UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION *Plaintiff,* vs. McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC, TIMOTHY M. McGINN, AND DAVID L. SMITH, GEOFFREY R. SMITH, Individually and as Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, LAUREN T. SMITH, and NANCY McGINN, *Defendants,* LYNN A. SMITH and NANCY McGINN, *Relief Defendants. and* GEOFFREY R. SMITH, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, *Intervenor.*	Case No. 1:10-CV-457 (GLS/CFH))

NOTICE OF SEVENTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR AN ORDER (A) DISALLOWING PREFERRED INVESTOR PAPER CLAIMS AND (B) APPLYING RECOVERY OFFSET TO PREFERRED INVESTOR CLAIMS (INVESTMENT FUND REDEMPTIONS)

PLEASE TAKE NOTICE that upon the Seventh Claims Motion of William J. Brown, as Receiver, for an Order (A) Disallowing Preferred Investor Paper Claims and (B) Applying Recovery Offset to Preferred Investor Claims (Investment Fund Redemptions) ("Motion"), Phillips Lytle LLP will move before the Hon. Christian F. Hummel, United States Magistrate Judge, United States District Court for the Northern District of New York, James T. Foley - U.S. Courthouse, 445 Broadway, Albany, New York 12207-2924,

on July 18, 2019 at 9:30 a.m., seeking an Order to be entered approving the Motion. No oral argument is requested.

PLEASE TAKE FURTHER NOTICE that objections, if any, to the relief requested in the Motion must be made in writing, and should be filed and served upon the undersigned at the address listed below in accordance with the Federal Rules of Civil Procedure and the Local Rules for the United States District Court for the Northern District of New York.

PLEASE TAKE FURTHER NOTICE that if no responses are timely filed and served with respect to the Motion, the Court may enter an Order granting the Motion, disallowing the Preferred Investor's paper claims, and applying the Recovery Offset to certain Preferred Investor's Receivership Claims without further notice or opportunity to be heard offered to any party.

Dated: May 22, 2019

PHILLIPS LYTLE LLP

By /s/ Catherine N. Eisenhut
William J. Brown (Bar Roll #601330)
Catherine N. Eisenhut (Bar Roll #520849)
Attorneys for Receiver
Omni Plaza
30 South Pearl Street
Albany, New York 12207
Telephone No. (518) 472-1224

and

One Canalside
125 Main Street
Buffalo, New York 14203
Telephone No.: (716) 847-8400

Doc #01-3672982.1

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

vs.

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, AND
DAVID L. SMITH, GEOFFREY R. SMITH,
Individually and as Trustee of the David L. and
Lynn A. Smith Irrevocable Trust U/A 8/04/04,
LAUREN T. SMITH, and NANCY McGINN,

Defendants,

LYNN A. SMITH and
NANCY McGINN,

Relief Defendants. and

GEOFFREY R. SMITH, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

Case No. 1:10-CV-457
(GLS/CFH)

SEVENTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR AN ORDER (A) DISALLOWING PREFERRED INVESTOR PAPER CLAIMS AND (B) APPLYING RECOVERY OFFSET TO PREFERRED INVESTOR CLAIMS (INVESTMENT FUND REDEMPTIONS)

William J. Brown, as Receiver ("Receiver"), by his counsel, Phillips Lytle LLP, moves (the "Motion") for an Order (A) disallowing the Preferred Investors' paper claims listed on Exhibits A-1 through A-3 to the Motion and (B) applying the Recovery Offset to

certain Preferred Investor's Receivership Claims (each as defined in the accompanying Declaration), and respectfully represents as follows:

The Receiver files the Motion to request entry of an Order (A) disallowing the Preferred Investors' paper claims listed on Exhibits A-1 through A-3 to the Motion and (B) applying the Recovery Offset to certain Preferred Investor Claims as shown on Exhibit B based on the accompanying Memorandum of Law and Declaration of William J. Brown, as Receiver ("Declaration"), each dated May 22, 2019.

RELIEF REQUESTED

The Receiver requests that the Court enter an Order substantially in the form attached as Exhibit C ("Order") (A) disallowing the Preferred Investors' paper claims listed on Exhibits A-1 through A-3 to the Motion and (B) applying the Recovery Offset to certain Preferred Investor Claims as set forth on Exhibit B to the Motion, together with such other and further relief as the Court deems just and proper.

The Receiver reserves all rights to object on any other basis to the claims of all investors or claimants, including the Preferred Investors.

