it you don't have a copy that agreement?

THE WITNESS: Well, I didn't say it was an important document. That's your opinion.

MR. NEWMAN: Was it not an important document? Was it not --

THE WITNESS: It's an important agreement and agreement is between the parties and the parties know what the agreement is.

Certainly it's better to have it -- a document, but I don't think it's necessary. The fact is -- the facts speak for themselves. The money was pledged. The money wasn't taken. The money was available to cover those. And the parties involved, which you've pointed out McGinn Smith Advisors, McGinn Smith & Company, and McGinn Smith Capital Holdings and their representative and the representative of the LLCs in effect knew exactly what the agreement was.

So, the fact it was or was not memorialized, I suppose it's better, but if it wasn't done, I don't agree with you it was a

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1 critical part of the transaction.

2 MR. NEWMAN: Why doesn't that
3 agreement that you're discussing or referring to,
4 why isn't it in your computer records, electronic
5 files?

6 Even if it's not been signed, why
7 can't you -- when we received documents from your
8 firm that go back to 2002, 2003, you talked about
9 this agreement being in 2004, 2005, why doesn't this
10 agreement exist even in draft form in your computer
11 records?

12 MR. FRANCESKI: Let me object. I
13 don't know that the staff has made any request that
14 would cover that issue. Does mean he can't answer
15 that question sitting here today. You may be making
16 an assumption that is not correct.

17 THE WITNESS: I may be making an
18 assumption.

19 The fact is is that we had an in-house
20 counsel from the mid '90s at least, maybe earlier up
21 through 2003 which basically prepared those
22 documents for us.

23 MR. FRANCESKI: Those types of
24 documents?

25 THE WITNESS: Those types of

Page 932

1 documents.

2 That counsel left in 2003. We did not
3 rehire a counsel until Mr. Carr joined us, which I
4 believe was 2007.

5 When the LLCs had outside needs for
6 counsel, we hired outside counsel. A lot of
7 internal things which would have been done by
8 counsel, I certainly wouldn't have done it because
9 I'm ashamed to admit I'm not terrible proficient on
10 drawing up a legal document or in effect even typing
11 one up. It's a skill set I never mastered. That
12 may, in fact, be the reason for it. I don't know.

13 The counsel that we had left and joint
14 IASG. I may or may not have asked her to do it.
15 Probably not likely, but it's a possibility.

16 But, we were not drawing up a lot of
17 legal documents during that period of time from 2003
18 to 2007 internally. There was no -- there was
19 nobody to have it on the computer. That's why --
20 when I drafted it up, I draft things up on a
21 handwritten basis.

22 Generally, when they are eventually to
23 be -- if it's just a letter or an e-mail, I give it
24 to a secretary or someone.

25 Legal document, I would have been

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1 looking for a legal person and there won't have been
2 one available.

3 MR. NEWMAN: You had outside counsel,
4 right?

5 THE WITNESS: Right. I had various
6 outside counsel, depending on different
7 transactions.

8 MR. NEWMAN: You testified earlier
9 that you relied on Kurstin Savage (phonetic) in
10 terms of your LLC offering memorandum?

11 THE WITNESS: They did our security
12 work, yes.

13 MR. NEWMAN: I think you testified you
14 had some other attorneys that assisted you in terms
15 of the LLC?

16 THE WITNESS: From time to time they
17 did legal work as it involved the closing of a loan,
18 yes.

19 MR. NEWMAN: I think -- your outside
20 counsel left in 2003; is that correct?

21 THE WITNESS: Our in-house counsel.

22 MR. NEWMAN: I believe your testimony
23 was this agreement was formulated in 2004, 2005?

24 THE WITNESS: Yes.

25 MR. NEWMAN: She had left by the time

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1 this agreement came into contemplation?

2 THE WITNESS: That's correct.

3 MR. NEWMAN: What transactions besides
4 this RTC were related to this contemplated security
5 agreement?

6 THE WITNESS: I think the first one
7 that actually got me thinking about it was an entity
8 it's called Seat of the Fourth. Seat of the Fourth
9 was an active entity through to the '90s and the
10 early part of 2000, 2001, 2002.

11 They were primarily engaged in the
12 security alarm business. In 2003, as we testified
13 earlier, I think everyone is well aware, the
14 business of the home security alarm business that
15 McGinn Smith developed for years basically was no
16 longer available to it.

17 We had taken a company public called
18 IASG. And so Seat of the Fourth, as we got into
19 2003, 2004 started to really wind down and became
20 more of a conduit of any things that might have been
21 residuals left.

22 There was a loan by one of the
23 entities, I don't remember which, a fairly good
24 size. And that would have been one that was clearly
25 a company that was owned by us, so that's one.

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1 M & S Partners borrowed money --
 2 MR. FRANCESKI: Let me stop you. I
 3 don't want to interrupt your answer. Mr. Newman
 4 asked for the name of the entities. If you give us
 5 history as well as the names, we'll be here forever.
 6 THE WITNESS: M & S Partners, McGinn
 7 Smith & Company through its preferred, a number of
 8 the -- in the later years transactions that involved
 9 TDM Cable or Transaction Funding, those were both
 10 entities.

11 RTC. I'm sure there is others that
 12 don't come to mind right at the moment.

13 MR. NEWMAN: You said that --

14 **Q. BY MR. ROWEN: What about SAI?**

15 A. No.

16 **Q. Was SAI a similar entity to RTC Trust?**

17 MR. FRANCESKI: Objection. What do
 18 you mean similar?

19 A. No. I answered why we took the
 20 position with RTC that we did as opposed to S & M.

21 **Q. The reason being because MSCH being
 22 the trustee on RTC?**

23 A. No.

24 **Q. Because of the interest your entities
 25 had in the success of RTC based on a trustee**

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1 **relationship and a placement agent relationship?**

2 MR. FRANCESKI: Can we just get on the
 3 record what we're talking about here? You two seem
 4 to be having a conversation, but I don't think there
 5 was any investment in SAI. There may have been an
 6 investment in SAI trust. If that's it, make it
 7 clear.

8 Am I right?

9 THE WITNESS: Yes. But I think
 10 Steve -- asked --

11 MR. FRANCESKI: You don't know what
 12 he's asking. Let him ask the question.

13 **Q. BY MR. ROWEN: SIA Trust being the
 14 entity we discussed and compared with RTC Trust.
 15 What potential conflict arose out of RTC
 16 Trust and its investment by any of the four funds
 17 that would be different from SIA Trust and any
 18 investment it received from the four funds?**

19 A. What I answered earlier, maybe not
 20 particularly clearly, was that the loans to the RTC
 21 Trust that were instituted by two of the LLCs, one
 22 was the First Advisory and the prior to that there
 23 was Third Albany possibly. I know there was two.

24 The position that we took on that was that,
 25 in effect, those loans were done after the original

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1 offering. They were done as a clear objective was
 2 buying the future stream or the future income stream
 3 at a time when it was deficient of meeting its
 4 obligations.

5 So, to me that raised questions in terms of
 6 both conflict and a credit decision. So, therefore,
 7 the decision regarding RTC and the clear difference
 8 in my mind is that that was an entirely different
 9 situation because of the -- both of the conflict and
 10 credit decision.

11 **Q. SIA Trust was not deficient at the
 12 time it borrowed money from any of the four LLCs?**

13 A. No.

14 **Q. What about Pacific Trust?**

15 A. I don't believe it was deficient. I
 16 don't know. I can't remember the history of that.
 17 I don't believe it was deficient.

18 **Q. That would not be covered by the
 19 security agreement?**

20 A. Pacific Trust was covered, because it
 21 was a -- it was -- at the stage that we made the
 22 loan, it was winding down and the ongoing stream was
 23 going to be directed to a McGinn Smith entity.

24 Therefore, again potential for -- we didn't
 25 make the loan at the time of the initial offering.

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1 Pacific Trust, I believe, was a situation where we
 2 were taking some investors out of the transaction,
 3 either it had reached maturity, I don't recall all
 4 the events, but I think that was the case.

5 Therefore, again, different circumstances
 6 you're using money to in effect retire the debt to
 7 be above the level of criticism, I would construe
 8 that as to be eligible for the pledge of the fees.

9 **Q. What about JGC?**

10 A. No.

11 **Q. That was not covered by the security
 12 agreement?**

13 A. We didn't have any interest in it, no.

14 **Q. What was your role with JGC Trust?**

15 A. Personal role?

16 **Q. Yes.**

17 A. Didn't have any personal role. It was
 18 a -- it was a local waste management contractor.
 19 And I believe there was a -- there was an original
 20 trust that -- I think -- yes. Let me back up and
 21 change my answer.

22 I believe the JGC Trust was an original
 23 trust used to finance -- away from the funds, away
 24 from the funds. And the loan to -- subsequent loan
 25 to JGC I think was in addition to the trust

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1 agreement that we raise some capital from outside
2 investors. That's the best of my recollection.

3 **Q. Who is the trustee for JGC Trust?**

4 A. Again, it might have been McGinn Smith
5 Capital Holdings.

6 **Q. What would JGC Trust need a loan from
7 any of the four LLCs for?**

8 A. I believe it was part of their working
9 capital and business plan.

10 My recollection, it wasn't a material loan
11 in addition to the trust. But, I would have to look
12 at the records. My recollection is a very small
13 loan.

14 **Q. What is the status of JGC Trust?**

15 A. That's not current. We've been trying
16 to collect on some of the collateral. My
17 recollection was that the loans were secured by the
18 assets of the company, which were primarily garage
19 trucks and other things.

20 And we had some -- we made some sales, got
21 some, but I think there is outstanding balance on
22 it.

23 Again, I don't think it's material. But
24 it's outstanding, and somewhere in the process of
25 trying to be collected.

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1 **Q. The broker-dealer raised funds for JGC
2 Trust?**

3 A. It was a small offering that I think
4 Mr. McGinn was involved in.

5 And my recollection was it was raised by
6 three or four investors. Not a broad, company-wide
7 offering.

8 **Q. Were those investors paid back their
9 principals?**

10 A. I believe so.

11 **Q. You're aware of whether JGC's loan
12 from the four LLCs was used to support the repayment
13 of principals those investors?**

14 A. I don't believe so, no.

15 **Q. Sounds like a lot of thought goes into
16 whether or not an entity should be covered by the
17 security agreement.**

18 **Who is involved with the decision of
19 whether or not a loan would be covered by the
20 security agreement?**

21 MR. FRANCESKI: Objection to the
22 commentary, but the question I'm okay with.

23 A. The parties would be MS Advisors.

24 **Q. Who within MS Advisors would make the
25 decision?**

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1 A. Mr. McGinn, Mr. Smith and primarily

2 Mr. Livingston in some peripheral cases. He was not
3 as much involved as myself and Mr. McGinn.

4 **Q. Did you and Mr. McGinn have a
5 unilateral of whether or not a loan should be
6 covered by the security agreement?**

7 A. I don't think it's unilateral. As I
8 indicated, there was clear criteria laid out. If
9 there was a decision to be made as to whether that
10 criteria was in effect covering it, someone had to
11 make that decision, then I guess it would be
12 Mr. McGinn and myself, primarily.

13 **Q. Mr. Cooper maintained a list. Who
14 would tell Mr. Cooper to put a new entity or loan on
15 the list?**

16 A. Mr. McGinn or myself.

17 **Q. Mr. Cooper came onboard with you when?**

18 A. I think Mr. Cooper has been with us
19 three years.

20 **Q. Who maintained the list prior to
21 Mr. Cooper?**

22 A. Well, again, we're talking about these
23 decisions being made at the MSA level which --
24 therefore, I would be basically responsible knowing
25 who was on that list and who wasn't.

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1 **Q. Did you maintain the list?**

2 A. I didn't maintain the list. I know
3 who -- exactly who would qualify and who wouldn't at
4 the time of the facility. I, in fact, would, as
5 I've indicated in my testimony earlier today, take
6 that into account as to whether that facility was
7 going to be made.

8 **Q. Is there any -- did Mr. Cooper create
9 the list? You mentioned there is a list now.**

10 A. What I've -- we keep referring to it
11 as a list. There is a schedule of fees and a
12 schedule of those loans credit facilities,
13 investments that, in effect, are used to be offset
14 with that. That Mr. Cooper has.

15 **Q. The schedule of loans or investments
16 is maintained by Mr. Cooper. Who maintained that
17 schedule prior to Mr. Cooper?**

18 A. I would have maintained it, I guess.
19 There was not a list. When I make the facility, I
20 know whether it's going to be part of that or not.

21 **Q. I'm trying to understand the
22 documentation and the schedule.**

23 **So, did anyone maintain a schedule as
24 documentation before Mr. Cooper?**

25 A. No, I don't believe so.

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1 MR. RATTINER: Who instructed
2 Mr. Cooper to make the list?

3 THE WITNESS: Myself I guess.

4 MR. RATTINER: Do you recall when that
5 was?

6 THE WITNESS: Again, I testified
7 earlier that by concern started in 2008, in
8 particular, as we were going to be looking going
9 forward with schedule of fees or not taking of fees,
10 and how that would be maintained.

11 So that, in fact, there was sufficient
12 fees in the aggregate to not only cover those
13 pledges, but to cover anything else that might be
14 involved.

15 MR. RATTINER: Did you have a meeting
16 with Mr. Cooper to alert him to the entities that
17 would qualify under the 20 percent?

18 THE WITNESS: Again, yeah. We have
19 gone over a number of items indicating, as he in
20 effect has processed this for me, particularly in
21 the last year, making sure that we were always
22 within those limits. And we were within those
23 limits to such a large degree that it didn't have a
24 major concern for me.

25 As I testified last week, the number

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1 of those pledges approached somewhere in the
2 \$3 million range, three to maybe three eight,
3 something like that.

4 And the level of fees that were owed
5 to us were of multiples of that, probably twice
6 that. It wasn't a concern -- it was a concern, but
7 it wasn't an overriding concern that I knew we were
8 approaching the level that we might exceed it. I
9 know I had a wide berth of room.

10 MR. RATTINER: How many fees have
11 been forfeited based on the agreement?

12 THE WITNESS: I believe that the
13 number is in the 3 to \$4 million range. I think
14 it's closer to the four. I think it's around three
15 seven, three eight, something like that.

16 MR. RATTINER: What happens with those
17 fees once they are forfeited, they were given to
18 who?

19 THE WITNESS: It's basically the
20 liability of the funds is -- if, in fact, we choose
21 to offset it, and, again, I know I've testified to
22 this before, I'll be happy to do it again, is that
23 through -- we've only completed our work on a tax
24 basis through 2007. We're working on 2008 as we
25 speak.

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1 2008 we're going to basically use that
2 for those companies that we think we should offset
3 it. Now either because of a credits impairment or
4 because of a personal fee management as it evolves
5 around all the issues McGinn Smith is faced with at
6 the moment.

7 MR. RATTINER: This 3.7 or 3.8 does
8 not include the rework?

9 THE WITNESS: It does. I believe
10 that -- best of my recollection, that's the all
11 encompassing number as we speak.

12 MR. RATTINER: This credit agreement
13 you discussed in terms of a draft, was the draft a
14 handwritten draft?

15 THE WITNESS: I remember drafting it
16 up, yes, in the form of notes which I normally then
17 processed to somebody else. We can't seem to find
18 it.

19 MR. RATTINER: Can you give us the
20 terms of that agreement?

21 THE WITNESS: Sure. It was actually a
22 change to the original proposal. Again, not -- we
23 had no written change. The original terms of the
24 agreement were that any entity that invested some
25 form of interest, 20 percent was the number that we

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1 arbitrarily selected, and that the entity that was
2 making the facility or the loan, would, in effect,
3 get a market rate on that investment or loan,
4 generally private placement market rate was between
5 10 and 12 percent.

6 If, in fact, the fees that were due us
7 were not in a net positive position, because we're
8 going back to 2004, 2005, and, in fact, we had fees
9 that were due to us over the next three to four
10 years, we knew there would be substantial accrual of
11 those fees, then in fact that facility would get the
12 full benefit of whatever the market rate was.

13 If, in fact, we were in a net positive
14 position, it was more owed to us than we had taken
15 out, originally we had fixed it at 1 percent. The
16 idea was simply they weren't getting anything if
17 they paid the fees, that was a nominal
18 consideration. There was other benefits to the
19 funds of not advancing the fees, so that was enough.

20 At some point, I don't know exactly
21 when this was, I think it was in maybe 2006 or 2007,
22 that number was changed to 3 percent, which is where
23 it stands now.

24 MR. NEWMAN: Why was it changed?

25 THE WITNESS: I think there was a --

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1 there was a thought of where -- that it would be
2 more -- first of all, more beneficial to the funds.
3 The 1 percent was fairly nominal rate. Although 1
4 is better than zero, and that 3 was closer to money
5 markets or other rates would be.

6 If we haven't taken the fee and it was
7 put into a money market account, then, in effect,
8 that was probably what you could argue it would be.
9 That's why the change was made.

10 MR. NEWMAN: Who made that decision?

11 THE WITNESS: I believe I made that
12 decision.

13 Actually, Mr. McGinn was involved in
14 that decision, too. I don't remember specifically.

15 MR. NEWMAN: Who was the primary
16 decision maker?

17 THE WITNESS: You know, it was -- my
18 recollection was -- is that there had been a --
19 there was a paydown on one of the related party
20 loans. And we were adjusting rates. At that time
21 we made the decision it should be 3 instead of 1.

22 MR. NEWMAN: To answer my question,
23 who was the primary decision maker?

24 THE WITNESS: Mr. McGinn and myself.

25 MR. NEWMAN: You would say it was an

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1 equal decision?

2 THE WITNESS: Yeah. We had the
3 discussion. Sure.

4 MR. NEWMAN: Who initiated the idea?

5 THE WITNESS: I actually think it was
6 Mr. McGinn at the time. I wouldn't say that with
7 certainty. It was a discussion.

8 MR. NEWMAN: Mr. McGinn was not
9 involved with the advisor between 2003 and November
10 of 2006?

11 THE WITNESS: He was involved with the
12 advisor in that he was a member of MS Advisors. He
13 was kept apprised at various times as to what was
14 going on. But, his involvement was minimal.

15 MR. NEWMAN: He had the ownership
16 position, but it was a passive situation there in
17 terms of decision making, that was being done by
18 you?

19 THE WITNESS: It was being done
20 primarily myself, yes. He was involved in the other
21 business.

22 MR. NEWMAN: I want to go back just to
23 this RTC Trust for a minute.

24 You said it was a grantor trust
25 established under New York law?

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1 THE WITNESS: I believe so.

2 MR. NEWMAN: Who actually creates the
3 trust document?

4 THE WITNESS: At the time we had
5 in-house counsel. Marianne McGinn was the party.
6 And since I believe that transaction was, as I
7 indicated earlier, at the time Marianne was with the
8 firm, it would have been herself.

9 MR. NEWMAN: In terms of the terms of
10 the trust, who gives her the terms of that? Is that
11 you?

12 THE WITNESS: That business was really
13 run by Mr. McGinn, and he would have been
14 responsible.

15 MR. NEWMAN: Understand McGinn Smith
16 Holding was the trustee for the RTC Trust?

17 THE WITNESS: McGinn Smith Capital
18 Holdings.

19 MR. NEWMAN: The trust is established
20 in -- the trust is the structure that holds the
21 alarm contract investments?

22 THE WITNESS: Correct.

23 MR. NEWMAN: Interest, investments?

24 THE WITNESS: Correct.

25 MR. NEWMAN: Then when the money is

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1 raised, there is an initial offering done -- it was
2 approximately 2002 there was about \$6 million raised
3 by RTC.