Dated: May 22, 2019

PHILLIPS LYTLE LLP

By /s/ Catherine N. Eisenhut
William J. Brown (Bar Roll #601330)
Catherine N. Eisenhut (Bar Roll #520849)
Attorneys for Receiver
Omni Plaza
30 South Pearl Street
Albany, New York 12207
Telephone No. (518) 472-1224

and

One Canalside
125 Main Street
Buffalo, New York 14203
Telephone No.: (716) 847-8400

Exhibit A

Exhibit A-1

Duplicate Paper Claims

Claim No.	Description of Investment	Amount of Claim of Receiver's Website	Amount of Paper Claim
5784D & 5789P	McGinn Smith Transaction Funding	$25,000.00	$25,000.00
5785D & 5790P	McGinn Smith Transaction Funding Corp.	$75,000.00	$75,000.00
5782D & 5788P	FIIN Secured Senior Subordinated Notes due 12/15/2008	$125,000.00	$125,000.00
5781D & 5787P	FIIN Secured Senior Subordinated Notes due 12/15/2008	$75,000.00	$75,000.00
5783D	McGinn, Smith Capital Holdings	$50,000.00	$50,000.00
6727D	TDM Verifier 09	$45,118.75	$45,118.75
6743D	TDM Verifier 09	$9,023.75	$9,023.75

Exhibit A-2

Discrepant Paper Claims

Claim No.	Description of Investment	Amount of Claim of Receiver's Website	Amount of Paper Claim
5795D & 5791P	TDM Verifier Trust 09 10% Contract Certificates due 12/31/11	$13,535.63	$15,000.00
6658D	TDM Luxury Cruise Trust 07	$92,500.00	$100,000.00

Exhibit A-3

Other Paper Claims

Claim No.	Description of Investment	Amount of Paper Claim	Reason for Disallowance
5781D-5785D	CMS Financial Services	$75,000.00	Claim for investment in non-Receivership Entity
5781D-5785D	One City Center	$20,000.00	Claim for investment in non-Receivership Entity
6727D	Exchange Blvd. 2	$15,000.00	Claim for investment in non-Receivership Entity
6727D	SAI Trust 00	$47,486.61	Claim for investment in entity excluded from Receivership pursuant to Plan of Distribution
6727D	Unspecified	Unspecified	No liability claim
6743D	Exchange Blvd. 2	$15,000.00	Claim for investment in non-Receivership Entity
6743D	Unspecified	Unspecified	No liability claim
6659P	TAIN Secured Junior Notes due 12-15-2009	$100,000.00	No liability claim
6660P	TAIN Secured Junior Notes due 12-15-2009	$100,000.00	No liability claim
6661P	TAIN Secured Junior Notes due 12-15-2009	$100,000.00	No liability claim
6662P	Third Albany Income Notes, LLC	$116,000.00	No liability claim

Exhibit B

Exhibit B

Recovery Offset

Receivership Claim No.	Aggregate Amount of Receieivership Claims	Approximate First Distribution on Account of Preferred Investor Claims	Total Value of Four Funds Notes Exchanged for Fund Investments	Return on Fund Investments (10.7%)	Recovery Offset Amount	Adjusted First Distribution
6727D	$45,118.75	$4,511.88	$183,000.00	$19,581.000	$202,581.00	($198,069.13)
6743D	$9,023.75	$902.38	$305,000.00	$32,635.000	$337,635.00	($336,732.63)
6658D	$92,500.00	$9,250.00	N/A	N/A	$291,349.75	($282,099.75)
6163D - 6165D	$100,741.80	$10,074.18	$705,000.00	$75,435.000	$780,435.00	($770,360.82)
5781D-5785D, 5795D	$363,535.63	$36,353.56	$239,000.00	$25,573.000	$264,573.00	($228,219.44)

Exhibit C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION *Plaintiff,* vs. McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC, TIMOTHY M. McGINN, AND DAVID L. SMITH, GEOFFREY R. SMITH, Individually and as Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, LAUREN T. SMITH, and NANCY McGINN, *Defendants,* LYNN A. SMITH and NANCY McGINN, *Relief Defendants. and* GEOFFREY R. SMITH, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, *Intervenor.*	Case No. 1:10-CV-457 (GLS/CFH))

ORDER APPROVING SEVENTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR AN ORDER (A) DISALLOWING PREFERRED INVESTOR PAPER CLAIMS AND (B) APPLYING RECOVERY OFFSET TO PREFERRED INVESTOR CLAIMS
(INVESTMENT FUND REDEMPTIONS)

Upon the Seventh Motion of William J. Brown, as Receiver, for an Order (A) Disallowing Preferred Investor Paper Claims and (B) Applying Recovery Offset to Preferred Investor Claims (Investment Fund Redemptions); and notice of the Motion having been given to the Securities and Exchange Commission, each Preferred Investor listed on Exhibits A-1, A-2, A-3, and B to the Motion, by first class mail, and all parties who have

filed a Notice of Appearance in this action by ECF, and all creditors of the McGinn, Smith entities and other parties in interest via the Receiver's website, which notice is deemed good and sufficient notice; and the Court having deemed that sufficient cause exists; it is therefore

ORDERED, that the Motion is approved, and it is further

ORDERED, that each of the Paper Claims listed on Exhibits A-1 through A-3 to the Motion is disallowed; and it is further

ORDERED, that the application of the Recovery Offset to reduce the distributions to Preferred Investors is approved as set forth on Exhibit B to the Motion, and the rights of the Receiver to object on any other basis to the claims of all investors or claimants, including the Preferred Investors, are expressly preserved.

Dated: ____, 2019

____

HON. CHRISTIAN F. HUMMEL

Doc #01-3663134.1

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

---x

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, AND
DAVID L. SMITH, GEOFFREY R. SMITH,
Individually and as Trustee of the David L. and
Lynn A. Smith Irrevocable Trust U/A 8/04/04,
LAUREN T. SMITH, and NANCY McGINN,

Defendants,

LYNN A. SMITH and
NANCY McGINN,

Relief Defendants,

- and -

GEOFFREY R. SMITH, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

---x

Case No. 1:10-CV-457
(GLS/CFH)

DECLARATION OF WILLIAM J. BROWN, AS RECEIVER, IN SUPPORT OF SEVENTH CLAIMS MOTION FOR AN ORDER (A) DISALLOWING PREFERRED INVESTOR PAPER CLAIMS AND (B) APPLYING RECOVERY OFFSET TO PREFERRED INVESTOR CLAIMS <u>(INVESTMENT FUND REDEMPTIONS)</u>

William J. Brown, as Receiver, declares, under the penalty of perjury, pursuant to 28 U.S.C. § 1746, as follows:

1. I am the Receiver of McGinn, Smith & Co. Inc., et al. ("MS & Co.") appointed by the Court in this action pursuant to the Preliminary Injunction Order dated July 26, 2010 (Docket No. 96).

2. I make this Declaration in support of the Receiver's Seventh Claims Motion ("Motion") for an Order (a) disallowing the Preferred Investors' paper claims listed on Exhibits A-1 through A-3 to the Motion and (b) applying the Recovery Offset to certain Preferred Investor Claims (each as defined below).[1]

PROCEDURAL BACKGROUND

3. MS & Co. was a broker-dealer registered with the Securities and Exchange Commission ("SEC") with its headquarters in Albany, New York from 1981 to 2009. From 2003 through 2010, the broker-dealer was owned by David L. Smith ("Smith"), Timothy M. McGinn ("McGinn"), and Thomas E. Livingston.

4. On April 20, 2010, the SEC filed a Complaint initiating the above-captioned action (Docket No. 1). Also, on April 20, 2010, this Court granted a Temporary Restraining Order (Docket No. 5), which, among other things, froze certain assets of the above-captioned Defendants and Relief Defendants, and appointed the Receiver as temporary receiver with respect to numerous entities controlled or owned by Defendants McGinn and Smith, including those listed on Exhibit A to the Preliminary Injunction Order entered in this action (Docket No. 96) (collectively, the "MS Entities").

5. On July 26, 2010, following a hearing, the Court entered an order granting the SEC's Motion for a Preliminary Injunction and appointing the Receiver as

[1] Exhibits A-1 through A-3 and Exhibit B have been redacted to contain only claim numbers which have previously been provided to each investor in accordance with this Court's previous direction that investor names remain confidential.

receiver, pending a final disposition of the action ("Preliminary Injunction Order") (Docket No. 96).

6. On August 3, 2010, the SEC filed an Amended Complaint (Docket No. 100). On June 8, 2011, the SEC filed a Second Amended Complaint (the "Complaint") (Docket No. 334). On February 17, 2015, the Court issued its Memorandum-Decision and Order (Docket No. 807) ("MDO") granting the SEC's motion for summary judgment. The Court entered judgments in favor of the SEC in 2016 (Docket Nos. 835, 836, 837).

7. Generally, McGinn and Smith "orchestrated an elaborate Ponzi scheme, which spanned over several years, involved dozens of debt offerings, and bamboozled hundreds of investors out of millions of dollars." MDO at 7. McGinn and Smith raised over $136 million between 2003 and 2010 in over twenty unregistered debt offerings, including the Four Funds -- FAIN, FEIN, FIIN, and TAIN -- and various Trust Offerings, by representing that investor money would be "invested," when instead it was "funneled" into various entities owned or controlled by McGinn and Smith. That money was then used to fund unauthorized investments and unsecured loans, make interest payments to investors in other entities and offerings, support McGinn's and Smith's "lifestyles," and cover the payroll at MS & Co. MDO at 7.

THE FOUR FUNDS

8. The Four Funds—FAIN, TAIN, FIIN, and FEIN— were single-purpose, New York limited liability companies formed between September 2003 and October 2005. The private placement memoranda ("PPMs") for each of the Four Funds were substantively identical, and each offered $20 million worth of Notes, with the exception of TAIN, which offered $30 million. The offerings had three tranches of Notes,

which paid quarterly interest of 5% to 10.25%, and promised a return of principal at maturity in one, three or five years. MDO at 10.

9. McGinn and Smith engaged in a course of conduct and dealings that were contrary to the PPMs issued for the Four Funds. First, investor proceeds from the Four Funds were used to purchase contracts from pre-2003 trusts for the purpose of redeeming or making interest payments to investors. Second, the Four Funds used investor money to directly invest in, rather than purchase investments from, affiliates. Many of the affiliated investments provided no cash flow to the Four Funds and were ultimately considered worthless. Finally, proceeds from the Four Funds were funneled through McGinn Smith Transaction Funding Corporation ("MSTF") and then used to pay MS & Co.'s payroll. MDO at 11-12.