4 Does that refresh your recollection at
5 all?

6 THE WITNESS: I would have guessed
7 smaller than that.

8 MR. NEWMAN: Based on the information
9 we received from the firm -- we'll get the exact
10 number -- there is an offering raising a certain
11 amount of money from investors.

12 The investors in the RTC Trust
13 offering is getting what? What is their interest
14 they are receiving?

15 THE WITNESS: They are note holders in
16 the trust. There are notes pledged to them, a
17 certain return.

18 The structure of the transactions,
19 generally I don't know if I can recall specifically
20 for RTC, but generally constituted a senior tranche
21 or senior level and a junior level.

22 Senior level was generally financed by
23 institutions, typically banks. I think from time to
24 time we had a small insurance company play in that
25 space.

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1 The junior tranche was generally
2 clients of McGinn Smith who became the junior note
3 holders.

4 MR. NEWMAN: Did each one receive the
5 same interest rate or different rates?

6 THE WITNESS: The tranches received
7 different interest rates.

8 MR. NEWMAN: There are three tranches?

9 THE WITNESS: Two.

10 MR. NEWMAN: The promise to pay is
11 made by the trust?

12 THE WITNESS: I believe that's the
13 case.

14 MR. NEWMAN: That would be -- the
15 trust is owned by McGinn Smith Capital Holdings?

16 THE WITNESS: Well, McGinn Smith
17 Capital Holdings is the trustee. I don't really
18 know the legal nuances of that. I would refrain
19 from answering.

20 MR. NEWMAN: What do you understand --

21 THE WITNESS: The grantor trust, my
22 understanding of it, is simply that they are the one
23 responsible. They are the ones who hold the assets.
24 They are the ones responsible for paying the notes.
25 And that the ownership itself resides in the trust.

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1 And I think from a legal standpoint, I
2 think there is residual if you will, that once the
3 obligations of the trust are satisfied, there
4 remains a residual interest. I don't know if that
5 reverts to the trustee or someone else. I don't
6 know the legal aspects.

7 MR. NEWMAN: I'm trying to determine
8 who are the actual owners of the trust are?

9 THE WITNESS: I'm not trying to be
10 evasive. As I said, it's so often there was not
11 residual interest. It was never intentioned to be a
12 residual interest.

13 I don't know if there was specific
14 names affiliated with the trust in terms of
15 ownership. I don't know the legal aspects of a
16 grantor trust, whether the trustee itself assumed
17 that ownership. I'm not sure.

18 MR. NEWMAN: Who is making the promise
19 to pay?

20 THE WITNESS: The trust itself.

21 MR. NEWMAN: We don't know how that --

22 THE WITNESS: The trustee in effect
23 acts on behalf of the trust, but your question is
24 there an ownership in the trust, an equity
25 ownership, and I don't know -- my understanding is

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1 that there is none, unless if, in fact, there was in
2 any way there was a residual interest, I don't know
3 who that would go to, whether that would go to the
4 trustee or -- if there was some other -- when the
5 trust itself is formed, whether there is a
6 ownership. I don't know the answer to that.

7 MR. NEWMAN: Is McGinn Smith Capital
8 Holdings the one who is operating the trust?

9 THE WITNESS: That's correct.

10 MR. NEWMAN: Managing the trust?

11 THE WITNESS: That's correct.

12 MR. NEWMAN: Making the decision on
13 what contracts to buy and sell, paying the monthly
14 expenses, etc.?

15 THE WITNESS: That's correct.

16 MR. NEWMAN: Who is actually
17 issuing -- these are quarterly interest payments?

18 THE WITNESS: There was different
19 formats.

20 In the early years, for most of the
21 trusts, they were done on a monthly basis. At some
22 point there was a change to quarterly interest for
23 administrative purposes.

24 MR. NEWMAN: Who is issuing the actual
25 checks?

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1 THE WITNESS: It would have been our
2 back office group, which consisted of primarily
3 Patty Secluna (phonetic). As years evolved, Dave
4 Rees, Brian Cooper might have taken it over.

5 MR. NEWMAN: Who is directing the
6 payments? Who is saying this is the amount you have
7 to pay to this person?

8 THE WITNESS: Mr. McGinn generally
9 controlled that process.

10 MR. NEWMAN: When moneys are received
11 from the alarm contracts from the customers, where
12 do those funds go?

13 THE WITNESS: It was generally an
14 operating account. They came initially into a lock
15 box arrangement, which is set up at a bank. That
16 lock box would transfer the money to the operating
17 account of the trust.

18 That operating account would then
19 subsequently, upon the dates that the interest
20 payments were due, would issue the checks or wires
21 or whenever form the client desired.

22 MR. NEWMAN: In the operating account,
23 who had signatory over that?

24 THE WITNESS: Probably a multiple
25 number of people. Certainly Mr. McGinn. More

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1 likely than not myself. And generally somebody from
2 the operational side, whether it be -- might have
3 been Dave Rees. Might have been Brian
4 Shay (phonetic) -- not Brian Shay. Those would be
5 the principal parties.

6 MR. NEWMAN: What was McGinn Smith
7 Capital Holding's financial benefit as acting as
8 trustee?

9 THE WITNESS: None.

10 MR. NEWMAN: There is no financial
11 benefit for McGinn Smith Capital Holdings acting as
12 a trustee?

13 THE WITNESS: Only if the assumptions
14 I'm making that if there is a residual interest at
15 the end of it, if it goes to the trustee, I'm not
16 certain of that. It was never anticipated there
17 would be residual interest in these things, in terms
18 of fees or ongoing economic benefit, there was none.

19 MR. NEWMAN: Was there any employment
20 agreement or contract between the trust and/or you
21 and Mr. McGinn to pay the monthly or quarterly or
22 annual salary or financial benefit?

23 THE WITNESS: None.

24 MR. NEWMAN: The money that is raised
25 from the offering, whatever amount it was, the

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1 initial offering, that money is used to purchase the
2 contracts?

3 THE WITNESS: Just the contracts,
4 correct.

5 MR. NEWMAN: Once the contracts are
6 purchased, the trust is up and running and there is
7 operating income and expenses and -- there is a cash
8 flow for the trust that is going to dictate the
9 ability to pay the notes and principal?

10 THE WITNESS: Correct.

11 MR. NEWMAN: Generally speaking?

12 THE WITNESS: Correct.

13 MR. NEWMAN: What -- at the time of
14 these investments in 2006, these loans, what was the
15 financial status of RTC, the RTC Trust?

16 Had the trust up to that point been
17 making all the required interest payments?

18 THE WITNESS: The trust had a split
19 life, for lack of a better description.

20 My recollection was is that a majority
21 of the trust was purchased by IASG. And some
22 portion of the trust was not. And I don't know if
23 it was 15 percent or 17 percent or 13 percent, but
24 there was some portion.

25 And the reason for that -- again, I

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1 wasn't involved, but the best of my recollection was
2 within RTC Trust there was two or three different
3 monitoring companies. And one of the monitoring
4 companies chose not to, in effect, transfer the
5 assets to IASG. I don't know if it's because they
6 never been sold -- there were two ways to acquire
7 the assets. Buy them outright or lend money against
8 them.

9 But, in any rate, at some point in
10 time, roughly 85 percent of RTC investors were paid
11 back. And there was this residual amount, we'll
12 refer to it as 15 percent for lack of my total
13 memory, and then -- so, that portion, that
14 15 percent portion continued to be serviced by the
15 remaining contracts that they did not get sold or
16 transferred to IASG.

17 At some point in time, and it would
18 have been about the time of this loan, there was a
19 deficiency of dollars. At which point, as I've
20 indicated earlier, a decision was made to in effect
21 take possession of the ongoing stream going forward.

22 An analysis was done of the value and
23 the RMR at the time. That analysis concluded that
24 the price that we were paying, if you will, as it
25 related to the grid loan note and what the possible

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1 credit facility might be, was about 36 times, which
2 was a multiple considerably -- less than the norm.

3 Normally, the low side on valuation of
4 these things is about 40 times. Generally can run
5 as high as I -- there have been transactions at 100
6 times. Not a particular smart purchase, but,
7 nonetheless, there have been purchases at that
8 level.

9 So, from a valuation standpoint, it
10 was our opinion that the run out of these things
11 were likely to be beneficial for some period of
12 years. But in order to meet its ongoing obligation,
13 there had to be a credit facility.

14 So, we provided it. We knew the
15 business. And as I said before, as an additional
16 credit guarantee, we pledged the fees.

17 When -- in our judgment, the -- when
18 this winds down, those continued dollars will
19 continue to flow to us.

20 MR. NEWMAN: I want to be more
21 specific. What was the approximate dollar amount of
22 the -- what you called the deficiency at the time
23 the investments were made or loans were made by the
24 notes?

25 THE WITNESS: I think the first one

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1 was made, it was running maybe 5 or \$6,000 a month.

2 MR. NEWMAN: 5, \$6,000 a month behind?

3 THE WITNESS: Yes. It was
4 insufficient, correct.

5 MR. NEWMAN: That was for the interest
6 payments?

7 THE WITNESS: No. I think that was
8 a -- I think by that time there was amortization
9 going on. I'm not absolutely certain. But whatever
10 the obligation was at that time, was deficient to
11 that amount. And it obviously grew as attrition
12 went.

13 As we're looking at this loan here,
14 which is in 2006, you can see that the number had
15 grown to about 18,000.

16 MR. NEWMAN: Did RTC seek to borrow
17 the money from any lenders, third parties?

18 THE WITNESS: It did not. It would
19 not have been available. This type of lending is a
20 very specialized lending that is done by maybe a
21 half a dozen people in the country. And when McGinn
22 Smith was active in the markets, they were one of
23 the largest ones.

24 MR. NEWMAN: Why couldn't RTC have
25 received a loan from a third party?

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1 there is a deficiency in operating income. There is
2 moneys owed and note payments by RTC.

3 Who are those note payments owed to?
4 Who are the people who are owed this money,
5 receiving the payments?

6 I'm talking about the RTC now note
7 holders.

8 THE WITNESS: Some of the original
9 note holders, until such time as they were paid out,
10 now they have been fully paid out. The money that
11 continues to come in is being used to reduce the
12 loan made by the LLCs.

13 MR. NEWMAN: I'm asking you, at the
14 time the money is being lent, the initial investment
15 or loans is being made by the LLCs, are there moneys
16 that are owed to note holders?

17 THE WITNESS: Sure.

18 MR. NEWMAN: Once the loans are
19 starting to come in from the LLCs, are those moneys
20 being used to pay the note holders for the trust?

21 THE WITNESS: Yes. That's -- we are
22 providing a credit facility to RTC, which is then
23 used to meet its obligation. And we are buying a
24 future income stream going out long past, hopefully
25 into perpetuity, past the time that the note holders

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1 THE WITNESS: Because it wouldn't --
2 it wouldn't have enough to interest anybody. It was
3 too small a facility.

4 MR. NEWMAN: The notes lend this money
5 over a period of time to RTC, correct?

6 THE WITNESS: Yes.

7 MR. NEWMAN: And there is a promise to
8 pay?

9 THE WITNESS: There is a promise to
10 pay.

11 MR. NEWMAN: Who is making the promise
12 to pay the notes back for this money?

13 THE WITNESS: RTC.

14 MR. NEWMAN: There is also a promise
15 that is owed to the initial investors. Moneys that
16 are owed to the original note holders too?

17 THE WITNESS: The initial note holders
18 are now out. The recurring monthly revenue is being
19 applied to reduce the loan. But the original note
20 holders are out. They are paid, paid in full.

21 MR. NEWMAN: Paid in full by the
22 moneys invested by the notes?

23 THE WITNESS: No. Totally out of
24 the --

25 MR. NEWMAN: Had he time -- you said

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1 are paid out, which is exactly what happened.

2 MR. NEWMAN: At the time these
3 initials loans are starting to be made, there is an
4 operating deficit based on the cash flow of the
5 contract?

6 THE WITNESS: That's correct.

7 MR. NEWMAN: Why is this a good
8 investment for the LLC investors given the financial
9 condition of these -- of this RTC at the time these
10 moneys -- substantial amounts of money is being
11 lent, why do you believe, as the investment advisors
12 for the LLCs, this is a good investment?

13 THE WITNESS: Because the income
14 stream is going to go long beyond when the investors
15 are paid out.

16 What you do is take the investment
17 stream going out, take it back to a present value,
18 you do a multiple of what we call RMR, and, in
19 effect, based on those numbers, you determine
20 whether it is a good loan.

21 At 36 times, that was a good loan.

22 And, in fact, what has happened we are
23 now in effect getting those dollars that will --
24 they may go on forever.

25 In the meantime, from a credit

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standpoint, and I'm beating this to death, but because of the concerns that you have raised, we determined that in effect we wanted to pledge our fees to support that.

So, in the crudest sense, there was -- in our judgment, there was no risk to the funds. Their investment is totally covered by fees, and they are, in effect, getting an ongoing investment stream, which if they did nothing, if they paid the fees out, they obviously got zero, or if the money was sitting in cash, they are basically getting zero.

From the perspective of evaluation 36 times, it more than stands up in the marketplace. From a present value standpoint, the return was above market. And from a risk standpoint, it was zero.

Those are the three criteria I would use.

MR. NEWMAN: How did the investment turn out?

THE WITNESS: For the investors, fine.

MR. NEWMAN: RTC?

THE WITNESS: Yes.

MR. NEWMAN: All the moneys were

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repaid?

THE WITNESS: Yes.

MR. FRANCESKI: You mean the LLC note holders?

MR. NEWMAN: Yes.

Were they repaid --

MR. RATTINER: We have the RTC investors and also the LLC investors.

The RTCs were paid back with the moneys invested from the LLCs?

THE WITNESS: Well, no. What they were paid by partial whatever that deficiency was, whether it was \$5,000 a month or \$18,000 a month, that money that went into RTC would be used as working capital was, in fact, used to meet the deficiency I referred to not -- not entirely, but the deficiency.

Those people, I believe, Mike's question was did the RTC investors get paid, and I answered yes.

MR. RATTINER: Have the LLC investors been paid back from RTC?

THE WITNESS: The note is in the process of being paid down every month. There is an application of fees.

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MR. RATTINER: Based on the RMR?

THE WITNESS: Yes.

MR. RATTINER: Did you conduct the analysis for the RMR?

THE WITNESS: It was done I believe by Mr. Keenholtz (phonetic) or Mr. McGinn.

MR. RATTINER: How long did that analysis show it would take to pay back the LLC?

THE WITNESS: At the time it was a seven- or eight-year backpack.

MR. RATTINER: Would the LLCs have already matured?

The four LLCs have a majority date of five years?

THE WITNESS: Yes. But, again, the LLCs were designed as an operating ongoing company. The debt that they had, yes, matured, but the -- don't confuse the fact that the debt meant that that was the end of the LLCs. The LLCs were designed to be a perpetuating operating company. And they were like any other operating company, they would get ongoing financing, and that they would continue to make loans, and have loans or investments that were in their portfolio that would go on beyond the majority date.

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There was no -- there was not an attempt to, in effect, time every investment and every loan to December 31, 2008. You couldn't possibly do that. That was never the design of the operating company.

MR. RATTINER: Have you ever doubted whether or not the LLCs would be paid back based on the RMR analysis?

MR. FRANCESKI: On this particular transaction?

MR. RATTINER: Right.

THE WITNESS: No. Because they had the fees pledged to cover.

MR. RATTINER: What is the current pay back rate?

THE WITNESS: I think \$10,000 a month right now.

MR. RATTINER: Is that in line with what you initially thought?

THE WITNESS: No. That's come down as the attrition in the industry has risen, that's come down from I think -- best of my recollection, the RMR at the time was over 20,000 a month.

MR. RATTINER: Now you have a 16-year pay back period?

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1 THE WITNESS: Not at all. More likely
2 than not offset it and pay the loan back.

3 MR. RATTINER: Based on collateral?

4 THE WITNESS: Right.

5 MR. NEWMAN: Based on the fees coming
6 in, you're talking about the fees owed to
7 different -- let me finish the question.

8 The fees owed to the McGinn Smith
9 affiliates?

10 THE WITNESS: I'm sorry. I
11 anticipated again.

12 MR. NEWMAN: Looking at the loans, the
13 stream of money being lent by the LLCs to RTC in
14 2007, looks like \$20,000, \$30,000 was being lent on
15 a monthly basis from January 2007 through
16 approximately October 2007.

17 MR. FRANCESKI: It's probably a yes on
18 that, but the numbers are that high back at the
19 beginning.

20 THE WITNESS: It looks like, Mike, the
21 first advance was back in April of 2006.

22 MR. NEWMAN: Right. Looking ahead,
23 looking at the stream of money going from -- flowing
24 from the LLCs to RTC, there is approximately 20 or
25 \$30,000 going on a monthly basis.

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1 What was the operating performance of
2 the trust in 2007 as this money is being lent?

3 THE WITNESS: I believe the best of my
4 recollection there would be that the RMR at that
5 time was in excess of \$20,000. That's my best
6 recollection.

7 MR. NEWMAN: The performance operating
8 standpoint was continuing -- continuing to operate
9 in a deficit?

10 THE WITNESS: It was operating in a
11 deficit at that time.

12 MR. NEWMAN: It wasn't improving?

13 THE WITNESS: It would not likely
14 improve based on the nature of the business.

15 MR. NEWMAN: Why do you believe as the
16 investment advisor -- you are the fiduciary for the
17 LLCs. Why do you believe it was in the best
18 interest in the LLCs to continually lend money to a
19 failing exercise?

20 THE WITNESS: Specifically to this,
21 you look at what your anticipated cash flow is --
22 remember, there is life when the investors no longer
23 have to get any money because they are paid out.

24 MR. FRANCESKI: Can I help here, Mike?

25 MR. NEWMAN: No. He's answering the

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1 question.

2 MR. FRANCESKI: There are numbers on
3 here that will explain it very clearly.

4 MR. NEWMAN: The witness is
5 testifying.

6 MR. FRANCESKI: Trying to help.

7 THE WITNESS: At any rate, there is an
8 ongoing stream that, based on the underlying
9 contracts, could last for 40 years. Nobody knows
10 for certain.

11 Most people, once they get past a
12 certain period of time with the alarms, they keep
13 them forever.

14 What you're looking at is that you're
15 trying to identify the fact that there is a deficit
16 now. You're not thinking that at some point that
17 deficit is going to go away, because there is no
18 longer a need to pay the original investors of RTC.

19 So, therefore, there is going to be --
20 let's assume there is no attrition. Assume that my
21 recollection, which may be faulty, was \$20,000 a
22 month. Well, that's \$240,000 a year.

23 If there was no attrition, it would
24 take roughly two years to pay that loan back.

25 And then, subsequent to that, you

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1 would have that \$20,000 every single month. That
2 would make a pretty good investment.

3 When you do that analysis, you
4 basically have to make some assumptions, like
5 everything else, one of the assumption is attrition.
6 You look at what the history has been. My
7 recollection is we used 12 percent attrition rate,
8 but I'm not certain. But you assume that cash flow
9 is going to diminish. And then you have some idea
10 of when that would be paid out.

11 And, again, from an operating
12 business, that LLC would have had the advantage of
13 that cash flow for as long as the company was in
14 business.

15 If at the time you're making the
16 decision that you're not -- you're not doing it on
17 an evaluation that is excessive, as I said, my
18 recollection it was about 35 or 36 times RMR, which
19 is very appropriate and actually quite cheap.

20 And, B, from an attrition standpoint,
21 you're making an assumption that will hold up.
22 There are contracts in place. If you look at these
23 things the attrition actually -- there wasn't a lot
24 of attrition. You go -- you look at 2006 and go to
25 basically the next year, the deficit was about the

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1 same.