10. In late 2007, David Smith received an e-mail from David Rees, MS & Co.'s comptroller, which showed a $48.8 million deficit in the Four Funds. Notwithstanding that deficit, Smith continued to solicit new investments in the Four Funds. MDO at 12. In January, 2008, Smith sent a letter to investors in the Four Funds notifying investors that interest payments on the junior tranches of Notes were being reduced from 10.25% to 5%. *See* Letter attached hereto as Exhibit A. By April 2008, interest payments on the junior tranches of Notes were eliminated entirely. *See* Letter attached hereto as Exhibit B. The reduction, and subsequent elimination, of interest payments were attributed by McGinn and Smith to the collapse of various debt and credit markets and the "sub prime mess." In October 2008, David Smith sent a letter to all Note holders in the Four Funds, outlining a restructuring plan which extended the maturity dates of the Notes, reduced

interest payments for all tranches, and forfeited all future fees due to MS & Co. *See* Letter attached hereto as Exhibit C; MDO at 12-13.

FUND INVESTMENTS

11. In late 2007, at the same time that the problems within the Four Funds first publicly emerged, the Preferred Investors were permitted to exchange their virtually worthless Four Funds Notes for par value investments in a third-party, independently controlled Delaware limited partnership investment fund ("Fund"), which was a successful investment fund not controlled by Smith or McGinn and expressly not a part of their Ponzi scheme.[2] The Fund was a substantial investment fund which (unlike MS & Co.) conducted extensive due diligence, closely monitored its investments, and conducted itself as a legitimate business. In 2013, the Fund exited from its investments and in 2014, the Fund made its final distributions to investors.

12. Investors in the Fund, including the Preferred Investors, received a substantial return of one hundred percent of their principal investment plus a net rate of return of approximately 10.7% (collectively, the "Fund Recoveries").[3] The Preferred Investors began receiving distributions from the Fund in 2008, when other Four Funds investors saw their interest payments cease. While the Preferred Investors were given par value for the exchange of their virtually worthless Four Funds Notes for Fund investments and eventually recovered handsomely from the Fund, similarly situated Four Funds investors now stand to recover only a small percentage of their principal investment.

13. Three of the Four Funds — FAIN, FEIN, and TAIN — held investments in the Fund in 2007. When the Preferred Investors exchanged their Four Funds

---

[2] The Fund was voluntarily dismissed from this action per Order entered on June 9, 2010 (Docket No. 68).

[3] This data was provided to me by the former manager of the Fund.

Notes, they received a corresponding portion of a Four Funds investment in the Fund. In certain instances, the Preferred Investors were able to exchange FIIN Notes for a Fund investment held by FEIN or TAIN through a series of intercompany accounting transfers.

14. Five Preferred Investors received Fund Recoveries in the aggregate amount of $1,876,573.75. The exchanges of the Preferred Investors' Four Funds Notes for investments in the Fund took place between September 2007 and December 2007. The Preferred Investors hold claims against MS & Co. on account of other investments which were not exchanged for investments in the Fund (collectively, the "Preferred Investor Claims") in the aggregate amount of $610,919.93.

15. The Receiver's Claims Website (defined below) includes all of the "Preferred Investor Claims". The Preferred Investor Claims have been adjusted for pre-Receivership distributions of principal and interest like all other investor claims. The Preferred Investor Claims, however, have not been adjusted to account for the Fund Recoveries.

CLAIMS PROCEDURE

16. On March 9, 2012, in my capacity as Receiver, I filed a Motion ("Claims Procedure Motion") (Docket No. 466) for entry of an Order approving, among other things, the Receiver's proposed procedure for the administration of claims against the MS Entities.

17. On March 27, 2012, the Court entered an Order granting the Claims Procedure Motion (Docket No. 475), which was subsequently amended by an Order dated April 17, 2012 ("Claims Procedure Order") (Docket No. 481). Each investor and known creditor of the MS Entities was mailed on May 1, 2012 an Access Notice describing the

claims process and enclosing (i) Notice of the Claims Bar Date and Claims Procedure and (ii) a Claim Form. A confidential password providing access to the Receiver's Claims Website at www.mcginnsmithreceiver.com ("Claims Website") was also provided. If an investor or creditor agreed with the description and amount of their claim(s) as listed on the Claims Website and the claim(s) were not listed as disputed, contingent or unliquidated, the investor or creditor did not need to take any further action. All other investors and creditors needed to timely file a paper claim before the bar date of June 19, 2012, as further described in detail on the Claim's Website. I listed each Preferred Investor's claim as "Disputed."

18. The Claims Procedure Order established June 19, 2012 ("Bar Date") as deadline for creditors and investors to file claims against the MS Entities.

19. In accordance with the Claims Procedure Order, nearly six hundred creditors and investors timely filed paper claims prior to the Bar Date. In addition, more than 3,127 claims of investors and creditors were included on the schedules posted by the Receiver on the Claims Website in accordance with the Claims Procedure Order.

20. The Receiver conducted an initial review of the paper claims timely filed by creditors and investors in accordance with the Claims Procedure Order and determined it was necessary to establish a reserve as to investor claims totaling approximately $23,617,190 since those claims have been listed by the Receiver as disputed, contingent or unliquidated.

PAPER CLAIMS

21. Certain of the Preferred Investors submitted paper claims ("Paper Claims") because they did not agree with the claims granted by the Receiver and listed on the Claims Website and presumably also because the Claims Procedure Order required a

claimant to file a Paper Claim to have their claim considered if it had been categorized as disputed, contingent, or unliquidated on the Receiver's Claims Website. The Preferred Investors submitted a total of twenty Paper Claims, which are described on Exhibits A-1, A-2 and A-3 to the Motion. The Paper Claims can be categorized as Duplicate Claims, Discrepant Claims, Non-Receivership Claims, No Liability Claims, and Excluded Claims, as described in further detail in the Memorandum of Law in Support of the Receiver's Motion for an Order (a) Disallowing Preferred Investor Paper Claims and (b) Applying the Preferential Payment Offset.

PLAN OF DISTRIBUTION PROCESS

22. On December 30, 2015, the Receiver filed a Motion (Docket No. 847) ("Plan Distribution Motion") to seek approval of (i) a plan of distribution of assets of the MS Entities to investors ("Plan of Distribution"); and (ii) interim distributions to investors with allowed claims scheduled or timely filed in accordance with the Claim Procedure Order.

23. On October 31, 2016, the Court entered a Memorandum-Decision and Order (Docket No. 904) ("Plan Distribution Order") granting the Plan Distribution Motion, overruling objections, approving the Plan of Distribution, and allowing the Receiver to make interim distributions as set forth in the Plan Distribution Motion.

24. Among other things, the Plan of Distribution provides for a reserve for disputed claims to allow the Receiver to make initial distributions, but to also provide for funds to be reserved until any objections to disputed claims can be heard and decided by final order of the Court. As of April 15, 2019, $6,578,150.28 has been distributed to investors with allowed claims as a First Distribution. I estimate that investors will receive,

at most, a recovery ranging from approximately 13.5% to 21.7%, depending upon the outcome of certain claim objections. *See* Third Written Status Report of the Receiver (Docket No. 925).

25. The Plan of Distribution provides that all investor claims would be calculated by using the "Net Investment" methodology, i.e., the claim amount is equal to the amount of the initial investment made less any distributions received prior to the appointment of the Receiver, including any distributions of principal or interest. Plan of Distribution, Art. IV. The Plan of Distribution further provides for a collateral recovery offset ("Collateral Recovery Offset"), where distributions made on account of investor claims will be reduced on a dollar-for-dollar basis to the extent the investor has received a recovery from a source other than the Receivership in connection with their claimed loss. *Id.* Art. II.

CLAIMS MOTIONS

26. On September 21, 2017, in my capacity as Receiver, I filed a Motion (Docket No. 937) ("First Claims Motion") to seek disallowance of certain filed paper claims that were duplicative of the corresponding claims granted by the Receiver. On November 9, 2017, I filed a Statement (Docket No. 957) in furtherance of the First Claims Motion, adjourning the First Claims Motion with respect to those duplicative investor paper claims filed by investors whose Receiver-granted claims have been disputed by the Receiver. On December 28, 2017, the Court entered an Order granting the First Claims Motion and disallowing the duplicative paper claims other than with respect to those filed by investors with disputed claims (Docket No. 966).

27. On February 15, 2018, in my capacity as Receiver, I filed a Motion (Docket No. 974) ("Second Claims Motion") to seek disallowance of certain filed paper claims for which there is no basis for payment in the books and records of MS & Co. On April 13, 2018, the Court entered an Order granting the Second Claims Motion and disallowing the paper claims.

28. On March 19, 2018, in my capacity as Receiver, I filed a Motion (Docket No. 984) ("Third Claims Motion") to seek disallowance of certain claims of former MS & Co. brokers. On May 4, 2018, I filed a Reply (Docket No. 1002) to the Response of Frank Chiappone (Docket No. 995) to the Third Claims Motion. On March 6, 2019, the Court entered an Order granting the Third Claims Motion and disallowing the brokers' claims.

29. On July 6, 2018, in my capacity as Receiver, I filed a Motion (Docket No. 1009) ("Fourth Claims Motion") to seek disallowance of paper claims filed by certain preferred investors and to apply a preferential payment offset to the distributions to be made to the preferred investors. On August 27, 2018, I filed a Reply (Docket No. 1020) ("Reply") to the Opposition filed by certain preferred investors (Docket No. 1019) to the Fourth Claims Motion.