2 It wasn't until we got into the later
3 stages, and maybe we've now seen the attrition in
4 that industry work it's way up, I think there is a
5 lot of reasons to explain it. Certainly the
6 economic we're in as it relates to housing is a part
7 of it.

8 But, at the time of the loan, it was a
9 good loan. It was a good loan.

10 If the assumptions had stayed, it was
11 a good loan. In addition to that, we were supported
12 by the fact we are prepared if it wasn't a good
13 loan, we were prepared to put our own butts on the
14 line.

15 And the mere fact we're willing to do
16 that suggests to me we must have thought it was
17 going to be a good loan, because in the end, our
18 fees are used to pledge and guarantee those amounts,
19 who is that hurting. It's us. It's our money
20 contractually.

21 So, we didn't make that decision on
22 the basis that we enjoy losing whatever it might be.
23 Whether it was 250 or \$400,000, that isn't anything
24 anyone takes on lightly. So, obviously, at the time
25 we did it we thought the valuation was good. And

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1 the likelihood is that we wouldn't -- we, I speak of
2 we, McGinn Smith Advisors, etc., wouldn't, in
3 effect, lose any money.

4 To me it's testimony that we felt very
5 comfortable with the loan.

6 MR. NEWMAN: You still feel that way
7 today? You still think it was a good loan?

8 THE WITNESS: Under the circumstances
9 at the time, absolutely.

10 MR. NEWMAN: You would do it again if
11 you had to?

12 THE WITNESS: If the circumstances
13 were the same, yes.

14 MR. PAULSEN: The long-term analysis
15 sounds promising, but who benefits from that?

16 THE WITNESS: The funds. The LLCs,
17 because they would own the income stream forever.

18 MR. PAULSEN: How about the investors?

19 THE WITNESS: The investors of the
20 LLCs?

21 MR. PAULSEN: Yes.

22 THE WITNESS: The investors of the
23 LLCs would have an income stream supporting their
24 notes. And, in fact, and again --

25 MR. PAULSEN: Let me be more specific.

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1 At the conclusion of the life of that
2 investment, those LLC programs are lasting six
3 years?

4 MR. FRANCESKI: Objection. Asked and
5 answered.

6 THE WITNESS: The answer is no. The
7 notes had a five or six year. Conceptually, I've
8 said it a couple times, we saw these as operating
9 companies with a perpetual life. And a number of
10 the investors, and it's been the experience of
11 McGinn Smith & Company, if we hadn't run into this
12 difficulty and this default, whatever you want to
13 label it, it is my judgment and experience that a
14 number of those, probably a large number of those
15 investors would have, in fact, taken and rolled into
16 some new form of participation, whether it be a new
17 note, a form of equity, whatever made sense at the
18 time.

19 We have had investors that basically
20 were perpetual investors in these types of
21 investments. Obviously what has been a game changer
22 for all of us, the investors first and foremost,
23 because they are the ones that have been punished
24 the most, because we have not lived up to our
25 obligations, they are obviously front and center

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1 that have been hurt, but the -- but obviously we,
2 meaning the entities, McGinn Smith Advisors, and
3 McGinn Smith Company probably more specifically, and
4 certainly the principals, have been hurt and the
5 ability to, in effect, carry out the original
6 mission or the original goal is going to be
7 challenging, because of the impairment and because
8 of, obviously, the position that McGinn Smith finds
9 itself in.

10 But we didn't know that a year ago,
11 let alone three years ago or four years ago.

12 This to us was going to be a end of
13 the business that had a very niche market, had a
14 very important role to play.

15 I mean, specially finance companies
16 are business that compete; that don't have a
17 tremendous amount of competition, but are competing
18 with the money center banks. There is a clear
19 market out there for their business. And that's, in
20 our judgment, what we were trying to build.

21 MR. NEWMAN: When you're making the
22 initial promises to the investors in the LLCs, there
23 is a promise made there is going to be -- they
24 can -- when the notes mature, they are going to have
25 back a certain amount of money?

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1 THE WITNESS: That's correct.
 2 MR. NEWMAN: When you're making
 3 investment decisions on behalf of the LLCs as the
 4 advisor, it's your obligation, correct me if you
 5 disagree, to make investment decisions that are
 6 going to provide returns for those investors within
 7 a specified time period that you promised when you
 8 sold the investments?

9 THE WITNESS: To a degree.

10 MR. FRANCESKI: Objection.

11 MR. NEWMAN: Do you agree?

12 THE WITNESS: Not entirely.

13 MR. NEWMAN: Why?

14 THE WITNESS: It's an operating
 15 company. An operating company has the ability as
 16 long as they are operating reasonably soundly and
 17 well to get future financing.

18 So, to your question of the initial
 19 investors that had a promise -- I think was the term
 20 you used -- to get their contractually obligated
 21 rate of return, plus their money back, the answer is
 22 yes.

23 From an operating standpoint, no
 24 operating company could have -- basically say we'll
 25 make a variety of loans and investments that all

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1 will mature on December 31, 2008 or January 15,
 2 2009.

3 We're on operating company. We know
 4 that there will be either new forms of capital
 5 raising. There will be repeat investors, because
 6 that's been our experience for 29 years. That if
 7 those people were in effect -- if the operating
 8 company lived up to its obligation, we all know
 9 we're here because that wasn't the case, had they,
 10 probably 80 percent of those people would have been
 11 more than willing to, in effect, take out another
 12 investment.

13 And it may have gone the same form or,
 14 quite frankly, with the experience it may -- we may
 15 have done a different form.

16 But, I think what you're suggesting is
 17 that we, as an operator of a business, had an
 18 obligation to have every one of those loans or
 19 credit facilities or investments mature on the date
 20 that the thing is going, I would disagree with you
 21 strongly. That was never the intent. It was never
 22 sold that way. It was never indicated that that's
 23 the way it would come down. And I don't know of any
 24 operating company that would do that.

25 Even Fortune 500 companies know they

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1 are going to have recapitalization and --

2 MR. NEWMAN: What is the significance
 3 of the maturity date?

4 There is a maturity date promised for
 5 each of the tranches of the notes. What is the
 6 significance of that date in terms of your decisions
 7 as the investment advisor for these LLCs?

8 THE WITNESS: The significance is that
 9 every individual note holder who had that note and
 10 maturity date had the absolute right to expect their
 11 money back.

12 MR. NEWMAN: How does that equate to
 13 the decision you're making on behalf of the
 14 investment advisor?

15 THE WITNESS: If I'm making investment
 16 decisions that are not impaired and that are
 17 working, some money is going to be available at the
 18 time of maturity. We're going to have some
 19 liquidity available, but we also know we're going to
 20 refinance or recapitalize.

21 Virtually all the companies within
 22 some of the decisions we made were also in that
 23 position, as most companies are.

24 What happened in a great number of
 25 cases is that ability to, in effect, refinance or

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1 recapitalize doesn't happen. Call it because of the
 2 misfortune of the company or the marketplace,
 3 liquidity crisis, we all know it did happen.
 4 Therefore, those companies went into default, which
 5 then triggered the difficulties we now have.

6 At the time, at the time we're making
 7 those investment decisions, we know that there is
 8 going to be the ability to, in effect, refinance,
 9 recapitalize and -- whether it's the underlying
 10 investments, whether it's the entity in it's
 11 entirety.

12 MR. NEWMAN: What if an investor
 13 wanted to satisfy or -- what if they decide they
 14 want to follow what's been promised them or accept
 15 what has been promised on the offering date, on a
 16 specify maturity date they are going to be entitled
 17 to get a certain amount of money?

18 MR. FRANCESKI: I object to that
 19 question. That's not all the private placement
 20 said.

21 MR. NEWMAN: In terms of the
 22 expectation of the investor, the investor, correct
 23 me if you disagree with this, when an investor
 24 invests in the LLCs, they are doing that in part
 25 because they have an expectation to get a certain

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1 amount of money back in a certain time period as
2 promised in the offering document?

3 THE WITNESS: Absolutely.

4 MR. FRANCESKI: Note my objection.
5 It's not what the offering document says.

6 MR. NEWMAN: I'm trying to learn from
7 you or understand from your testimony, as a person
8 making the investment decisions to try to generate a
9 certain amount of return to pay the required
10 interest payments, and then the amount of principal
11 that's going to be owed to the specify period, how
12 reviewing those -- that responsibility as the
13 investment advisor in terms of evaluating what
14 investment decisions you're making at the time
15 you're making them?

16 THE WITNESS: Evaluating in two ways:
17 One, the business of the LLCs, as clearly stated in
18 the prospectus, they make their money through a
19 spread. Spread being what they expect to earn on
20 the chosen investments, chosen loans, and what we
21 have to pay. We talked about what that bogey was,
22 etc.

23 In addition that, what I guess I'm
24 trying to get across is that as an operating company
25 and the assumption that that operating company is

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1 operating without impairment, it is an ongoing
2 business, their ability to refinance and
3 recapitalize is a very real one, because it's our
4 experience in 29 years.

5 To use a hypothetical, and I know we
6 can always challenge hypotheticals, let's say for
7 the moment at the time of maturity, to your point,
8 50 percent of the people decide that they want their
9 money and they don't want to basically participate
10 in the particular LLC anymore, the ability to pay
11 that 50 percent has to come from really one of two
12 sources, from excess earnings that would now be in
13 the earnings in the company through the spread
14 business that we built up some excess. That didn't
15 happen, but that is the business plan.

16 Number 2, the ability to, in effect,
17 refinance those 50 percent, whether it presumably is
18 with another investor or whether the assets now
19 appreciated to the point the LLC could, in effect,
20 get away from investor moneys, maybe find more
21 traditional financing, companies such as ourself,
22 banks, whatever, but there was an expectation that
23 that would happen. To what degree, I don't know. I
24 used a hypothetical of 50 percent.

25 The one thing I knew for sure, we

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1 wouldn't have to finance out 100 percent, because
2 that's never been -- it's never been our experience.
3 Quite frankly, most operating companies don't
4 operate on that basis.

5 Fortune 500 companies whenever their
6 debt matures, they don't necessarily pay everything
7 off. They refinance it.

8 That's the nature of the financing
9 world. They don't say it's December 31, we have
10 \$100 million, what do they do? Go to bankers and
11 refinance it. That's the way the world works.

12 MR. PAULSEN: I don't understand why
13 there needs to be a refinance or a recapitalization.

14 Are you saying as a fiduciary you're
15 acting responsibly and taking investors' proceeds,
16 entering into transactions that mature or have a
17 revenue stream, as you say, into perpetuity long
18 after the maturity of the notes.

19 How is that acting responsibly on
20 behalf of the investors?

21 THE WITNESS: Because I'm running a
22 company. These investors are investing in a
23 company, in a debt instrument of the company. They
24 are dependent if they are going to get their money
25 back by they assume they are -- that the company is

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1 going to run itself in a way that they can get their
2 money back.

3 That's what my job is, is to run the
4 company. Not -- everybody I believe looks -- is
5 looking at these things as a -- as a contractual
6 investment. They have made an investment in the
7 company. And --

8 MR. PAULSEN: For a specific time
9 period?

10 THE WITNESS: That's correct. If I
11 buy a bond -- if I buy a bond in IBM, or let's --
12 use General Motors. I bought a bond in General
13 Motors, what was my expectation? That at the
14 maturity I would get paid back.

15 Fast forward to when in the last
16 couple years when the bonds came due, General Motors
17 would do what? Would they reach into their cash and
18 pay all those bonds off? Absolutely not.

19 They would, in effect, refinance it.

20 As we know, General Motors got to a
21 point they weren't able to refinance it, and then
22 went bankrupt.

23 When people bought those bonds in
24 General Motors, they were buying those bonds on the
25 basis that General Motors had been around, was going

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1 to be around, was going to make money, and would be
2 able to live up to their obligation through whatever
3 manner, whether it be through earnings that they had
4 accrued and built on the balance sheet or whether
5 they are able to refinance it.

6 All they knew, they were investing in
7 a company. And I think where everybody is kind of
8 maybe it's not clear and put the blame on myself is
9 that's what this thing is all about. It was buying
10 or making an investment in a company that, yes, they
11 were going to get a return, and if they wanted to,
12 they would be able to cash out at the maturity date,
13 but they were buying the story of what the operating
14 company was going to do. That it was a specialty
15 finance company.

16 And I think everybody is focused on,
17 well, there was a specific investment within that
18 operating company that was somehow totally
19 responsible for maturing and not being impaired and
20 being totally current and that their money came back
21 on the same date simultaneously.

22 That was never the case. It was not
23 explained that way, and the prospectus makes it very
24 clear.

25 I guess I just don't know any other

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1 way to explain it.

2 MR. PAULSEN: Are you saying that the
3 revenue stream, as you described before in
4 anticipation of it continuing in perpetuity, are you
5 saying to me the investors post expiration of
6 maturity of those notes would share in that revenue?

7 THE WITNESS: If, in fact -- no. Only
8 if they reinvested.

9 MR. PAULSEN: That's the point I'm
10 trying to make.

11 THE WITNESS: It's a bad point.

12 MR. PAULSEN: You are entering into
13 transactions that become profitable or generate a
14 revenue stream after these mature.

15 THE WITNESS: If I buy a bond in
16 Pfizer and Pfizer comes out with a cancer-curing
17 drug, do I participate as a bond holder in the
18 revenue that Pfizer produces over the next 20 years?

19 Have I benefitted from the standpoint
20 that the company itself produced revenues, produced
21 a position -- a financial position they were able to
22 ultimately honor my obligation. There are different
23 investors.

24 The fact is an operating company must
25 operate profitably and be able to be an ongoing

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1 enterprise to meet its debt obligations. But in
2 terms of participating going forward, once that
3 obligation comes due, no, they are not equity
4 players.

5 If they are stock holders, I guess you
6 would make that argument. But they still have to
7 have a business that ultimately is a business good
8 enough to meet its obligations.

9 What we know that did not happen here,
10 we can point to reasons why it did not happen, I
11 don't think that's the point of this inquiry, but
12 that was the goal. That was the mission. And
13 that's what we saw going forward. And we saw our
14 investors -- again, I don't know how many would
15 have, but I can tell you one thing, that, to your
16 point, if 100 percent of the investors on
17 December 31 said I want my money back, the company
18 would not have been able to do that, unless they
19 could refinance.

20 MR. PAULSEN: Making the decisions you
21 were making, they could not have gotten their money
22 back?

23 MR. FRANCESKI: Objection. No
24 operating can do that.

25 THE WITNESS: We have the ability to

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1 refinance and make spread. That was the business.

2 MR. FRANCESKI: No company can pay all
3 the bond holders and not all the bond holders demand
4 to be paid at the same time. Either can a bank.

5 MR. NEWMAN: Let's take a break.

6 MR. ROWEN: Off the record.

7 (A short recess was taken.)

8 MR. ROWEN: Back on the record.

9 MR. RATTINER: You said before that
10 the some of these moneys were guarantied by the
11 pledges, such as the RTC note; is that correct?

12 THE WITNESS: I think, again, I don't
13 want to nuance words, guarantee I'm not sure. We
14 pledged the fees to pay for --

15 MR. RATTINER: Who is entitled to
16 those fees? How does that work out? Give me a
17 hierarchy.

18 THE WITNESS: The fees are -- there
19 are three sources of fees. There is the
20 broker-dealer McGinn Smith & Company, which only had
21 one source. That was from underwriting.

22 There is the McGinn Smith Advisors,
23 which the managing member. And their fee is also
24 set at the 1 percent level.

25 And then there is McGinn Smith Capital

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1 Holdings, which acted as the trustee and the
2 administrator and is entitled to a quarter of a
3 percent.

4 MR. RATTINER: The pledge would go to
5 who in this case?

6 If you decided to go the route of not
7 taking fees and taking money owed to --

8 THE WITNESS: Whatever liability that
9 the specific fund had, of course there would be
10 potential aggregate, would be that liability would
11 be either diminished or eliminated, and the asset
12 would be paid.

13 MR. RATTINER: In this case, according
14 to Exhibit 23 is it, if you look at the last page,
15 97 on that document -- not the last page, the page
16 that ends at 97, that amount on 3/17/09 is \$363,700.

17 THE WITNESS: That's correct.

18 MR. RATTINER: Is that the amount
19 still owed?

20 THE WITNESS: Less.

21 MR. RATTINER: Do you know how much
22 less?

23 THE WITNESS: I think it's under 300,
24 but I'm not sure.

25 MR. RATTINER: Approximate amount owed
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1 of 300 of so, how would that be applied?

2 THE WITNESS: Well, if we chose to, in
3 effect, payoff that loan, you could go through the
4 mechanics of the fund paying the dollars to McGinn
5 Smith Advisors, and McGinn Smith Advisors could send
6 the cash back. That's an exercise that doesn't seem
7 worth doing.

8 So, this asset, if you will, will be
9 removed from the portfolio of, in this case, I think
10 we're First Advisory, whatever. It's not First
11 Advisory -- whatever.

12 So, that would be eliminated as an
13 asset. And the liability from where -- whatever
14 that liability was, whether it was McGinn Smith
15 Advisors, McGinn Smith Capital, whatever one choose
16 to allocate would be eliminated.

17 From the standpoint of the LLC, their
18 assets and liabilities would be offset.

19 MR. RATTINER: In this case the
20 300,000 approximately would go to First Advisory?

21 THE WITNESS: That's correct.

22 MR. RATTINER: It would go from the
23 fees due to the three entities would discussed?

24 THE WITNESS: That's correct.

25 MR. RATTINER: Those fees, that
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1 300,000 would then go through the indenture in terms
2 of a payout?

3 THE WITNESS: No. They wouldn't be
4 paid. There would no longer be a liability of the
5 LLC. It would be removed, because they've, in
6 effect, as I said, instead of going through it -- it
7 seemed to be an exercise of -- an unnecessary
8 exercise to actually take the cash, my advisory, and
9 have them send it back to the funds. You would just
10 offset it.

11 MR. RATTINER: Who would ultimately
12 receive the funds -- First Advisory receives the
13 funds and pays back the investors with that money?

14 THE WITNESS: Sure. In effect, the
15 LLC has certain liabilities. Some of them are to
16 McGinn Smith & Company. Some to Advisors. Some to
17 Capital Holdings and the rest to their bond holders.

18 We know that the liabilities to the
19 three previous is first. And so that liability
20 would be removed. They would no longer have that
21 liability. They wouldn't owe the money, because, in
22 effect, they have exercised their, to use your term,
23 guarantee. We all know what we're talking about.

24 MR. RATTINER: Those three entities
25 would forego that? They would be not entitled to
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1 the \$300,000?

2 THE WITNESS: Absolutely. They would
3 be gone.

4 **Q. BY MR. ROWEN: Back in April 2009, we**
5 **discussed private placements you were involved in**
6 **entities called Coventry Care Link and CMS Financial**
7 **Services, one bond offering from 2003, one bridge**
8 **loan offering in 2007, and one equity offering in**
9 **2007.**

10 **Could you please update us on the status of**
11 **those offerings?**

12 A. You're referring to the OTR in
13 April 2009?

14 **Q. Yes.**

15 A. The offering in 2003, the bond
16 offering was converted to a preferred stock. At the
17 time of the acquisition, in 2007, when USA Assurance
18 Company was purchased, the loans that you are
19 referring to were all converted to stock.

20 I believe in the 2003 offering, you said a
21 bridge loan, bridge loan -- that was not converted.
22 Investors had a choice. Some converted. Some did
23 not. There are still some outstanding on that.

24 What was the third?

25 **Q. Equity offering in 2007.**
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1 A. That's -- that's CMS. That's still
2 out there. We're not still offering it. It's still
3 in place. The company is operating.