30. On October 16, 2018, in my capacity as Receiver, I filed a Motion (Docket No. 1025) ("Fifth Claims Motion") to seek to apply a preferential payment offset to the distributions to be made to preferred investors One City Center Associates and Burton Fisher.

31. On March 6, 2019, the Court entered an Order granting the Fourth Claims Motion and the Fifth Claims Motion, and disallowing the Preferred Investors' paper

claims and applying the preferential payment offset (Docket No. 1042) ("Preferential Offset Order").

32. On April 25, 2019, the Receiver filed a Motion (Docket No. 1052) ("Sixth Claims Motion") to seek to apply a preferential payment offset to the distributions to be made to investor Lesley Levy and equitably subordinating the claims of Lesley Levy.

APPLICATION OF THE PREFERENTIAL PAYMENT OFFSET

33. To calculate the Recovery Offset, I first used the books and records of MS & Co. to determine the principal amount of Four Funds Notes that each Preferred Investor exchanged for a corresponding investment in the Fund. I then applied the net rate of return of 10.7% to the principal amount of the Fund investment received in exchange for the Four Funds Notes. The Recovery Offset represents the aggregate distribution received by each Preferred Investor by the time the Fund wound up in 2014, comprised of the principal amount of each Preferred Investor's Fund investment plus the net return on the Fund investment. The Recovery Offset was then applied to the estimated first distribution for each Preferred Investor's aggregate Preferred Investor Claims using the Rising Tide methodology, as shown in Exhibit B to the Motion.

34. The Preferred Investor holding Receivership claim number 6658D ("Preferred Investor 6658D") held an initial investment in the Fund that does not appear to have resulted from exchanges of MS & Co. investments. The books and records of MS & Co. indicate, however, that in September 2007, Preferred Investor 6658D increased by at least $250,000 their initial Fund investment as a result of an exchange of FIIN and TAIN Notes. Accordingly, I have calculated Preferred Investor 6658D's Recovery Offset to be the

amount of distributions received by Preferred Investor 6658D from the Fund attributable only to the incremental increase in the Fund investment that occurred in September 2007.[4]

NOTICE

35. In connection with service of the Motion and all accompanying papers, including this Declaration, I will cause to be mailed to each of the Preferred Investors listed on Exhibits A-1 - A-3 and B to the Motion, a copy of the Motion and related pleadings.

Dated: May 22, 2019

/s/ William J. Brown
William J. Brown

Doc #01-3663709.2

[4] This data was provided to me by the former manager of the Fund.

Exhibit A

January 15, 2008

____
____
____

Re: $_____ Third Albany Income Notes, LLC – Internal Investment # _____
Registration: ____________________

Dear: _________

As an investor in one of the following mezzanine debt funds (FUNDS) managed by McGinn, Smith Advisors (MSA), we thought that it was important to communicate with you the general status of the funds, our view on the current credit markets and their impact on your fund, how MSA views the markets going forward, and steps that we are considering to address the present credit conditions.
The FUNDS include:

- First Independent Income Notes, LLC
- First Excelsior Income Notes, LLC
- Third Albany Income Notes, LLC
- First Advisory Income Notes, LLC

Each of the LLC's has three series of notes that have been issued: Senior Notes, Senior Subordinated Notes, and Junior Notes, all with varying interest rate coupons and maturities. In each of the LLC's, the notes starting with the Senior down through the Junior have a primary call on the assets and cash flow of the various investments in each of the LLC's. Thus, the Senior Notes receive all of the income and asset value of the entire LLC until satisfied, followed by the Senior Subordinate Notes, and finally the Junior Notes are entitled to asset coverage and cash flow only after the Senior and Senior Subordinate Notes are satisfied. You are an investor in the Junior Notes.

MSA is the sole equity member of all the FUNDS, and therefore as the managing member is responsible for all the decisions impacting the business of the FUNDS. MSA has a fiduciary responsibility to manage the FUNDS in a manner consistent with the investment goals and to best preserve the assets of the FUNDS.

Over the last several months, a number of investors have inquired as to the impact on the FUNDS due to the turmoil, and in some cases collapse, of the various debt and credit markets, as a result of the sub-prime mortgage debt crises that started to boil over in July of 2007. As the impact has grown, and in our judgment the crisis shows less and less probability of being resolved quickly and easily, MSA has begun an effort to get

GOVERNMENT
EXHIBIT
GB4

MGS0011910

ahead of events and formulate strategies that will protect the value of the LLC's and your investment in them.

While the media, including newspapers and financial publications, have provided a daily accounting of the credit market crisis and the subsequent financial impact, I realize some of you may not be in a position or have the interest to follow what has been taking place, so I have provided a brief summary. First, it should be understood that the credit crisis is primarily a result of the major Wall Street investment banks and the largest commercial banks in the country developing and marketing a variety of investment instruments built on a shaky foundation of sub prime mortgages. Sub prime mortgages can be defined as those mortgages offered to borrowers with spotty credit, mortgages that required too little equity, mortgages on properties in less desirable areas or where the supply of housing was growing beyond the demand, and where the terms of the mortgage often emphasized "teaser rates" or interest only requirements early in the amortization schedule. While these types of mortgages carry a high risk of default, the early years of the recent housing boom produced unusually low rates of default and created a false sense of security for the mortgage lenders.