4 **Q. So, from the bridge loan offering in**
5 **2007, how much is still outstanding?**

6 A. I think there was -- I think the
7 bridge loan was originally 3 million. Best of my
8 recollection, about 2 million converted. I would --
9 using math, I would suggest a million dollars is
10 still outstanding.

11 **Q. What is the current status of CMS**
12 **Financial Services?**

13 A. It's improved dramatically. Through
14 it's ownership of the underlying securities or
15 insurance company that they purchased, it's done
16 very well.

17 The company increased its assets from 56
18 million to 112 million. The underlying insurance
19 company still making a proximately \$3 million a year
20 net. Sales were up about 8 percent.

21 The valuation of the preferred on a pure
22 book value basis is probably worth about 60 percent
23 of face. And I hope -- market value I would say is
24 worth 75 percent face.

25 We've actually had -- in a very difficult

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1 producing the revenues.

2 The other company that they own is known as
3 Covenant Care Link, which was the original company.
4 Covenant Care Link is no longer a registered
5 insurance company. They didn't feel they needed
6 that when they acquired USA. But they have a
7 particular insurance product in the long-term care
8 business. And that they are expanding through not
9 only USA, but through other insurance company
10 outlets. That portion of the company is still
11 unprofitable.

12 **Q. Through one or more of these**
13 **offerings, preferred stock was purchased in USA,**
14 **correct?**

15 MR. FRANCESKI: Purchased by whom?

16 MR. ROWEN: Specifically I'm -- I
17 believe the equity offering in 2007 also included a
18 preferred stock?

19 THE WITNESS: Yes.

20 A. When the offering of CMS, when they
21 acquired USA, they got common stock in CMS and
22 preferred stock in the USA.

23 **Q. What is the status of the preferred**
24 **stock in USA?**

25 A. It's good. I would say it's worth 100

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1 environment, they did extremely well.

2 MR. NEWMAN: The three million, you
3 said two million converted?

4 THE WITNESS: Best of my recollection,
5 at the time of the equity offering, bridge loan note
6 holders had an opportunity to convert. And I think
7 there was about three million outstanding. And I
8 think, best of my knowledge, about two million
9 converted and a million remained outstanding.

10 MR. NEWMAN: That one million has not
11 been repaid?

12 THE WITNESS: No. But they made some
13 interest payments. Last two months they finally got
14 around to making interest payments.

15 There is some cash flow improvement.
16 The company is much better than it was a year or two
17 ago.

18 **Q. BY MR. ROWEN: What makes up the**
19 **revenues of CMS Financial Services specifically?**

20 A. CMS really owns two entities. They
21 own 100 percent of each. They own the insurance
22 company that they acquired in the fall of 2007.
23 That's known as USA Assurance Company.

24 And that's right now the driving force.
25 That's the profitable company. That's the company

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1 cents on the dollar.

2 The only thing ahead of them was a trust
3 preferred for \$15 million that they did.

4 The value that I'm speaking of is really
5 reflected, in my judgment, in USA. Not in the
6 Covenant Care Link.

7 **Q. What other raising of funds for**
8 **Covenant Care Link or CMS were you involved in?**

9 A. Going back to 2003?

10 **Q. Sure.**

11 A. I think that was the original
12 offering. It was a 9 million note offering.

13 Subsequent to that, there was a -- there
14 was this bridge loan offering think I think was
15 \$3 million.

16 **Q. How about through Coventry Resources?**

17 A. Coventry Resources was the original --
18 was the original entity, which issued the bonds, 9
19 million in bonds in 2003. Also the bridge loan that
20 we're talking about.

21 Then in 2005 they signed a letter of intent
22 with USA, consummated that transaction in October
23 of 2007. Prior to that, which I'm going to guess
24 was January of 2007, CMS was form to facilitate that
25 and raise equity. That is the equity offering what

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1 occurred in October of 2007.

2 I can't think of anything other than those
3 three offerings that come to mind.

4 **Q. Did Coventry Resources raise money for**
5 **the four LLCs?**

6 A. Coventry Resources borrowed money from
7 the four LLCs, at the time of the conversion, if you
8 will, that was converted to preferred stock,
9 preferred A.

10 **Q. Preferred stock in who?**

11 A. CMS.

12 **Q. What is the status?**

13 A. That's what I was referring to, that
14 is now worth, in my judgment, probably \$0.75 on the
15 face dollar.

16 The original \$9 million offering, that is
17 preferred B, that stands behind the A.

18 **Q. How much was loaned by the LLCs to**
19 **Coventry Resources?**

20 A. I think the ultimate conversion was
21 \$8 million, which would have involved a fair amount
22 of accrued. Probably 6 million, 6 and a half
23 million.

24 **Q. Whose direction were those loans made?**

25 A. From the LLCs?

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1 going to take too long, and not likely be successful
2 enough.

3 Therefore, an acquisition of an ongoing
4 insurance company with a broker network would be
5 necessary.

6 **Q. Was Coventry Resources in default of**
7 **those 2003 bonds at the time of the four funds'**
8 **investments?**

9 A. I don't know for sure. They offered
10 in 2003. They were current up through 2005, maybe
11 even 2006.

12 We started lending money, I guess, probably
13 in 2005, best of my recollection. So, if they
14 weren't in default, they were probably approaching
15 it, and may have been. Exact timing, I don't
16 recall.

17 **Q. Were the funds loaned -- were the**
18 **moneys loaned by the four LLCs to Coventry used to**
19 **pay interest to the 2003 bond holders?**

20 A. Not in general. There may have been,
21 you know, maybe the first loan or something out, but
22 that was never the specific reason for it.
23 Whether -- I don't think the original bond holders,
24 which you're referring to, there was a -- when --
25 they were current. They had a reserve to pay it.

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1 **Q. Yes.**

2 A. MS Advisors.

3 **Q. Who else was involved in the decision**
4 **to have the four LLCs invest these funds?**

5 A. Primarily myself.

6 **Q. What was the purpose of the loans at**
7 **the time?**

8 A. Purpose of the loans at the time was
9 the letter of intent that was signed for that
10 acquisition that ultimately was consummated two
11 years later was to facilitate that acquisition and
12 ongoing working capital needs.

13 **Q. Can you go into more detail of the**
14 **ongoing capital needs?**

15 A. Well, at the time that they had not
16 acquired the company, they were building out their
17 marketing plan for the Covenant Care Link product.
18 They had signed up a number of large banks and a
19 national marketing organization, which they needed
20 to help fund.

21 That was the distinguishing feature of
22 Coventry, in my judgment, that particular program,
23 and what was later determined was that they needed a
24 platform to get it done. Trying to do it within
25 their own insurance company, their own brokers, was

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1 And we lent money in anticipation of the
2 acquisition, kept -- turned out longer than we had
3 hoped for.

4 We continued to lend money from 2005 to
5 2007 basically. And they weren't paying those bonds
6 during that whole period of time.

7 There may have been one payment early on or
8 something. I don't know. It would have been to
9 provide capital. It may very well have been used
10 one time, two times, but that was not the purpose of
11 it, no.

12 **Q. The four LLCs provided a series of**
13 **loans to Coventry Resources?**

14 A. Ongoing capital loans.

15 **Q. Would Coventry Resources be able to**
16 **pay interest in 2005 without this loan from -- these**
17 **loans from the four LLCs?**

18 A. On the 2003 bonds?

19 **Q. Yes.**

20 A. Going forward, no.

21 **Q. In 2005?**

22 A. Well, I don't know exactly when the --
23 they had an ability to pay up to somewhere around
24 2005. I don't know when.

25 If you're asking going forward 2005, 2006,

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1 the answer is no. At some point in 2005 they are
2 current, but after that the answer is no.

3 MR. NEWMAN: Coventry raises money in
4 2003 approximately \$9 million?

5 THE WITNESS: That's correct.

6 MR. NEWMAN: Notes were issued for
7 that?

8 THE WITNESS: Yes.

9 MR. NEWMAN: Approximately how many
10 investors were in that?

11 THE WITNESS: Oh boy, maybe 50, 60.

12 MR. NEWMAN: Was this a McGinn Smith
13 placement?

14 THE WITNESS: It was.

15 MR. NEWMAN: What was your role in
16 Coventry in 2003? You were on the board of
17 directors?

18 THE WITNESS: After the offering, I
19 was on the board of directors. Prior to that, I was
20 not.

21 MR. NEWMAN: Did you receive any
22 salary or compensation from Coventry.

23 THE WITNESS: No.

24 MR. NEWMAN: You were not compensated
25 being a member of the board of directors?

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1 THE WITNESS: I think there was a
2 warrant plan. I'm not sure it got instituted. I
3 never got anything. There was some talk. There was
4 no compensation.

5 MR. NEWMAN: What was the placement
6 fee for that deal?

7 THE WITNESS: Placement fees typically
8 6 to 10 percent. Probably 10 percent. Generally
9 private placement had a 10 percent placement fee.

10 MR. NEWMAN: McGinn Smith
11 approximately got \$900,000 roughly?

12 THE WITNESS: In gross proceeds.

13 MR. NEWMAN: Were there any other
14 affiliated fees besides that for McGinn Smith?

15 THE WITNESS: I don't believe there
16 were, no.

17 MR. NEWMAN: Coventry in 2003 is not a
18 public company?

19 THE WITNESS: No.

20 MR. NEWMAN: Did you have any equity
21 position in Coventry, you personally?

22 THE WITNESS: I believe, I testified
23 to this last week, that M & S Partners for five
24 years before that when Mr. Holderman (phonetic) had
25 concluded another project with us and was seeking

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1 some side capital, I'm quite certain Mr. McGinn and
2 I, through M & S Partners made an equity investment.
3 It's not a material investment. I don't know what
4 it amounts to.

5 MR. NEWMAN: There was some percentage
6 of ownership in Coventry?

7 THE WITNESS: Yes. But de minimis.

8 MR. NEWMAN: When was that acquired?

9 THE WITNESS: Well, I'm guessing four
10 years ahead of 2003. Probably 1999, 1998.

11 MR. NEWMAN: What was the dollar
12 amount?

13 THE WITNESS: I believe it was
14 \$100,000.

15 MR. NEWMAN: Have you recouped that
16 investment?

17 THE WITNESS: No.

18 MR. NEWMAN: Going forward, after
19 2003, other than your equity position and board of
20 director position, were there any other affiliations
21 between you or any of your affiliated companies with
22 Coventry?

23 THE WITNESS: Other than the loan that
24 Steve asked me about, the bridge loan, seems to me
25 there were two bridge loans, but maybe one took the

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1 other out. But there was -- there were -- talked
2 about raising some stock at some time, but I don't
3 think we ever did.

4 Other than the CMS offering, which
5 we're talking about, I don't think there is anything
6 else.

7 MR. NEWMAN: 2003, \$9 million is
8 raised. This is -- does Coventry -- is it an
9 operating company with revenues?

10 THE WITNESS: Yes.

11 MR. NEWMAN: Did it have sufficient
12 revenues to pay the note holders in the 2003
13 offering?

14 THE WITNESS: When you say -- you mean
15 pay interest? Yes.

16 MR. NEWMAN: At some point you said
17 they were behind?

18 THE WITNESS: I'm trying to remember.
19 They were current, I believe, in the 2005. Whether
20 it was all the way to the end of 2005, I don't
21 recall. Somewhere within that period of time.

22 MR. NEWMAN: It's your testimony that
23 you -- the LLC moneys that were lent or invested in
24 Coventry were not used, except for initially to make
25 any interest payments to the bond holders?

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<p>1 THE WITNESS: Not on an ongoing basis.</p> <p>2 I'm not willing to state with certainty that the</p> <p>3 first time we made a loan that some of the money</p> <p>4 wasn't used for interest. It could very well have.</p> <p>5 But it was not used to fund those on an ongoing</p> <p>6 basis.</p> <p>7 MR. NEWMAN: I think we said the</p> <p>8 moneys that were lent to Coventry were \$6,</p> <p>9 \$7 million, approximately?</p> <p>10 THE WITNESS: Ultimately, it -- I</p> <p>11 believe it came to that amount, yes.</p> <p>12 MR. NEWMAN: We have that money. Then</p> <p>13 we have \$9 million in 2003. Then the \$3 million</p> <p>14 bridge loan offering.</p> <p>15 THE WITNESS: That was the bridge loan</p> <p>16 to an equity raise, which I don't think ever</p> <p>17 happened.</p> <p>18 Steve asked me about it. I don't</p> <p>19 think we ever got that. That was all designed to</p> <p>20 get -- raise capital for this acquisition in 2005,</p> <p>21 which was one of those things not consummated until</p> <p>22 2007 or the company didn't.</p> <p>23 MR. NEWMAN: Was that the only bridge</p> <p>24 loan offering?</p> <p>25 THE WITNESS: I said I'm familiar with</p> <p style="text-align: right;">Page 1004</p>	<p>1 conveyed to them? Was there a letter?</p> <p>2 THE WITNESS: That was all handled by</p> <p>3 Mr. Holderman and Coventry and his counsel.</p> <p>4 Really we believe -- we were clearly</p> <p>5 aware of it. But, it was at their direction.</p> <p>6 MR. NEWMAN: Do you know how much of</p> <p>7 the actual -- how much in the way of payments have</p> <p>8 been made to the \$9 million note holders?</p> <p>9 THE WITNESS: I think the original</p> <p>10 coupon was 12 percent.</p> <p>11 As I said, I think it was paid in full</p> <p>12 for at least two, if not three years. I think that</p> <p>13 offering was either summer or fall of 2003.</p> <p>14 So, if you paid 12 percent on</p> <p>15 \$90 million, you're basically paying a million</p> <p>16 dollars a year for three years, \$3 million.</p> <p>17 MR. NEWMAN: When was the option given</p> <p>18 to them to go to preferred B shares?</p> <p>19 THE WITNESS: I think the work was</p> <p>20 done obviously preliminary or prior to the actual</p> <p>21 consummation of the acquisition. So, I think the</p> <p>22 legal work was probably done in March of 2007.</p> <p>23 Probably investors exercised their option probably</p> <p>24 that summer, 2007.</p> <p>25 MR. NEWMAN: For a year or two the</p> <p style="text-align: right;">Page 1006</p>
<p>1 the 3 million. And I think there may have been</p> <p>2 another one. And maybe the second one took out the</p> <p>3 first one. I don't remember.</p> <p>4 It might have been a smaller one of a</p> <p>5 million. Whether the \$3 million took out the</p> <p>6 million dollars, I don't recall.</p> <p>7 MR. NEWMAN: What is the status of the</p> <p>8 \$9 million note holders.</p> <p>9 THE WITNESS: They converted to</p> <p>10 preferred B stock. They stand behind the LLC's</p> <p>11 preferred A stock.</p> <p>12 In order to consummate the transaction</p> <p>13 in 2007, balance sheet need to be relieved of some</p> <p>14 of its debt. It was converted to preferred stock.</p> <p>15 MR. NEWMAN: How was this done? Was</p> <p>16 it done by election of the investors or was this</p> <p>17 done unilaterally by Coventry?</p> <p>18 THE WITNESS: No. It was done by the</p> <p>19 election of the note holders.</p> <p>20 MR. NEWMAN: What choices were they</p> <p>21 given?</p> <p>22 THE WITNESS: I guess given a choice</p> <p>23 of convert or maintain their note. Choose not to</p> <p>24 convert.</p> <p>25 MR. NEWMAN: Who -- how was this</p> <p style="text-align: right;">Page 1005</p>	<p>1 notes were in default?</p> <p>2 THE WITNESS: That would be correct,</p> <p>3 yeah. Some time in 2006, maybe the entire year</p> <p>4 2006, into 2007.</p> <p>5 MR. NEWMAN: Were the investors in the</p> <p>6 \$3 million bridge loan offering told that the 2003</p> <p>7 Coventry note holders had not been paid as</p> <p>8 promised?</p> <p>9 THE WITNESS: Sure.</p> <p>10 MR. NEWMAN: That was disclosed in the</p> <p>11 offering document?</p> <p>12 THE WITNESS: In the offering document</p> <p>13 to the bridge loan?</p> <p>14 MR. NEWMAN: Was that disclosed, the</p> <p>15 prior note holders have not been paid?</p> <p>16 THE WITNESS: I don't know, because I</p> <p>17 can't even tell you the exact timing of the bridge</p> <p>18 loan note. I wouldn't want to make that statement.</p> <p>19 MR. NEWMAN: Would you agree that's</p> <p>20 something that should be disclosed?</p> <p>21 THE WITNESS: Sure.</p> <p>22 MR. NEWMAN: What was your involvement</p> <p>23 in the bridge loan offering?</p> <p>24 THE WITNESS: The bridge loan offering</p> <p>25 was conducted by Coventry. Obviously some of McGinn</p> <p style="text-align: right;">Page 1007</p>

1 Smith clients participated, as did clients outside
2 of McGinn Smith.

3 I don't recall us acting as -- I think
4 Coventry Resources was the underwriter and the
5 placement agent.

6 MR. NEWMAN: McGinn Smith wasn't
7 involved in the bridge loan offering?

8 THE WITNESS: Involved? We didn't
9 construct or structure it. I don't think we were
10 the placement agent. I'm trying to recall. I think
11 Coventry Resources was.

12 Certainly some of our investors were
13 involved in it. So, we would have been -- if we
14 weren't the placement agents, we would have been
15 part of the, quote, selling group.

16 MR. NEWMAN: Do you know if McGinn
17 Smith participated in that offering?

18 THE WITNESS: Yes.

19 MR. NEWMAN: Was McGinn Smith the
20 primary underwriter?

21 THE WITNESS: No.

22 MR. NEWMAN: Issuer?

23 THE WITNESS: Coventry Resources had
24 their own broker-dealer. My recollection is they
25 were the placement agent. But --

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1 MR. NEWMAN: Coventry Resources?

2 THE WITNESS: They had their own
3 broker-dealer.

4 MR. NEWMAN: Who was that?

5 THE WITNESS: It was Coventry or
6 Coventry Resources. I don't know the exact name.

7 MR. NEWMAN: Did you individually or
8 through any entity have an interest in Coventry
9 Resources, the broker-dealer?

10 THE WITNESS: No.

11 MR. NEWMAN: McGinn Smith did
12 participate in the offering, but it was primary
13 Coventry Resources is your testimony?

14 THE WITNESS: I know we participated
15 in the offering. I wouldn't go so far to say who
16 was primary and who wasn't.

17 There was investors that they got and
18 investors that we got. And, again, I'm trying to
19 state from memory -- I don't think we were the
20 placement agents. I think they were. I think we
21 would have been involved as the selling -- through a
22 selling agreement.

23 MR. NEWMAN: Did you personally sell
24 any -- the bridge loan offering?

25 THE WITNESS: I'm sorry.

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1 MR. NEWMAN: The Coventry bridge loan
2 offering of \$3 million?

3 THE WITNESS: I don't believe I did.

4 MR. NEWMAN: Any McGinn Smith brokers
5 sell --

6 THE WITNESS: My recollection the
7 participation came out of our New York office. It
8 was two or three brokers who were recently active in
9 it.

10 MR. NEWMAN: Did you review the
11 offering memorandum for that offering?

12 THE WITNESS: Yes.

13 MR. NEWMAN: Did you express any
14 concerns about there not being any disclosure in the
15 offering memorandum concerning the prior success of
16 the \$9 million note offering?

17 THE WITNESS: I don't know if that's a
18 fact. I don't recall that not being disclosed in
19 the offering. Since I don't, I don't recall whether
20 I stated a concern.