In pure destructive power, the sub prime mess has become Wall Street's version of Hurricane Katrina. It has reeked havoc on the nation's largest brokerage firm, Merrill Lynch, and biggest bank, Citigroup, which have announced billions of dollars in losses and have fired their celebrated CEOs. Dozens of similar companies in the mortgage business have folded completely. As stunning as today's losses are, more carnage lies ahead. Wall Street banks are holding tens of billions in risky securities on their books, and no one seems to have any idea what they are worth. The follow on crisis is that confidence in the value of all securities, but mostly the smaller and more illiquid securities, is destroyed. Investors are reluctant to pay any price because they are not sure what the real value is, and if they are forced to sell them in the future they may do so only by slashing prices. Thus, investors go on strike and refuse to bid any price. In addition, many of these securities were purchased with debt. As prices go down, lenders require more security through increased equity. To get equity and raise cash, investors have to sell the illiquid securities. With no real markets, prices are driven forever lower, and a vicious cycle is started. In a high number of cases, there is simply no price that investors are willing to pay, and the value of the securities must be further marked down, generally based on some theoretical model put together by the investment bankers. That is why Merrill Lynch predicted a $4.5 billion sub prime loss for the third quarter, then jolted investors and analysts three weeks later by announcing that its real default was $7.9 billion, or 76% more than the initial estimate. And just last week, Merrill Lynch again announced an increase in their losses to over $15 billion dollars, approximately 3 ½ times their original estimate. And Merrill is not alone. Losses on CDO's, asset backed securities, and other structured products include announced losses by Citigroup ($9.8 billion, followed by an additional $24 billion dollars as of January 14th). UBS ($4.4 billion), and Morgan Stanley ($3.7 billion). These conditions, aside from producing real and enormous losses for the holders of these debt instruments are creating a far more difficult problem for the capital markets in general. The aforementioned lack of liquidity, or the inability to sell ones investments, causes enormous difficulty throughout the investment cycle. For example, companies who are looking to raise equity either in the private or public markets often borrow capital in the form of short term debt in order to

"bridge" the time between the present and when they can complete their equity offering, a time that can easily take up to one year. This type of credit has become increasingly scarce as lenders are withdrawing from the markets until they have a better level of comfort regarding risk and their own financial condition. Merger and acquisition activity that is often financed with debt has dramatically decreased. The last six months has seen daily announcements of the withdrawal of financings for these types of transactions. Meanwhile, the funds at the heart of the situation known as structured investment vehicles or SIV's – need to find investors for billions of dollars coming due in the next six to twelve months. However, as ratings firms come out with reports that lower the ratings of these type of securities, this causes a further depression in the value of those investments and a large number of buyers are now precluded from investing because their corporate indenture prevents them from investing in lower rated securities. Holders of the SIV notes are bearing the brunt of this fallout because they face two options: they risk losing money if the SIV sells assets at a loss in order to meet their capital needs, including the payment of maturing notes, or try to provide liquidity for the SIV's by buying more of its debt. The FUNDS in which you are invested have some of those similar problems.

The impact on the FUNDS from the aforementioned credit crisis has primarily been on liquidity and the upcoming need to sell assets in the next year to pay off maturing notes. While there have been losses in the FUND's investments, we have a limited and manageable exposure to the real estate markets, including the mortgage market. Our real concern, is the present and future ability to sell our present investments at a value that is needed to meet the FUND's obligations. When managing the FUND's assets, MSA always had to be mindful of meeting the future liquidity needs. It was always anticipated that those needs would be able to be met through a combination of having some of the assets mature at approximately the same time as its liabilities, that some of the assets would be invested in public securities with a ready market, that the FUNDS would have the ability to raise new capital from either present or new investors, and that some of the assets would be able to be sold to other investors. The credit crisis has impacted all of those strategies, and unless the markets dramatically improve over the next year, we will face the same challenges that we do today.

As mentioned previously, there presently is no market at fair prices that exist for non-public debt securities. Investors are now looking for the safest most liquid securities until the crisis is better understood or is resolved. In addition, many of the investments in these companies are dependent on new financings to have the capital to pay off their existing debt to the FUNDS. Several of our investments fall into this category. For example, we have an investment in several of the FUNDS in a company that provides print and advertising financing for the independent film industry. For the last nine months they have had a commitment from an investment bank to raise approximately $10 mm in equity, contingent on the company's ability to secure a credit line of $10-15 mm. That capital is to be used to retire their obligation to the FUNDS. To date, the company has been unable to procure the credit line, and thus the equity raise has been put on hold. They have no source of funds to repay us until that capital raise is completed. Thus, we have no choice but to extend their debt, probably past the time when our obligations to our debt holders are due. Another example is a company that we have financed that is in the business of evaluating and providing capital to companies based on the worth of the

company's intellectual property. A major investment bank has given the company a term sheet that will provide $750 million of financing over the next five years. However, the original structure called for a substantial portion of that capital to be provided up front and that would be used to repay our debt. The investment bank is now only willing to provide the capital on a staggered basis over the next five years, with the result that while we are confident of being repaid in full, it is not likely that we will be paid out until the fourth and fifth year of their commitment. Again, a decision that will impact our liquidity for next year.