21 I still don't know if that's the case.
22 You're insinuating it is. I don't recall that.

23 MR. NEWMAN: What is the status of
24 that \$3 million -- the investors in the \$3 million
25 bridge loan?

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1 THE WITNESS: Well, again, best of my
2 recollection, two of it was converted to equity.

3 MR. NEWMAN: That preferred B or A?

4 THE WITNESS: Basically converted to,
5 I think, common stock.

6 And, again, best of my recollection,
7 there is still a million outstanding.

8 MR. NEWMAN: Common stock in CMS?

9 THE WITNESS: Yes.

10 MR. NEWMAN: How come the LLC
11 investors did not receive common stock?

12 THE WITNESS: Well, they actually do.

13 MR. NEWMAN: They have preferred
14 stock.

15 THE WITNESS: But also common.

16 MR. NEWMAN: What is the percentage
17 common versus preferred?

18 THE WITNESS: They got mostly
19 preferred A, which is, in my judgment, where the
20 real value is.

21 But as an addition to that, they got a
22 certain amount of common stock. And I think the
23 common stock would give them about -- I think it's
24 north of 20 percent of the company, 22 percent of
25 the company in common.

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1 MR. NEWMAN: The rest is in preferred?
2 THE WITNESS: Well, they had their --
3 they have 100 percent of the preferred A. Then in
4 terms of common ownership of CMS -- might be north
5 of that. It's definitely at least 25 percent.
6 MR. NEWMAN: How many shares are we
7 talking about?
8 THE WITNESS: I don't know. I'm not
9 sure the number of shares matters.
10 MR. NEWMAN: Millions of shares?
11 THE WITNESS: No. I just don't
12 remember the actual share other than -- I'm quite
13 certain their participation is north of 25 percent?
14 MR. NEWMAN: How are they titled?
15 THE WITNESS: In the individual LLCs.
16 MR. NEWMAN: They are certificates in
17 each of the LLCs' name for CMS?
18 THE WITNESS: Yes.
19 MR. NEWMAN: Why don't they have all
20 their interest in common as -- preferred -- there is
21 no -- preferred stock is not traded stock, right?
22 It's not listed, public stock?
23 THE WITNESS: Neither is the common.
24 It's not a public company.
25 MR. NEWMAN: The common is not public?

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1 THE WITNESS: CMS is a private
2 company. The reason they have most of their
3 interest in preferred is because we wanted them to
4 be ahead of the common. That's the nature of the
5 structure.
6 They are -- the LLCs are a preferred
7 A. So, they are -- after the trust preferreds,
8 which were issued to \$50 million to acquire the
9 company, the preferred As are next in line.
10 MR. NEWMAN: Is there a dividend for
11 the preferred shares?
12 THE WITNESS: It's a dividend
13 accruing.
14 MR. NEWMAN: It's not been paid?
15 THE WITNESS: I believe it was --
16 there was one or two payments just recently.
17 MR. NEWMAN: This year?
18 THE WITNESS: I believe so, yes.
19 MR. NEWMAN: What transpired that
20 enabled those payments to be paid?
21 THE WITNESS: Fortunes of the company
22 are getting better. They've still got a ways to go,
23 but they have grown their assets. They have grown
24 their earnings. I think they are in a terrific
25 space. Long-term care is absolutely going to be a

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1 terrific place to be.
2 They have weathered what was a very
3 difficult environment in 2008 and 2009. Consumers
4 are very resistant to spend money or anything.
5 These guys did pretty well.
6 MR. NEWMAN: These two payments made
7 recently, would those be the first actual income or
8 payments paid to the LLCs based on the \$9,000 -- or
9 the money they loaned?
10 THE WITNESS: I think there was an
11 initial payment when the deal was first done, but
12 it's de minimus. This is -- it's not significant.
13 MR. NEWMAN: This valuation you've
14 given, 75 cents on the dollar, what is that based
15 on?
16 This is a non-public illiquid stock.
17 Have you had it valued by a third party?
18 THE WITNESS: No. It's based on
19 basically taking the book value of the company,
20 which, for insurance companies is basically totally
21 liquid assets, cash and marketable securities,
22 meaning government securities. You would then first
23 subtract what's known as the trust preferreds, which
24 was in the amount of \$15 million that was used to
25 make the acquisition or part of the acquisition in

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1 2007, which I've referred to.
2 You would subtract that preferred from
3 the underlying value almost as if it's a bond.
4 That's what trust preferreds are. They are
5 basically bonds in the disguise of equity.
6 Then you would go to the next chain of
7 seniority, which would be the preferred As. If you
8 look at it just from a cash value basis, I believe
9 that those are in the 50 to 60 cents on the dollars.
10 If you had a liquidation of the
11 company, which of course you generally don't want to
12 do, value generally based on liquidation. To
13 determine from a book value standpoint, if you had
14 to liquidate the company, those things would be
15 worth 50 to 60 cents on the dollar.
16 I have arbitrarily said in my judgment
17 you don't value the company on a liquidation basis.
18 You value it on a prospect earnings basis what have
19 you. So, in my judgment, if you put an enterprise
20 value on this company and follow the same
21 methodology, you would find a value north of the 50
22 to 60. I threw out 75. That's arbitrary.
23 MR. NEWMAN: You have not done an
24 evaluation on this company?
25 THE WITNESS: Well, yeah. I mean, I

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1 got that valuation I talked about through reviewing
2 the financial statements, audited statements,
3 their -- based on insurance accounting principals.
4 And that's the valuation I would come up with.

5 MR. NEWMAN: When did you get this
6 information?

7 THE WITNESS: December of this year.

8 MR. NEWMAN: But there has not been an
9 independent third-party evaluation of CMS to your
10 knowledge?

11 THE WITNESS: No.

12 MR. NEWMAN: Coventry?

13 THE WITNESS: No. The underlying
14 insurance company, they have ratings agencies, etc.,
15 who do that. In looking at CMS, no.

16 MR. NEWMAN: Has there ever been a
17 going concern issues for Coventry?

18 THE WITNESS: Under its new
19 organization, no.

20 MR. NEWMAN: At the time of the
21 2000 -- specifically, at the time of the \$3 million
22 bridge loan offering, was there a going concern
23 issue for Coventry?

24 MR. FRANCESKI: Objection. I think we
25 went into this already.

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1 THE WITNESS: I don't recall.

2 MR. NEWMAN: Was there ever a going
3 concern issue for Coventry?

4 THE WITNESS: I would think so. I
5 can't recall, but I would certainly think so.

6 MR. NEWMAN: Do you know when that
7 first came into being concerned?

8 THE WITNESS: Could have been any
9 time, 2005. They weren't making enough income to
10 pay the interest on the notes. So, generally, that
11 could trigger a going concern issue.

12 MR. NEWMAN: When you come up with
13 this valuation of CMS, have you factored in all the
14 money that's been raised and money owed?

15 THE WITNESS: I factored in -- because
16 I'm only -- the question related to the preferred A.
17 And so the other things don't come into account,
18 other than the trust preferreds and the bridge loan.

19 But the other dollars don't come in.
20 For example, the preferred B stands behind the
21 preferred A, so I did not compute that. No.

22 MR. PAULSEN: Can you identify who the
23 investors are in the trust preferreds, the
24 \$15 million specifically?

25 THE WITNESS: No. It was an offering

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1 put forth by Cohen & Company, which is an investment
2 bank that specializes in that.

3 My guess, they sold it to
4 institutional investors. We did not participate in
5 the offering. My guess is they placed it with one
6 institution.

7 MR. PAULSEN: There were no McGinn
8 Smith investors that participated in that
9 \$15 million piece?

10 THE WITNESS: There were none.

11 **Q. BY MR. ROWEN: Based on M & S
12 Partners' equity investment income in Coventry and
13 your role on the board of directors, was investments
14 by the LLCs in Coventry Resources included on the
15 schedule we discussed earlier this morning that
16 would be collateralized against fees?**

17 A. No.

18 **Q. Why not?**

19 A. Because the investment of M & S
20 Partners is so de minimis that it's probably less
21 than 1 percent. Way less than 1 percent. It's not
22 close to the 20 percent threshold we're talking
23 about.

24 **Q. Did you feel your role on the board of
25 directors created a conflict of interest?**

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1 A. At the time, no. I mean, in the real
2 world, people close to companies know the companies,
3 know the prospects, get involved. I think if you
4 had that difficult criteria, you wouldn't have a lot
5 of deals done.

6 I'm aware of it. Know I was involved. I
7 think that brought some perspective to the
8 investment that I wouldn't have had otherwise.
9 That's why I thought it was -- I certainly had no
10 self benefit. I wasn't going to benefit personally
11 from this. I just thought, I still believe, that
12 that particular space is -- offers different
13 opportunities and believed in Bob Holderman.

14 I've been through wars with him back in the
15 early '90s. And although there are times when I
16 have differences with him, he's a very credible,
17 capable guy. And I think he'll eventually bring
18 this thing to a position that the bondholders,
19 shareholders will be very happy with.

20 **Q. Who else was involved in the decision
21 not to include the loans to Coventry Resources on
22 the schedule of entities that would be
23 collateralized?**

24 A. I don't think it was discussed. The
25 interest is so small that it didn't even get

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1 mentioned.

2 **Q. The four LLCs make any other**
3 **investments in any Coventry entity directly or**
4 **indirectly?**

5 A. I don't believe so.

6 **Q. How about through 107 Associates?**

7 A. That's all the same offering. We've
8 been through that. 107 Associates in the fall of
9 2007 helped get the offering closed. And we've
10 discussed this. They put up roughly \$2 million.

11 **Q. I guess I'm trying to get an**
12 **understanding, why did the four funds make their**
13 **investments in 107 knowing full well 107 would be**
14 **investing in CMS and knowing Coventry failed to**
15 **repay the principal and interest on the previous**
16 **loans and had to be converted into stock?**

17 MR. FRANCESKI: Objection.

18 You can answer.

19 A. Because there is a concept in our
20 business, which I talked at length on this a week
21 ago, but I'll be happy to go into it again, is that
22 you sometimes are faced with a very difficult
23 choice. Do you put more money in to protect your
24 investment, or did you not put any more money
25 because of the circumstances you're describing them

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1 may call for not going forward on that choice.

2 The choice that we had in the fall of 2007
3 was that the money that was invested by the LLCs, in
4 my judgment, and in the judgment of Mr. McGinn, is
5 that if we don't get that transaction closed, if we
6 don't get that insurance company, that acquisition
7 consummated, that our ability to get the 6 and a
8 half or \$7 million or \$8 million, whatever it was,
9 including accrued interest back, was greatly
10 impaired.

11 On the other hand, if we get the deals
12 close, the prospects are promising and that has been
13 the case.

14 When I lent the money, never in my wildest
15 dreams did I think it was a long-term loan. I also
16 testified to this. It was done because we had,
17 through a number of delays, had not got the equity
18 offering off the ground until basically September
19 of 2007. Closing was October 7th of 2007.

20 So, we had probably two or three weeks to
21 raise the capital. It was -- in two or three weeks
22 sometimes you don't get the job done.

23 I was fully convinced we could get the job
24 done. The company was so promising, we were buying
25 at such a cheap valuation that we wouldn't have

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1 trouble raising the capital. Had we raised the
2 capital, 107 would be paid back.

3 But, the decision, as you've outlined it
4 for me, was simply is this an investment that, A,
5 I'm likely to get my money back soon, which in my
6 judgment I was because I thought my sales force
7 would be successful in raising the rest of the
8 equity capital. It was a \$15 million raise. We
9 raised basically \$5 million at that point. So, I
10 thought I was going to get the money back.

11 And, Number 2, very important to protect
12 the money that had previously been invested, because
13 without concluding this deal, it would certainly be
14 impaired.

15 It was a pretty easy decision, actually.

16 MR. ROWEN: We can break for lunch.

17 Off the record.

18 (A short recess was taken.)

EXAMINATION

20 BY MR. RATTINER:

21 **Q. Mr. Smith, we want to discuss NEI.**
22 **Tell us what that is?**

23 A. I don't -- NEI. I think it's an alarm
24 deal that Mr. McGinn did. I have no knowledge of it
25

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1 at all, to be honest with you.

2 Let me change that statement. I think I
3 do. I think it would -- had a deal that had to do
4 with one of the hedge funds that we worked with, an
5 alarm deal.

6 **Q. Did you receive any loans from NEI?**

7 A. Not that I'm aware of.

8 **Q. How about Mr. McGinn? Are you aware**
9 **of whether or not he received any loans?**

10 A. I'm not.

11 MR. ROWEN: Does your broker-dealer
12 raise anything for NEI or NEI Capital?

13 THE WITNESS: I don't think so. I'm
14 not that familiar with the name. It strikes me we
15 had a deal with a hedge fund. It's all I can
16 recall.

17 **Q. BY MR. RATTINER: How about TBM**
18 **Benchmark. Did you receive any loan from them? You**
19 **meaning Mr. Smith?**

20 A. I don't know. I don't think so, but I
21 don't know.

22 **Q. When was that deal raised?**

23 A. That deal has been going on, more
24 recent deal. I would say in the fall of 2009.

25 **Q. What is the current status of that,**

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1 **still open?**

2 A. Still open. It was I think kind of a
3 bifurcated deal. Stage deal, property acquisition.
4 I think there is approximately 4 to \$500,000 to be
5 raised. I think there is maybe one more property to
6 be acquired. Haven't really work very closely about
7 that stuff.

8 **Q. Who does that?**

9 A. Mr. McGinn.

10 MR. ROWEN: What was the purpose of
11 TDMM Benchmark?

12 THE WITNESS: It's kind of the same
13 concept as we had for TDM, it's sort of labelled the
14 triple play concept where generally gated
15 communities have an infrastructure in place for
16 Internet, alarms, telecommunications, telephone.
17 And most of those communities, the developer had --
18 when times were good, he had in effect developed
19 those properties on his own, then subcontracted out
20 to Comcast or whoever might be a carrier.

21 Now they are seeking some cash, so
22 they are remarketing them to folks like us at pretty
23 attractive prices. It's generally a deal that
24 instead of long list of homeowners, you deal with
25 the homeowner associate, so you have one party you

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1 are looking to to make payment on behalf of the
2 services they collect from the homeowners within the
3 community.

4 Other than that, it's pretty similar.
5 You're securitizing cash flows from those three
6 services.

7 MR. ROWEN: TDMM Benchmark would be
8 purchasing contracts?

9 THE WITNESS: Yes. Basically
10 purchasing from the homeowner's association a cash
11 flow coming from the individual homeowner's are
12 paying for their local telephone service or their
13 Internet service or their alarm service, that sort
14 of thing.

15 MR. ROWEN: We've had a number of
16 other TDMM entities. Why start a new entity and do
17 a new rate for an entity the TDMM Benchmark?

18 THE WITNESS: To isolate the specific
19 project, the specific community, do a deal by deal
20 instead of commingling a new deal with an old deal.
21 This is --

22 MR. ROWEN: How much has been raised?

23 THE WITNESS: I believe the deal is a
24 \$3 million offering. If I'm correct, I think there
25 is about 500 to go. It would be two and a half

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1 million, I think.

2 **Q. BY MR. RATTINER: What are those**
3 **proceeds going to be used for?**

4 A. Acquiring properties. I don't work in
5 that area. Tim really does that stuff, Tim and
6 Matthew Rodgers. I'm sort of on the outside looking
7 in.

8 **Q. Do you know how much of those proceeds**
9 **are being utilized to get contracts out of the**
10 **million being raised?**

11 A. I don't.

12 **Q. Do you review the private placement**
13 **memorandum for those deals?**

14 A. I review them for securities purposes
15 before they give it to our brokers to sell.

16 **Q. What is TNA Associates?**

17 A. You're reaching back.

18 TNA is an entity that was formed probably
19 in 1981, maybe '82. We did an offering for an
20 enterprise called CW Warehouse, which was a local
21 freezer cooler warehouse, stored butter, milk,
22 whatever.

23 TNA was a middle position. Real estate
24 deals were structured back in those days when there
25 was the ability to generate tax benefits for the

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1 investors. So, the idea was to lever up the
2 properties as much as you could so you would insert
3 a middle position between a conventional first
4 mortgage. And they would just lever it up, you get
5 more tax deductions for the investors. That's what
6 TNA was.

7 **Q. Do you have any affiliation with TNA?**

8 A. I'm still an owner. It hasn't
9 operated in 20 years. It's still there.

10 **Q. How about Three Rock?**

11 A. Three Rock is an entity that was -- I
12 don't think it's ever been active. It was formed --
13 an individual by the name of Mitchell Sacks. And he
14 was going to show us some properties. And he was --
15 he formed the partnership. We formed the
16 partnership. I don't think anything was ever done
17 under Three Rock.

18 **Q. As part the request in September, the**
19 **firm provided us with some promissory notes. We**
20 **discussed that last week.**

21 **Those promissory notes identified TDM Cable**
22 **and CCNT as entities that loaned money to yourself?**

23 A. Yes.

24 **Q. Are there any other promissory notes**
25 **created documents memorialized with a document or**

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1 outside ones that have not been memorialized that
2 you received personally?

3 A. For loans?

4 **Q. Correct.**

5 A. Over what time frame?

6 **Q. From 2003.**

7 A. I don't know. That's how we've taken
8 compensation. There really weren't any deals from
9 2003 to probably 2007, because Tim was in, as we
10 discussed, at IASG.

11 So, if you fast forward to 2007, 2008,
12 there was Verifier deals. There may been certainly
13 some there. And I guess the deals that we've done,
14 which I think familiar with all of them, are Chris
15 Charter Venture and the TDM and Verifier. I don't
16 think there is anything else.

17 MR. ROWEN: How do you rack these
18 loans personally?

19 THE WITNESS: They are given to my
20 accountant, Ron Simons, at the end of the year and
21 he does it for me.

22 MR. ROWEN: What is given to him?

23 THE WITNESS: The terms of the loan.

24 MR. ROWEN: Throughout the year, how
25 do you track these loans?

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1 THE WITNESS: Well, throughout the
2 year, you know, I don't know. I guess they are
3 supposed to be memorialized with loan documents,
4 which sometimes we have been not particularly good
5 at.

6 In terms of tracking them, basically
7 we have at the end of the year when Ron Simons asks
8 for our tax information, he gets more of it from, I
9 think, Brian Shay who at least with regard to the
10 business side and the personal side he gets from me.
11 That's how it's tracked. I don't keep track of
12 them, I guess.

13 I'm not sure how I mean. Do I put
14 them in a pile and list them? The answer is no to
15 both of those.

16 MR. ROWEN: How is Brian Shay made
17 aware of each loan and terms?

18 THE WITNESS: If it is, in fact, Brian
19 Shay, it might be Brian Cooper, Tim really handles
20 all of that. I'm really not involved in it.
21 Generally Tim does the financing from start to go.
22 And I would dare say the terms are almost always
23 market driven, 10 to 12 percent, I guess. And
24 either on a demand or term of generally five or six
25 years, but I don't get involved in that.

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1 MR. ROWEN: Your personal loans you
2 believe to be 10 to 12 percent?

3 THE WITNESS: I'm saying in my
4 judgment I think most of those loans could range in
5 the -- I guess that's not true. I think we had
6 loans as low as 6 percent.

7 Basically, it's driven by what the
8 company is agreeable to. And I'm not involved in
9 that decision-making process.

10 **Q. BY MR. RATTINER: What company?**

11 A. If there are with TDM or Verifier, I'm
12 not trying to run away from it. I don't do it. Tim
13 does it.

14 **Q. In terms of this compensation, this
15 started in 2006?**

16 A. You know, again, I don't know. I
17 think years ago we took some fees in that manner.
18 Then there wasn't any for a long period of time.
19 Whether the other fees were done in terms of cash or
20 loans, again, I just don't have any recollection. I
21 don't get involved in it. I don't want to quote you
22 something that I'm not sure of.

23 **Q. Did it stop from 2003 through November
24 of 2006?**

25 A. I wasn't doing those deals. I never

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1 been a -- an originator of that stuff. When he
2 left, the business model changed.

3 I said a number of times, at least on the
4 alarm side of the business, we were precluded by
5 non-compete agreements. So, we couldn't do it if we
6 wanted to.

7 After that expired, after Tim left IASG or
8 they sold the company. And so, he came back. We
9 got involved this that stuff.

10 Then this -- the TDM -- the TDM is only a
11 couple years old.

12 **Q. Prior to 2003, what was the form of
13 compensation prior to 2003?**

14 MR. FRANCESKI: Objection. Asked and
15 answered.

16 A. Virtually, before 2003, 95 percent of
17 our business was in the alarm business. And I don't
18 recall if the compensation was in the form of fees
19 or loans. Might have been a combination of both. I
20 just don't know.

21 **Q. For the TDM we discussed back in
22 October of 2006, that was not a new thing, those
23 loans?**

24 A. You mean a totally new concept?

25 **Q. Correct.**

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1 A. As I said, I know we have -- we had
2 done that way back when. Whether it was new from
3 2006, I don't know. We may have done a deal with
4 fees. We may not have.

5 **Q. What discussions surrounded that in**
6 **terms of bringing that back to life?**

7 A. I basically deferred to Tim on these
8 deals. I trusted him for 25 years. And that's
9 his -- he sources them, structures them and
10 determines the level of compensation available. I'm
11 generally treated as a partner. And pretty much
12 have the same sort of arrangements that he doesn't.

13 **Q. In this case you just receive the**
14 **check or a wire?**

15 A. Pretty much.

16 **Q. No other real information in terms of**
17 **what you did to deserve that?**

18 A. I'm an officer. I'm not working and
19 performing a lot of functions. I'm an owner that
20 assumes a certain liability. We're partners.
21 That's how I'm treated. It's not an area I spend
22 virtually any time in.

23 **Q. Those -- TDM Cable did an offering in**
24 **2006? Is it TDM Cable Funding in 2006? Is that the**
25 **title?**

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1 A. I don't know. TDM Funding may be a
2 group that used -- that was used to do the bridge
3 financing, or it may have been the actual name of a
4 deal. I don't know. I'm sort of embarrassed.

5 **Q. Do you recall if there was a deal in**
6 **or around October of 2006 with the title TDM Cable?**

7 A. There was 2007. 2006 could have been.
8 Probably was.

9 **Q. How was it disclosed within that PPM,**
10 **the loans to the officers?**

11 A. I believe that it's disclosed simply
12 as working capital, and not that it's specifically
13 going to be loans are going to be granted. I don't
14 recall any specific language detailing that.

15 **Q. Is that not material?**

16 MR. FRANCESKI: Objection.

17 A. I don't believe it is, no.

18 **Q. Why is that?**

19 A. Because I think as long as you're
20 disclosing the working capital, that's up to the
21 company to do what they choose with their working
22 capital.

23 **Q. In this case if the deal would raise 3**
24 **million, what would the PPM say?**

25 A. Sales raised three million.

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1 **Q. What would be the working capital**
2 **versus what is going to go to TDM? Would there be a**
3 **distinction within the PPM you're saying?**

4 MR. FRANCESKI: Objection.

5 A. The distinction would be all the money
6 goes to TDM. They apply it, I don't know what
7 proportions, but they obviously apply some portion
8 of it to acquire the asset, and some portion goes to
9 working capital. And out of that working capital,
10 basically fees that we take which, by the way,
11 construe our compensation for the rest of time. We
12 never get a salary. Never get anything else. Out
13 of that we have to, in effect, offer the services of
14 the McGinn Smith & Company to track and provide the
15 distribution. We don't charge the funds any money
16 for that. And so -- and in addition to that, it's a
17 potential liability that if the company needs
18 capital for whatever reason, they can call it and we
19 would have to repay it.

20 I don't think in -- there is any disclosure
21 that in the PPM that Tim and Dave or Matthew or
22 whoever it might be is going to get a specific loan.

23 **Q. Would you obtain underlying fees for**
24 **TDM, McGinn Smith & Company?**

25 A. Yes. If they sold the deal, sure.

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1 **Q. How about advisory fees?**

2 A. No.

3 **Q. What would the typical underwriting**
4 **fees be?**

5 A. Generally eight to ten, I think.

6 **Q. There was no other fee associated with**
7 **those types of raises?**

8 A. I don't believe so. I didn't
9 structure them. I don't recall any.

10 MR. NEWMAN: There are loans taken in
11 lieu of salary was for tax planning purposes?

12 THE WITNESS: Well, I think it may be
13 some of that. Again, it's a mechanism that allows a
14 couple things. It allows for there to be a way to,
15 in effect, put capital back into the business, if
16 it's needed. Because there is a loan. The company
17 can presumably call the loan as opposed to an equity
18 call.

19 It's a way that attempts to cover all
20 the expenses and operating expenses of that entity
21 as it relates to both the officers and their
22 affiliates.

23 We don't charge them anything to
24 administer the business from day one through day
25 five or six. There is an ongoing process, an

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1 ongoing management need for all of these things.
2 Basically, those services are performed on an
3 ongoing basis, primarily by, in the case of TDM, by
4 Mr. Rodgers and Mr. McGinn.

5 Admittedly, I don't get involved. But
6 that's just the choice of compensation.

7 **Q. BY MR. RATTINER: If Mr. McGinn were**
8 **to testify there was an advisory fee, would that be**
9 **similar to the things you're talking about now,**
10 **not -- the advisory fee, would that have covered**
11 **what you're speaking of?**

12 A. You know, I don't know what we're
13 referring to. Is this in the TDM deal?

14 **Q. Correct. You're saying you wouldn't**
15 **have been paid for anything --**

16 A. I don't think I've received an
17 advisory fee.

18 MR. FRANCESKI: Let me object. He
19 didn't say they didn't get paid for doing that. He
20 said he got paid up front from doing that.

21 MR. RATTINER: In lieu of.

22 MR. FRANCESKI: They got paid up front
23 that covered for services they provided for after.

24 They got paid once. Then they
25 provided the services.

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1 MR. RATTINER: I don't think that's
2 the testimony.

3 MR. NEWMAN: Why don't we ask the
4 question.

5 **Q. BY MR. RATTINER: In terms of the**
6 **advisory fee, what would that cover?**

7 A. I guess I'm not -- I'm not familiar --
8 the advisory fee payable --

9 MR. FRANCESKI: It's okay to say you
10 don't know, if you don't know. If you know what the
11 advisory fee is, help them and tell them that. If
12 you don't know, tell them that. You're not going to
13 help them by speculating about stuff.

14 A. I don't know.

15 THE WITNESS: Did I do okay?

16 MR. FRANCESKI: Yes.

17 MR. NEWMAN: These loans, the loans
18 we've seen are all payable at a future date. There
19 is no immediate repayment requirement?

20 THE WITNESS: I don't know if they are
21 all that way. My recollection is not good. I
22 thought maybe some were on demand, but some have a
23 future date.

24 But the fact is if there is need, the
25 same people who need the money are running the

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1 business and can call the loans. Basically ask them
2 to be repaid.

3 MR. NEWMAN: The loans you've received
4 all have a demand feature?

5 THE WITNESS: I don't think they all
6 do. Some of them were drawn that way. I don't have
7 that good a recollection. I know some have a future
8 date. The more recent ones had a date. But in
9 terms of not necessarily the legal context, but the
10 understanding is that if there is a demand for
11 capital, they could be called by the parties running
12 the company.

13 MR. NEWMAN: Is that a contractual
14 term in the loans themselves?

15 THE WITNESS: I don't think so.

16 MR. NEWMAN: You're saying they can
17 be -- someone could demand repayment even though
18 that's --

19 THE WITNESS: It's us. We basically
20 run the company. Own the company. So, that's
21 certainly a possibility, yes.

22 MR. NEWMAN: Have you ever received a
23 demand to repay a loan?

24 THE WITNESS: No.

25 MR. NEWMAN: The TDM Cable, CCB,

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1 Verifier, all these entities, loans were made to you
2 from them.

3 I think we got testimony over the
4 several days of your involvement in those entities
5 in one form or another. Did you ever have any
6 concerns from a conflict of interest standpoint that
7 you were borrowing money from entities through which
8 you had some interest, financial interest or
9 involvement?

10 THE WITNESS: No.

11 MR. NEWMAN: That never concerned you?

12 THE WITNESS: You're talking about my
13 own involvement?

14 MR. NEWMAN: You were getting personal
15 loans --

16 THE WITNESS: From companies I own,
17 no.

18 MR. NEWMAN: The loans you received
19 typically, how did they come back? How did you
20 determine how much money you were going to borrow?

21 THE WITNESS: That's, as I indicated,
22 Mr. McGinn sources structures, determines what level
23 of compensation by loan is available. And making
24 sure the cash flow is sufficient to service the
25 underlying assets and makes that determination. I

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1 don't have any involvement in that.

2 MR. NEWMAN: You wouldn't discuss that
3 with Mr. McGinn? You would just get a loan? You
4 wouldn't have any prior discussion as to how much
5 you're going to get?

6 THE WITNESS: I think it's fair to say
7 that as he is putting the deal together and
8 structuring the deal, he would comment as to what
9 potential dollars will be available to compensate us
10 through the loans. But I didn't have a discussion
11 in terms of trying to restructure that or argue
12 whether it's more or less. It's just sort of --

13 MR. NEWMAN: How -- say it was a
14 \$50,000 loan, hypothetically speaking, how is the
15 \$50,000 arrived at?

16 MR. FRANCESKI: Objection. Asked and
17 answered.

18 MR. NEWMAN: What is the basis for
19 that -- what is the basis for the number of any of
20 the loans you received?

21 THE WITNESS: I think the basis is to
22 first determine that the level of cash flow from the
23 underlying assets has a certain coverage for the
24 amount of capital that has to be paid interest on or
25 paid dividends or whatever form.

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1 In addition to that, there is some
2 level of money that is going to go to the company
3 that he -- Tim thinks is going to eventually be
4 sufficient to service all of the needs and in
5 addition that is compensation for us.

6 I don't know if he has any -- I don't
7 think he has any particular formula. He's never
8 discussed any particular formula with me.

9 MR. NEWMAN: In terms of the money
10 you're receiving, it's not -- this isn't a loan out
11 of need, financial need? This is a loan based on --

12 THE WITNESS: Easy for you to say.

13 MR. NEWMAN: -- based on some type of
14 compensation to you?

15 How is that, other than him figuring
16 out how much money the operating cost of the entity,
17 how is it he -- how is that determined how much
18 money you're entitled to on a per loan basis? Tell
19 us how that comes about?

20 THE WITNESS: I don't do it.

21 MR. FRANCESKI: If you know, tell
22 them. If you don't know, that's got to be the
23 answer. You're not going to help them by
24 speculating.

25 MR. NEWMAN: You're not going --

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1 you're getting loans. You have no idea how much
2 you're going to get? Is that what you're going to
3 tell us?

4 THE WITNESS: I'm not going to tell
5 you that. The amount of assets that are being
6 acquired for a typical transaction have a certain
7 degree of cash flow that will service a certain
8 amount of money raised.

9 So, predicated on what the cost of
10 those underlying assets is versus the amount of
11 money that can be serviced in the simplest form, the
12 difference would be what's available. That's the
13 absolutely basic most simplest form.

14 Whether Mr. McGinn follows that to the
15 letter, I'm not sure, but that's the way, -- simplest
16 form one could do it.

17 MR. NEWMAN: That explains the amount
18 available to lend?

19 THE WITNESS: Yeah.

20 MR. NEWMAN: Say there is \$100,000
21 available to lend. Does that mean you get \$100,000?

22 THE WITNESS: Well, that I don't know.
23 That's the part that I don't know -- Tim determines
24 that. Whether we're taking 100 percent of what's
25 available, I don't know the answer to that.

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1 MR. NEWMAN: How does he know what
2 you've done to warrant or justify the loan? You're
3 saying it's in lieu of salary or fees or direct
4 compensation.

5 How is it determined how your
6 performance, input, involvement equates to the
7 amount of money you're getting from the loan? How
8 is that determined?

9 THE WITNESS: Well, I guess it's a
10 market driven thing. How does one determine whether
11 my colleague next to me is worth \$100 an hour or
12 \$500 an hour.

13 There is a certain level of cash
14 available, as I said, predicated --

15 MR. NEWMAN: We know there is -- you
16 explained the money available. I'm trying to get
17 from point A to point B.

18 THE WITNESS: If there is a six-year
19 commitment to this, and the value of the parties
20 involved for that transaction over the next six
21 years is worth X, so if I'm getting, to use a
22 hypothetical, \$300,000 or Mr. McGinn is getting
23 \$300,000 over the next six years, you would equate
24 that to he's worth \$50,000 a year.

25 MR. NEWMAN: How about the term of the

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1 loan, the interest rate, how is that arrived at?

2 THE WITNESS: I don't know. It's
3 generally market driven. But, I --

4 MR. NEWMAN: Who determines the
5 interest rate?

6 THE WITNESS: Tim.

7 MR. NEWMAN: Is there any discussion
8 between the two of you about what the interest rate
9 is going to be?

10 THE WITNESS: No. I think it's
11 generally a fair market rate. That's the important
12 thing.

13 MR. NEWMAN: There are no instructions
14 or discussions between the two of you in terms of
15 interest rate you're going to be paying?

16 THE WITNESS: No.

17 MR. NEWMAN: How about the term of the
18 loan, the length of the loan, is there any
19 discussions about that?

20 THE WITNESS: Not that I ever recall,
21 no.

22 MR. NEWMAN: Is that because there is
23 never any intention on your part to repay these
24 loans?

25 THE WITNESS: No. The fact is that
Page 1044

1 if -- there are two circumstances. One is that if
2 the capital is needed back to the company, we repay
3 the loan, repay some portion of it.

4 If at the conclusion of the
5 transaction, for lack of a better word, a -- the
6 investors have been fully paid. B, there is no
7 longer any need to actually be working or servicing
8 it, then the loan becomes forgiven, and it's a
9 taxable event.

10 The length of time is not really the
11 important factor.

12 Ultimately, you're either going to
13 repay the loan or it's going to be forgiven and
14 becomes a taxable event. That's -- or the only two
15 circumstances I'm aware of.

16 MR. NEWMAN: How much money did you
17 receive approximately from TDM Cable in terms of
18 loans?

19 THE WITNESS: I think probably
20 \$600,000 is a fair number.

21 MR. NEWMAN: That money has not been
22 repaid?

23 THE WITNESS: No.

24 MR. NEWMAN: What did you do to
25 warrant a \$600,000 loan from TDM Cable?
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1 THE WITNESS: I'm basically being paid
2 as an officer of the company, and having the
3 liability of the company, and as a partner.

4 I have testified that in regards to
5 these specific transactions, I've not been involved
6 in the day-to-day -- I don't source the loans. I
7 don't structure the loans. I'm basically a partner.

8 MR. NEWMAN: Isn't TDM operated by
9 Mr. McGinn?

10 THE WITNESS: I think it's operated by
11 the three officers which --

12 MR. NEWMAN: Who makes the day-to-day
13 operating decisions?

14 THE WITNESS: Mr. McGinn.

15 MR. NEWMAN: What have you done on a
16 day-to-day basis for TDM Cable?

17 THE WITNESS: I testified three times
18 I don't do a lot. I'm basically an officer and
19 partner, which is why my compensation is what it is.

20 Same policies is in the end of the
21 business that I have run for years over at McGinn
22 Smith. We've had a partnership since 1978. And
23 we've always split things right down the middle. We
24 don't come in and say, Smith, what did you do today?
25 McGinn, what did do you?

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1 We have always taken commission.
2 Nobody has said, Smith, you did \$30,000 this month.
3 Deserve X. McGinn, you did nothing. You don't
4 deserve anything.

5 That's the way it's been for 30
6 something years. And I assume we'll continue that
7 way.

8 MR. NEWMAN: Do you draw a salary from
9 McGinn Smith brokerage?

10 THE WITNESS: I did. Yes.

11 MR. NEWMAN: How much was your salary?

12 THE WITNESS: Up until the last year,
13 it was approximately \$30,000 a month. Last year it
14 was closer to about \$15,000 a month.

15 MR. NEWMAN: Why weren't you paid in
16 the form of loans from your brokerage firm as
17 opposed to salary?

18 THE WITNESS: First of all, you don't
19 want to incur debt at the broker-dealer because
20 that's a liability that goes against your net
21 capital.

22 Number 2, I'm a salaried employee of a
23 C Corp. president and CEO, and certainly a more
24 traditional form of compensation would be salary,
25 which is what I take.
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1 MR. NEWMAN: That is a traditional
2 form of compensation for an officer --

3 THE WITNESS: For an operating
4 officer, yes.

5 MR. NEWMAN: TDM Verifier, how much in
6 the way of loans have you received from them?

7 THE WITNESS: I don't know.

8 MR. NEWMAN: Approximately?

9 THE WITNESS: When I threw the number
10 out I thought you were referring to everything. I
11 don't know.

12 MR. NEWMAN: What have you done to
13 justify or warrant the loans from TDM Verifier?

14 THE WITNESS: The answer is the same.

15 Repeatedly I said Mr. McGinn runs the
16 business and treats me as a partner. Outside the
17 liability and being an officer of the corporation, I
18 don't perform a lot daily.

19 MR. FRANCESKI: Did I hear you say the
20 \$600,000 figure you gave to Mr. Newman in response
21 to his question to TDM Cable is not limited to TDM
22 Cable?

23 THE WITNESS: Yes. I thought -- I
24 made a mistake. The question was in the recent time
25 frame, and I'm thinking within the last 12, 18

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1 months that's probably a number, but I don't know
2 what the number is.

3 MR. FRANCESKI: He specifically asked
4 you about TDM Cable and you said \$600,000.

5 THE WITNESS: Yes. When he asked me
6 about Verifier, my answer was I was thinking of them
7 together.

8 MR. NEWMAN: The point I was trying to
9 ask you about, whatever value the loan is, what you
10 did to justify that amount being lent to you?

11 MR. McCARTHY: Mr. Newman had asked
12 you regarding the percentage of the amount raised
13 that would be loaned to the officers. And there was
14 an issue where it wasn't quite the same amount. You
15 couldn't really answer the question; is that
16 correct?

17 THE WITNESS: Yes.

18 MR. McCARTHY: Is there a ratio of the
19 amount that is a fixed ratio? In other words, if
20 there is \$100,000 available to be loaned between the
21 three partners that are taking these loans, is
22 there -- is it 33 and a third percentage? Is the
23 40/20/10? Can you give us the ratio?

24 THE WITNESS: I'm sorry. Okay. I
25 assume the ratio, and you're referring to TDM where

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1 there are three partners, Rodgers, Smith and McGinn,
2 I'm assuming that it's a third, a third and a third.

3 I think we are all equal partners.

4 MR. McCARTHY: In previous deals where
5 it was just yourself and Mr. McGinn, were these
6 loans taken?

7 THE WITNESS: Yes.

8 MR. NEWMAN: And those deals, the
9 ratio would have been what?

10 THE WITNESS: 50/50.

11 MR. McCARTHY: Let's go off the
12 record.

13 (A short recess was taken.)

14 MR. ROWEN: Back on the record.

15 MR. RATTINER: I'll introduce
16 Exhibit 24.

17 (Confidential Private Placement
18 Memorandum was received and marked FINRA Exhibit 24
19 for identification.)

20 **Q. BY MR. RATTINER: Exhibit 24 is the**
21 **confidential private placement memorandum for TDMM**
22 **Benchmark Trust 09.**

23 **We'll use this as a deal that occurred, and**
24 **how we can relate it to what is raised and what is**
25 **loaned to the individual offices of the entity.**

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1 **Are you familiar with the TDMM Benchmark**
2 **Trust 09?**

3 A. I am.

4 **Q. Have you reviewed this private**
5 **placement memorandum?**

6 A. I believe I have, yes.

7 **Q. Do you sign off on it the after the**
8 **review?**

9 A. Physically, no.

10 **Q. Is there any evidence -- how do you**
11 **evidence your review?**

12 A. Just satisfied myself that I read it.

13 **Q. Who prepared the actual document?**

14 A. I believe Mr. McGinn.

15 **Q. Was there a law firm utilized as well?**

16 A. I don't know.

17 **Q. Here the cover of the document says**
18 **the total looking to be raised is 3 million?**

19 A. That's correct.

20 **Q. If we look at the chart in the middle**
21 **of the page, we'll see the expenses are 8 percent?**

22 A. Yes.

23 **Q. \$240,000?**

24 A. Yes.

25 **Q. Any other fees or expenses associated**

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1 with this deal?

2 A. I'm not familiar.

3 **Q. If we can turn to page 4, look at the**
4 **third paragraph, third paragraphs says, "The trust**
5 **will make a loan to TDMM. TDMM will purchase the**
6 **operating assets of Benchmark as well as the**
7 **contracts and total consideration of approximately**
8 **\$1.950 million and will expend approximately**
9 **\$600,000 in related acquisition costs utilizing the**
10 **loan from the trust."**

11 **Can you explain to us versus the 3 million**
12 **that is being raised these two numbers here and how**
13 **that correlates to your previous testimony in**
14 **regards to what we were discussing before?**

15 MR. FRANCESKI: If it does.

16 A. The million 950 seems to be the actual
17 contract, the asset purchase. 600,000 in related
18 acquisition costs, maybe for upgrades of the
19 equipment. But I don't know the answer.

20 **Q. Who received that 600,000?**

21 A. I don't know. If it's for upgrades or
22 actual costs incurred in improving the business or
23 expanding the business. Some vendor would get it.
24 I don't know exactly where that 600 is going, so I
25 can't answer the question.

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1 **Q. The remaining \$450,000, what happens**
2 **to that?**

3 A. There would be offering costs. You're
4 talking about roughly offering costs here of 3 --
5 \$240,000, 8 percent on \$3 million. Legal fees,
6 certainly part of it.

7 **Q. Where would we see the loans if**
8 **payable to you and Mr. McGinn in this summary here?**

9 A. I don't think you would.

10 **Q. Did you receive any loans from TDMM**
11 **Benchmark 09?**

12 A. I don't know.

13 **Q. Have you received any loans within the**
14 **last six months in general?**

15 A. From TDMM?

16 **Q. Regardless of the entity.**

17 A. I don't recall.

18 **Q. Do you know if Mr. McGinn received any**
19 **loans from TDMM Benchmark 09?**

20 A. I don't know.

21 MR. NEWMAN: You don't know if you've
22 gotten a loan in the last six months?

23 MR. FRANCESKI: I think it was 09.

24 MR. RATTINER: I said last six months
25 in my question.

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1 THE WITNESS: I don't recall.

2 MR. NEWMAN: When is the last loan you
3 received?

4 THE WITNESS: If I knew, I would tell
5 you. I don't know.

6 MR. NEWMAN: How would you find out?

7 THE WITNESS: Check bank records. I'd
8 asked Mr. McGinn. I would look at disbursements
9 that were made, and I would be able to tell you.

10 MR. RATTINER: I think we're done with
11 that exhibit.

12 **Q. BY MR. RATTINER: The firm encountered**
13 **a net capital deficiency in December of 2009; is**
14 **that correct?**

15 A. Yes.

16 **Q. Prior to December of 2009, had there**
17 **been any net capital deficiencies?**

18 A. Not that I'm aware of.

19 **Q. Were there any times where net capital**
20 **was tight in terms of on the verge of net capital**
21 **deficiency?**

22 A. By tight, within 25, \$30,000, I would
23 say yes.

24 **Q. Have you ever not paid an individual**
25 **based on a potential deficiency?**

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1 MR. FRANCESKI: Objection. An
2 individual?

3 **Q. BY MR. RATTINER: A representative of**
4 **the firm?**

5 A. I don't believe so. There may have
6 been a time with Mr. Lex (phonetic), who has a
7 demand that he be paid immediately upon receipt. We
8 generally don't pay that way. We tried to treat Mr.
9 Lex that way. He makes a lot of demands to be paid
10 immediately. And there may have been an instance
11 where we have told him he would be paid -- other
12 circumstances.

13 My recollection it was a time and --
14 sometime in the last three, four months where that
15 came up. And that's about the only time I can think
16 of.

17 **Q. Have you ever instructed anyone at the**
18 **firm not to pay the rent based on low funds?**

19 A. Well, I don't know specifically. We
20 always accrue it from a cash flow standpoint. I
21 wouldn't categorically say I've never said that. If
22 we don't have the cash, there may be a place I said
23 not to pay it.

24 **Q. How would that matter in terms of**
25 **accruing it versus paying it? How would that make a**

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1 **difference on your books?**

2 A. You would accrue it in terms of a
3 liability. But if you didn't necessarily have the
4 cash at that moment, you might ask that we not pay
5 it.

6 There are times I know we've been
7 behind in the rent at 45 Broadway in New York, 30,
8 60 days. And as far as I know we've always accrued
9 that liability.

10 But, I also know there were times we
11 were behind in the rent. Whether I specifically
12 instructed Mr. Shay or not, I don't know, but it's
13 not beyond the realm of possibility.

14 MR. RATTINER: I'll introduce
15 Exhibit 25.

16 (E-Mail was received and marked FINRA
17 Exhibit 25 for identification.)

18 **Q. BY MR. RATTINER: Exhibit 25 is an**
19 **e-mail exchange between Mr. Rees and yourself on**
20 **March 6, 2008.**

21 **If we look at the first e-mail, 6:03 p.m.,**
22 **we'll see an e-mail from yourself to Mr. Rees**
23 **stating, "Dave, do not pay Lex. I need the money to**
24 **meet a margin call."**

25 **You previously testified you did not trade**

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1 **on margin. What does this represent?**

2 A. I have no idea. We don't trade on
3 margin. I don't know what that possibly could be
4 referring to.

5 You can check the records of McGinn Smith &
6 Company.

7 **Q. Did you buy Deerfield Triarc on**
8 **margin?**

9 A. For the firm?

10 **Q. I'm not sure. You can tell us better**
11 **than I can tell you.**

12 A. I'm not sure I can. I don't honestly
13 recall the firm has ever -- I don't think the firm
14 ever even bought Deerfield. I'm really quite
15 perplexed by this.

16 **Q. On the e-mail bottom paragraph, "Tell**
17 **them that this is the president's account and he**
18 **wants some consideration."**

19 **Is that your personal account or the firm's**
20 **account?**

21 A. Let me take a moment to read the whole
22 thing.

23 I just can't imagine it's my account. I
24 don't really trade on margin. And not to be too
25 arrogant, I wouldn't be in need of meeting a margin

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1 call. Personal resources would not demand that.

2 The firm has never traded on margin. I'm
3 befuddled. I don't know what it is.

4 I don't what the relationship it has to
5 with Lex. Maybe it was -- maybe they are not
6 connected. Maybe that was just an entirely separate
7 question. But I -- I just don't know.

8 **Q. Do you recall a margin call of**
9 **\$360,000?**

10 A. At the firm level, no.

11 **Q. Even the LLCs, for that matter, did**
12 **the LLCs have brokerage accounts?**

13 A. Yes.

14 **Q. Did the LLCs own Deerfield Triarc?**

15 A. Yes.

16 **Q. Did they buy on margin?**

17 A. No. They bought the stock on a
18 private placement offering. Fully paid for. Stock
19 eventually went public. And they wouldn't be
20 related anyway.

21 Why would the LLCs be related to McGinn
22 Smith. They wouldn't have any relationship.

23 So I -- I just don't know. This is the
24 president's account.

25 **Q. How would any -- the second paragraph,**

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1 **there, "There is another \$75,000 available from Fin**
2 **relating to the sale of [REDACTED]'s UGMA account."**

3 **Who -- is [REDACTED] a customer of the LLCs?**

4 A. [REDACTED] is a customer. Now he's not. I
5 don't believe so. He's a customer of the firm. I
6 don't recall. None of it makes any sense.

7 MR. NEWMAN: Were funds from the LLCs
8 ever used to capitalize or go -- funneled into the
9 capital of McGinn Smith the broker-dealer?

10 THE WITNESS: No. Really drawing a
11 blank. The firm never purchased on margin. I don't
12 have -- I have a margin account, but I don't know --
13 or my wife does anyway. I don't think I've used it
14 in years and years and years.

15 I don't know what it means when it
16 says it's the president's account. Obviously I'm
17 the president. So, but, it must be some
18 unrelated -- maybe I'm referring to that -- the
19 account is a client of mine. I'm trying to throw my
20 weight around a little bit. None of it makes any
21 sense. Sorry.

22 I don't get the deal about Lex. I
23 don't know how that figures in.

24 The only thing I can think of was it
25 was an entirely separate situation. Maybe there was

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1 a disagreement between whether Lex was entitled to
2 be paid on something and, as I indicated a few
3 moments ago, Bill was a guy that tracked his
4 compensation pretty carefully and would be pretty
5 persistent about being paid promptly.

6 I'm just -- can't be of any help here.

7 Sorry.

8 **Q. BY MR. RATTINER: Prior to December**
9 **of 2009, did the firm report any net capital**
10 **deficiencies from 2006?**

11 A. I don't recall any, no.

12 **Q. Were you aware of any net capital**
13 **deficiencies that were unreported?**

14 A. No.

15 MR. RATTINER: I'll introduce
16 Exhibit 26.

17 (E-Mail was received about marked
18 FINRA Exhibit 26 for identification.)

19 **Q. BY MR. RATTINER: For the record,**
20 **Exhibit 26 is an e-mail from yourself to Mr. McGinn**
21 **and Mr. Livingston dated February 24, 2009. The**
22 **subject is Friday's payroll.**

23 Take a few minutes to review that e-mail.

24 (Witness complying)

25 A. I'm familiar with it. I'm sorry.

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1 There is a bunch more here.

2 **Q. Yes.**

3 A. Well, I'm familiar with when we
4 basically, in order to not be in violation of net
5 capital, did not pay what we considered principals
6 of the firm. And those are the people that you see
7 up above.

8 I'm not familiar that there was any time
9 that we didn't meet net capital. Obviously we were
10 struggling in this particular month, but we must
11 have found a way to meet it.

12 I don't know if we injected capital or what
13 have you. But, I would obviously have to review the
14 statement for that month.

15 But, obviously what we did up above was to
16 not pay people. Therefore, we wouldn't drain the
17 cash or the -- which would enhance the net capital.
18 Those people were not paid.

19 My recollection it happened on maybe at
20 least one other time during 2009. But, those were
21 the solutions, so that we wouldn't be in violations.
22 I don't know of any time that we were in violation
23 other than December, notwithstanding we took some
24 action to prevent it.

25 **Q. When you go through this e-mail here,**

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1 **was this plan enacted? Were these individuals not**
2 **paid?**

3 A. Yes.

4 **Q. You accrued these liabilities?**

5 A. No. We never paid it. They didn't
6 get paid.

7 **Q. What is the current status of this?**

8 A. They are all principals. They agreed
9 they wouldn't be paid.

10 **Q. It's still owed?**

11 A. No.

12 **Q. Is there a written documentation that**
13 **evidenced the fact they forewent those moneys?**

14 A. No. They are all -- look at the
15 names. They are all principals of the corporation.

16 I had a conversation and said we're in net
17 capital difficulty. I can't pay you this month.
18 That's it.

19 It was not accrued as a liability. They
20 were never paid.

21 **Q. This is a monthly or weekly or**
22 **bi-weekly payment?**

23 A. That looks like a bi-monthly or
24 every-two-weeks payment.

25 **Q. This happened at least one other time**

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1 **you said?**

2 A. I don't know if it happened with all
3 the parties. I think there was at least one other
4 time when Mr. Carr, Guzzetti, Koljay, Livingston,
5 probably not Guzzetti. I think there was one other
6 time when myself and virtually everyone on there but
7 maybe Maher (phonetic) or Guzzetti was involved.

8 **Q. How was this communicated to these**
9 **individuals?**

10 A. I believe I called them on the
11 telephone.

12 **Q. You received their consent?**

13 A. Yes.

14 **Q. So, this was not -- it was not paid?**
15 **You're saying it's not owed?**

16 A. That's correct.

17 **Q. Because of the verbal conversation?**

18 A. That's correct.

19 **Q. There is no contract or agreement in**
20 **place between you and these individuals stating they**
21 **wouldn't come after you with any recourse for these**
22 **amounts owed?**

23 A. No. They are all principals of the
24 firm. They agreed for the benefit of the firm they
25 wouldn't take the salary.

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1 **Q. If we go down a few lines, six lines,**
 2 **you have a statement here, "We can probably**
 3 **manipulate that for this month, but if no solution**
 4 **is found in the next couple of weeks, we'll have to**
 5 **report a net capital violation and more" than**
 6 **likely -- "more likely than not consider closing our**
 7 **doors.**

8 **What was the solution?**

9 A. I don't remember. I don't know if I
 10 put in capital.

11 I put capital into the firm a couple times
 12 in 2009. I don't know if that was one of them. I
 13 don't know if we made some sales. I don't know if
 14 we bought some preferred. There may be -- any one
 15 of those might have been a possible solution.

16 Obviously the tone of the paragraph is we
 17 were under a fair amount of stress. And I was
 18 trying to get across to my two partners that was
 19 something we needed to be very much aware of and
 20 focused on.

21 **Q. What did you mean by the word**
 22 **"manipulate"?**

23 A. I just -- doing the types of things
 24 that we're talking about. Whether we took salaries
 25 away from people or we found ways to get money into

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1 could have covered a lot of ground.

2 MR. NEWMAN: How long had there been a
 3 difficult financial condition at McGinn Smith?

4 THE WITNESS: Well, I think the -- we
 5 basically in 2008 business went south for lots of
 6 reasons, not the least of which was the general
 7 overall condition of the financial markets.

8 The brokerage business in general,
 9 obviously we were going through very difficult times
 10 in our business. And we were not immune from that.
 11 So that had gone down.

12 I think it's fair to say that one of
 13 the areas that we had always added to the revenues
 14 and profitability of the firm was in the private
 15 placements. And that that business was getting more
 16 difficult for lots of reasons. Deal flow itself was
 17 grinding to a halt. People were inclined not to do
 18 deals. The ability to raise the money was getting
 19 difficult because of the climate.

20 And probably unique to McGinn Smith
 21 was that the performance of the LLCs, which had, as
 22 we got into 2008, as we all know, we had differed
 23 some interest payments there. I think it's fair to
 24 say that that had some impact on both clients and
 25 brokers in terms of doing deals.

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1 the firm.

2 **Q. Did you confer with your FIN-OP to see**
 3 **if this was acceptable with regard to the net**
 4 **capital rules?**

5 A. I don't believe I did. If people
 6 don't get compensated and there is no contractual
 7 agreement to pay them, and not one of those people
 8 has a contract, I can't imagine why I would need a
 9 FIN-OP to tell me I could do that.

10 **Q. These are all salaries you're saying?**

11 A. Yes.

12 MR. NEWMAN: Mr. Shay was your FIN-OP
 13 at this time?

14 THE WITNESS: I don't think he was. I
 15 think Brian joined us in March, maybe April. Dave
 16 Rees would have still been the FIN-OP.

17 MR. NEWMAN: Is there any reason he's
 18 not copied on this e-mail?

19 THE WITNESS: No. I -- it says per my
 20 earlier e-mail. So, it would suggestion maybe I
 21 gave him an e-mail earlier. No, there is no reason.

22 MR. NEWMAN: When you say we've been
 23 living on the edge for some time, are you referring
 24 to the financial condition of McGinn Smith?

25 THE WITNESS: Yes. Although that

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1 We saw our business drop off
 2 dramatically. Same time, like in any business,
 3 expenses go up every year. Virtually every cost of
 4 the firm had gone up. Salaries, people had -- we
 5 tried to basically hold those salaries in check, but
 6 there is always some place you have to increase
 7 salaries.

8 Overall business expense, running from
 9 insurance to -- pick your poison. What doesn't go
 10 up every year.

11 Expenses are going up and revenues are
 12 going down, so it was aggravating through 2009 and
 13 we were, as this memo would suggest, I was extremely
 14 concerned about it.

15 **Q. BY MR. RATTINER: Bottom of the**
 16 **e-mails you go on to say, "Other than ourselves,**
 17 **we'll also have to figure out how to pay those**
 18 **employees whose checks we held."**

19 **Does that contradict where you said it was**
 20 **forgiven?**

21 A. I don't know. I don't think it does.
 22 I don't know who the -- who I'm actually referring
 23 to.

24 Other than ourselves, I don't think I
 25 considered just myself and Mr. McGinn.

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1 As far as I know, I don't think we ever
2 paid a single one of those parties. In fact, I'm
3 quite convinced.

4 I'm not sure whether I was thinking that
5 maybe at some point we would pay those employees or
6 not. I don't know. But I am quite certain we never
7 did.

8 **Q. Other than payments to these**
9 **individuals, what other payments did the firm forego**
10 **on and not book as a liability?**

11 A. From a cash flow standpoint, I think,
12 like any business, we probably were managing our
13 cash. We may have -- we're accruing expenses, but
14 maybe not paying them. They could run the gamut.

15 Generally, the ones you were most concerned
16 about were health care, because you didn't want to
17 be in a position that you had not paid that.

18 Obviously compensation to those that were not in a
19 position to forego it, which basically was every
20 employee but the ones listed there. And so I don't
21 know.

22 We could have either put capital in, could
23 have gotten more revenues than I had anticipated.
24 But, we managed to do it.

25 I don't know what our net capital was in

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1 February 2009. But I know from most of 2009 we
2 never ran above 250, which was about \$130,000 in
3 excess. And I think there was times when we were
4 close to 150, which put us at 30 at excess, which
5 obviously was not a lot of margin.

6 I don't believe there was a time other than
7 this December of 2009 when we had a disagreement in
8 terms of whether legal bills should be accrued at
9 the firm or whether they should be accrued
10 elsewhere, because they were going to be paid from
11 elsewhere. And I testified last time that was an
12 argument and discussion Mike and I had when he was
13 at our offices. We had another young woman there.

14 **Q. Stacy?**

15 A. Two on one and they won. I lost.

16 **Q. Things like rent, was the rent past**
17 **due for 99 Pine Street throughout 2009?**

18 A. I don't think so. There was a --
19 there was a question of assessments that we had not
20 paid and we had challenged.

21 If you had the pleasure of getting to the
22 back of our offices, you may have seen the roofs
23 that leaked and the variety of other problems that
24 we had with that floor.

25 At some point, after numerous

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1 communications to management, we told them we were
2 not going to -- we might have challenged we weren't
3 going to pay the rent, period. But, I think we did
4 not -- we withheld the assessment, whatever they
5 call it, and we never got any push back from them as
6 to whether that was owed.

7 We pointed out the money we had to spend to
8 repair roofs. We had to at one point we had a full
9 exhaust fan in our offices taking out some form of
10 odor that had been created from that little upstairs
11 roof. And there was all sorts of mold up there.
12 And we had an exhaust fan in the office for five
13 weeks.

14 There were lots of things we were not in
15 agreement with management.

16 **Q. How about 45 Broadway, are there rents**
17 **in arrears there?**

18 A. Yes.

19 **Q. How much was in arrears?**

20 A. We may have been -- I don't think we
21 were in arrears more than 90 days. I think we were
22 in arrears 60 days for probably a good part of the
23 year.

24 **Q. That was \$27,000 a month?**

25 A. Approximately, yeah.

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1 **Q. How was that reflected on the books of**
2 **McGinn Smith?**

3 A. As far as I know, it was accrued.

4 MR. NEWMAN: "Tim's deals have kept us
5 alive by something our profit." Tim McGinn?

6 THE WITNESS: Yes.

7 MR. NEWMAN: The deals you're
8 referring to?

9 THE WITNESS: TDMs, those provide a
10 lot of revenue for the firm.

11 The general brokerage business was not
12 going well for us. Most of Wall Street also.
13 That's what I meant by that remark.

14 MR. NEWMAN: "Fronting our profit."

15 THE WITNESS: Just simply we take --
16 we take money out of the deals and give them to the
17 firm. I'm not sure what -- there is anything other
18 to that than me.

19 Where are we?

20 MR. NEWMAN: "We've been living on the
21 edge. Tim's deals have kept us alive by fronting
22 our profit."

23 It's about halfway down.

24 THE WITNESS: Just simply means when
25 we close a deal, we take the profit out immediately

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1 and pay it to the firm.

2 MR. NEWMAN: What would be the profit
3 you're referring to?

4 THE WITNESS: There was both
5 underwriting fees, which we are aware of, and there
6 might have been additional profit in the deal that
7 in better years might have gone to either the
8 principals or elsewhere, and that we may have
9 directed to the firm.

10 I don't know that for a fact. But
11 that's certainly a plausible explanation.

12 **Q. BY MR. RATTINER: Would that be loans**
13 **you're referring to?**

14 A. No. That would be moneys not loaned,
15 but paid in terms of -- an injection of capital, if
16 you will.

17 **Q. For what premise? In this case the**
18 **entity raised more than they needed. They brought**
19 **their asset. They -- you got your underwriting fee.**
20 **That excess went to the BD?**

21 A. Directed to the BD from the principals
22 of the entity.

23 **Q. They issued direct money to the BD for**
24 **what?**

25 A. Equity capital.

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1 So, in effect, we are recognizing the

2 revenues in the form of capital raised to look at
3 every profit that an enterprise has and suggest
4 there has to be a specific duty or service performed
5 is just -- isn't the way business and capitalism
6 work.

7 The fact is there are times when your
8 margins are high and times they are low. And the
9 difference is excess profits.

10 We chose, as best I can interpret this, and
11 seems to make some sense, is that we directed some
12 of those moneys into the firm.

13 MR. NEWMAN: McGinn Smith was
14 interchangeable with the issuer?

15 THE WITNESS: No. The principals of
16 the issuer, which were Tim and Dave and Matthew,
17 were also principal in McGinn Smith. The issuer
18 wasn't interchangeable, but the principals basically
19 chose to direct money into the firm in terms of
20 reinforcing the capital the firm. I think that's --
21 I'm not sure where that's --

22 **Q. BY MR. RATTINER: Would Matt keep his**
23 **piece. He's not a principal of the firm?**

24 A. Correct.

25 **Q. Where would his profit go?**

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1 **Q. They got common stock or what?**

2 A. Directed I believe as simply fee
3 income. Gave it to the firm for investment banking
4 services or whatever as opposed -- they didn't issue
5 any more common stock. It would be reflected on the
6 books and records as income.

7 **Q. This would be excess of the fee**
8 **disclosed in the PPM?**

9 A. It would be a fee from our profit that
10 was -- that you referred to and we are directing it
11 in as a fee that's being paid by -- for services
12 performed by Tim and Dave, if you will, as
13 principals. Therefore, the firm is recognizing it
14 as income.

15 **Q. I have a hard time understanding. For**
16 **the profit piece, you haven't done anything to**
17 **generate a profit yet. You just raised the funds,**
18 **paid the fees, bought the asset.**

19 There is excess. The excess in some cases
20 was given as loans. In this case it's not. It's
21 given to the BD in lieu of fees or in lieu of
22 payment to the principals?

23 A. Well, when you say you don't
24 understand the concept of profit, profit is revenues
25 in excess of expenses.

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1 A. It would simply be an expense of the
2 deal, and Matthew would have to share in whatever
3 was left, minus whatever was directed to the firm.

4 **Q. He would receive a separate check?**

5 A. No.

6 **Q. He would forego those profit?**

7 A. He would forego those profits.

8 **Q. How is that reflected on the books of**
9 **the BD?**

10 A. As income, fee income.

11 MR. RATTINER: We'll enter this next
12 exhibit.

13 (Letter dated February 2, 2010 was
14 received and marked FINRA Exhibit 27 for
15 identification.)

16 **Q. BY MR. RATTINER: Exhibit 27 in front**
17 **of you is two separate documents. The first**
18 **document is date the February 2, 2010. It's a**
19 **letter from Randy Pearlman at FINRA to**
20 **Mr. Franceski. And you'll see the firm's response**
21 **signed by Joe Carr dated February 9, 2010 addressed**
22 **to Mr. Pearlman.**

23 Take a look at that.

24 (Witness complying)

25 **Q. BY MR. RATTINER: What was your**

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involvement in this response?

A. This first letter we're talking about, which I think was the September 30 letter which emanated from your offices, was asked for a variety of a loan documents. And my recollection was that Mr. Franceski e-mailed that to me and maybe even sent me a hard copy, which I think he generally does.

I believe I then turned that over to either Brian Shay or Brian Cooper asking them to search for the documents.

After that, I really didn't have any involvement, other than I -- some of these documents were then produced. I signed them at some point.

I believe my testimony last week when I was in here, this issue came up, was that I remembered signing a bunch of documents a couple of months ago.

Subsequent to that, the -- we identified -- in fact, I think it was at that same session I was part of the interview, was that Mr. Carr went back to the offices and determined that, in fact, those documents had been produced on November 2 I believe is the date.

So, my recollection of signing some documents, although I don't remember specifically

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which documents probably makes some sense, because we were in February and go back a couple months, that's around November, I guess.

The -- my understanding was is that simply we were to search for the documents. If we didn't have them, we were to produce them.

We did that. There was no intent to mislead FINRA. Simply we were reestablishing the documents we didn't have.

I think Mr. Carr's notation here that the key element, at least as far as we're concerned, was that the accounting entry was, in fact, accurate. And that nobody had drawn up -- after searching for the documents, couldn't find it, so they were attempting to get the documentation back up to speed.

I believe Mr. Carr then, on determination by Mr. Cooper or Mr. Shay that those documents were not available, produced them -- but that -- probably Joe's assistant Kimberly probably put documents in front of me. I signed them. And assuming Mr. Carr turned them over to Mr. Shay or maybe Mr. Carr sent them back. I don't know.

Q. Other than today's conversation, did you tell FINRA these documents were not created at

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the time of the loans?

A. I think my recollection was on the last OTR on February whatever, 2, 3, 4, this question arose the next day, and there was some resistance by my attorney for me to discuss that. So I -- we had a little discussion with Mike on all that. But I -- my recollection is the one question I did answer was that I thought it was November 2, because I think that was the one piece of evidence that I was aware of.

Q. Look at Exhibit Number 6. If you can, turn to page -- we're going to be looking at the one you signed yourself, which is the top one. If we can turn to page 4.

Exhibit 6 is the promissory notes?

A. Between TDM Cable and David L. Smith.

Q. On page 4, "In witness thereof, this note has been executed and delivered on the date specified above by the duly authorized representatives of the maker."

What is the date on the document that that paragraph corresponds to?

A. I don't know if it does. The only date on the document is October 2.

I'm not an attorney. Generally I would

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guess this is a form letter referring to the date that would normally be there and there is no date.

This is apparently a form note, but the only date I see on the document is October 2, 2006, which is obviously not the day I signed it.

Q. Why is that so obvious?

A. Because I just testified to the fact we didn't find these documents.

They were create on November 2. So, sometime between November 2 and when these were sent to your offices must have been when I signed them.

Q. Prior to your testimony, how would the staff have been aware of that?

MR. FRANCESKI: Objection. This witness can't testify to what the staff is or is not aware of.

Q. BY MR. RATTINER: When did you inform the staff that you signed this document on or after November 2009, however the document was dated October 2, 2006?

MR. FRANCESKI: Objection. Asked and answered.

Do it again.

A. The only time that I believe that I testified to the staff was at the OTR back in early

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1 February. When I indicated, not specifically
2 because I didn't know specifically, indicated I
3 signed a bunch of documents. Whether these were
4 part of that, I don't know for certain.

5 There is probably a good chance to believe
6 that would be the case, because that was documents
7 that were -- but I don't -- the document was given
8 to me, to be honest with you, I probably signed it.
9 That's -- I testified to that before. These
10 documents are often handed to me with a nice big
11 arrow to sign here, and that's what I have done.

12 I cannot testify then or today whether the
13 documents that I indicated that I signed a couple
14 months ago when I was testifying included this. One
15 might conclude that, but I can't say that with fact.

16 **Q. The response dated February 9, 2010,**
17 **Letter Number C, Exhibit 27, what do you mean by,**
18 **"No representation has been made to FINRA concerning**
19 **the date upon which each document was signed"?**

20 A. Where is that?

21 MR. FRANCESKI: This is Mr. Carr's
22 letter.

23 MR. NEWMAN: Do you know what that
24 statement means?

25 THE WITNESS: Yeah. Fairly simple.

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1 If the document was not signed on the date, the
2 explanation is the document had not been drafted at
3 that time.

4 I don't know what other conclusion to
5 come to. We didn't find the document. There is
6 only one or two choices. They are lost or never
7 drafted. So, we replaced them.

8 I don't know if -- I guess Mr. Carr
9 responded by saying no representation has been made.
10 I didn't -- wasn't my letter and I didn't draft the
11 other one. That's -- I think that's the obvious
12 conclusion one could draw.

13 **Q. BY MR. RATTINER: Did you review the**
14 **letter prior to it being submitted by Mr. Carr?**

15 A. I don't believe so.

16 MR. NEWMAN: I want to go back to the
17 fall of last year.

18 You're aware that FINRA asked for loan
19 documentation pertaining to all these various
20 related parties affiliated loans; is that correct?

21 THE WITNESS: Yes.

22 MR. NEWMAN: You knew at the time you
23 were signing the various loan documents that had
24 been identified in Mr. Carr's letter that those loan
25 documents were going to be provided to FINRA staff

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1 in response to a request for information?

2 THE WITNESS: What I don't know, Mike,
3 is what I said, when I signed the documents, I don't
4 know if they refer directly to this.

5 I clearly knew that was a request of
6 FINRA. Mr. Franceski sent me the letter. I turned
7 it over to either Cooper or Shay. I don't recall
8 who.

9 They, as I understand it -- basically
10 my involvement stopped then. They searched for the
11 notes, didn't find them, we then documented those
12 entries that were in place.

13 Those notes were at some point placed
14 in front of me. I don't know if they were these
15 specific ones, but, as I said, reasonable people
16 could conclude they were. That's what the issue
17 was.

18 So -- but that's really it. In my
19 understanding, there was absolutely zero attempt to
20 mislead anybody. We found we were deficient in our
21 documentation. Mr. Carr corrected it. We signed
22 the notes. And we sent them to you.

23 MR. NEWMAN: Going back to my
24 question, do you understand when you were searching
25 for the loan documents and you -- when you were

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1 actually signing notes or loan documents that were
2 given to you that those documents were going to be
3 provided to the FINRA staff in response to the
4 information they were seeking?

5 THE WITNESS: Again, I don't recall
6 signing this specific one, but logic would suggest
7 yes.

8 MR. NEWMAN: We're not talking about a
9 specific loan.

10 THE WITNESS: I knew that documents
11 had not been found. And that they were going --
12 going to be prepared and then at some point I was
13 going to sign them.

14 I don't recall when I specifically
15 signed had them. I don't think it's relevant to
16 anything. The fact is I did sign them. They went
17 back.

18 The fact I don't remember when I did
19 it I don't think it's -- who cares.

20 MR. NEWMAN: My question is, did you
21 understand when you were signing these different
22 documents, these loan documents, that the documents
23 that you were signing were going to be provided to
24 FINRA staff?

25 THE WITNESS: Yes, sure.

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1 MR. NEWMAN: Mr. Carr in his letter to
2 the staff has identified several loans in which you
3 were the payor. There are six loans. Mr. Carr has
4 identified in which you were the payor, which
5 were -- signing date of those loans was subsequent
6 to September 30, 2009.

7 THE WITNESS: Yes.

8 MR. NEWMAN: You don't dispute that,
9 correct?

10 THE WITNESS: No. The only thing I am
11 disputing, and I don't think it's relevant is I
12 don't recall when I signed them and what they were.
13 I'm disputing I signed them subsequent to the FINRA
14 request. That's obvious to me and everything else.

15 MR. NEWMAN: You can't pinpoint the
16 precise date you signed them?

17 THE WITNESS: Exactly. But it was
18 clearly after the letter. And the best of my
19 knowledge, and I'm getting this secondhand, but the
20 notes were produced on November 2. It had to be
21 subsequent to the November 2. That's the only thing
22 I can tell you with any certainty.

23 MR. NEWMAN: You understand being the
24 president of a brokerage firm for 28 years --

25 THE WITNESS: A lot of years.

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1 MR. NEWMAN: You understand that your
2 firm and you are obligated, required to provide
3 full, complete and accurate information to FINRA
4 staff upon request?

5 THE WITNESS: Absolutely. And I think
6 we did that.

7 MR. NEWMAN: Did you have any concerns
8 at the time that you were signing these documents,
9 knowing they were going to be provided to FINRA
10 staff, that FINRA staff may be confused, misled as
11 to the date on which the -- the notes you were
12 signing had been actually signed?

13 THE WITNESS: No.

14 MR. NEWMAN: Did you ever tell --
15 sitting here today, do you have any concerns that
16 the documents that you provided to FINRA staff in
17 the fall of 2009, last fall, in response to an
18 information request misled the staff in any way as
19 to when the documents would have been signed and
20 created?

21 MR. FRANCESKI: Let me make sure I
22 understand what you're asking. Any concerns
23 today --

24 MR. NEWMAN: The staff may have been
25 misled based on the form of the documents provided

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1 in late 2009?

2 MR. FRANCESKI: Not that the staff was
3 misled, but they may be?

4 MR. NEWMAN: Yes.

5 Do you have any concerns sitting here
6 today?

7 THE WITNESS: As a result of the
8 conversation previously you brought it up, yeah.
9 But at the time I wasn't concerned. I thought we
10 were memorializing documentation we hadn't done and
11 we were doing it.

12 The evidence of the loans, we provided
13 it. Different time frame, I guess.

14 MR. NEWMAN: How were you able to --
15 six or seven documents -- six loan documents that
16 are identified here, how was it you were able to
17 remember, recreate the actual terms of the loans
18 several years later?

19 THE WITNESS: I didn't. I didn't
20 draft those documents. I testified that my
21 recollection is that I -- at or about the time I
22 signed a bunch of document, that's all I remember.
23 I didn't dictate the terms.

24 I can assume that those terms were
25 dictated by Mr. McGinn. And that he remembered

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1 them, because he did it the first time.

2 **Q. BY MR. RATTINER: What were the**
3 **interest rates of the loans you signed back in**
4 **November?**

5 A. I don't remember. I guess is I didn't
6 look at the front of the loan document.

7 I testified I generally just signed the
8 signature line. So, I don't remember.

9 MR. NEWMAN: I think you testified
10 earlier today you received market rate?

11 THE WITNESS: Generally they're in the
12 market rate, and that's obviously subject to
13 interpretation. It could be -- if it was a secured
14 loan, it might be as low as 6 percent or as high as
15 12 percent.

16 **Q. BY MR. RATTINER: How about as low as**
17 **3 percent?**

18 A. That would surprise me. Between
19 parties, maybe that's what they chose. I wouldn't
20 have -- I wouldn't have guessed that.

21 MR. NEWMAN: Do you think it's a fair
22 rate, 3 percent?

23 THE WITNESS: Between the company
24 who -- and the principals who own the company, I
25 mean, I'm not sure the rate is all that relevant,

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1 but.	1 attorney wants to.
2 MR. NEWMAN: Why isn't it relevant?	2 THE WITNESS: I don't have anything.
3 THE WITNESS: Because the parties who	3 MR. FRANCESKI: I have nothing at this
4 are borrowing the money are the same parties that	4 time.
5 own the company. It's a conceptual rate between the	5 MR. RATTINER: Off the record.
6 same parties. No one is being harmed by a low rate.	6 (Ending time: 3:55 p.m.)
7 No one is being advantaged by a high rate.	7
8 If we paid a high rate to ourselves or	8
9 low, what's the difference. The same parties are	9
10 paying and receiving.	10
11 The only time one would be concerned	11
12 with a particular rate would be if there is one	12
13 party being disadvantaged over another. Since they	13
14 are the same parties, I don't think see that to be	14
15 the case.	15
16 MR. NEWMAN: If you're repaying a loan	16
17 at 3 percent versus 10 percent, it's your personal	17
18 loan, you're going to be paying more interest at	18
19 10 percent versus 3?	19
20 THE WITNESS: But to myself. That's	20
21 my point.	21
22 MR. NEWMAN: Would you consider this	22
23 to be an arm's length transaction?	23
24 THE WITNESS: No. Parties are the	24
25 same. The people that own the company are making	25
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1 the loan to the people that own the company.	1 REPORTER'S CERTIFICATE
2 MR. NEWMAN: Do you have any concerns	2
3 about these loan transactions?	3 I, JILL A. PRAML-BUSSANICH, CSR No.
4 THE WITNESS: People do it all the	4 XI01807, Certified Shorthand Reporter, certify;
5 time. Only time one would raise the concern is	5 That the foregoing proceedings were taken before me
6 someone outside the interested parties being	6 at the time and place therein set forth, at which
7 disadvantaged or advantaged.	7 time the witness was put under oath by me;
8 Since the parties are the same, in my	8 That the testimony of the witness and all objections
9 own judgment, there is -- it's not terribly	9 made at the time of the examination were recorded
10 relevant.	10 stenographically by me and were thereafter
11 Q. BY MR. RATTINER: How about from the	11 transcribed;
12 perspective of the investors at TDM Cable Funding?	12 That the foregoing is a true and correct
13 A. We're the equity owners. The only	13 transcript of my shorthand notes so taken.
14 time investors would be concerned is that if he	14 I further certify that I am not a relative or
15 didn't get his agreed upon rate in capital back.	15 employee of any attorney or of any of the parties,
16 He's not an equity player.	16 nor financially interested in the action.
17 If I was an equity player, I might be	17 I declare under penalty of perjury under
18 concerned, but we're the equity players.	18 the laws of New Jersey that the foregoing is true
19 MR. NEWMAN: We'll take a break.	19 and correct.
20 (A short recess was taken.)	20 Dated this 17th day of February, 2010.
21 MR. RATTINER: Back on the record.	21
22 At this point we have no further	22
23 questions for you.	23
24 We'll give you the opportunity, if you	24 JILL A. PRAML-BUSSANICH,
25 want, to make any clarifying statements or your	25 CSR NO. XI01807
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