MSA has determined that we need to be very proactive over the next year to be in a position to overcome these credit market conditions and the lack of liquidity now present. If we have learned anything in being in the business for over 30 years, it is that a financial crisis is never solved in a short time or without substantial pain to investors. We don't believe that this one will be any different. We believe that the credit markets are likely to continue to be under very severe pressure and that a two to three year time horizon is the minimum for a return to normality.

MSA has spent the last several months reviewing a variety of strategies that will address the present problems and give our investors liquidity within a reasonable time frame from what they had originally expected.

First, any strategic approach has to recognize the capital structure of the FUNDS that calls for assets and cash flow to be pledged in their entirety to the most senior class of securities. Thus, as notes mature next year we need to be in a position to first retire the senior one year notes. We are confident that we will be in a position to maintain the current level of interest, and as long as conditions do not materially worsen; we will be able to retire the debt on a timely basis. The second class of securities issued by the LLCs is the Senior Subordinated Notes. Here too, as long as present conditions remain relatively stable, we believe that the current rate of interest will be maintained. However, the ability to retire the entire issue at the same time as the Senior notes is most unlikely. Our present thinking is that these notes will have to be extended for two-three years in order to establish the capital resources to pay off the debt. The third class of securities, the junior notes, present the biggest challenge because they are subordinate to the claims on assets and cash flow of the senior securities. In order to meet the obligations of the Senior securities, the FUNDS have to pledge all of their cash flow to them, **thus at the present time the rate of interest is being reduced to 5% on the Junior notes until such time as some of our investments return to a timely cash flow or we can refinance our debt or raise additional capital.** MSA is presently working on plans to provide the needed liquidity and help some of our investments restructure their debt in order to meet their obligations.

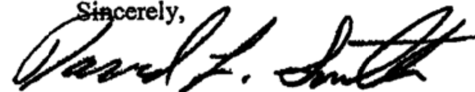
MSA is making a significant contribution to increasing the cash flow for all of the Funds by suspending the commissions due to McGinn, Smith & Co., the advisory fee due to MSA, and the administrative fee due to McGinn, Smith Capital Holdings. These fees for the combined Funds amount to $2,827,500, annually.

Over the next year we will hopefully be able to get a better handle on how to evaluate our investments. This difficulty to evaluate remains the number one problem for credit markets today. During this summer's credit crunch, more than 80% of investors in bonds tied to the mortgage market said they had trouble obtaining price quotes from their bond dealers. "Michael Vranos, recently told investors in his large hedge-fund company, Ellington Management Group, that he was suspending investor redemptions because he couldn't figure out values for some of the fund's investments". "There is no way to determine values that would be simultaneously fair both to investors redeeming from the funds and to investors remaining in the funds", he wrote in a September 30th letter. Recently the Federal Reserve, in a move to make credit markets more liquid, announced a plan that is designed to enable banks to borrow money directly from the Fed at below-market rates. However, there can be no assurances that this plan will ease the current credit and liquidity crisis.

In conclusion, MSA believes that by trying to get out in front of the problem of having sufficient liquidity by next year when the FUNDs notes become due, they are both doing the right thing and will lesson the anticipated challenges a year from now. **The Senior and Senior Subordinated note holders will maintain current interest payments, while Junior note holders will have their interest reduced to 5%.** Over the course of the year we will communicate with you regarding the progress and plans that we are making to address the liquidity needs for next December. Our obvious goal is first preservation of your investment and second to maximize cash flow to the FUNDs in order to have sufficient cash to meet the interest payments.

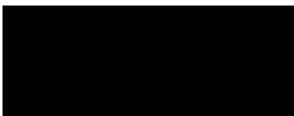
If there are any questions concerning this communication, please contact your McGinn, Smith & Co. representative.

Sincerely,



David L. Smith
Managing Member
McGinn, Smith Advisors

Exhibit B



Investment Bankers • Investment Brokers

6 Executive Park Dr.
Clifton Park, NY 12065
518-348-0060
Fax 518-348-0107
www.mcginnsmith.com

April 11, 2008

Re: $25000 First Independent Income Notes, LLC – Internal Investment # 1800
Registration:

Dear

In our communication of January 15, 2008 we outlined for you the negative impact that the present credit crisis resulting from the sub-prime mortgage collapse was having on First Independent Income Notes (FIIN), LLC. We provided the background leading to the crisis and reasons why we felt it was likely to worsen before the markets were able to stabilize. We cited the tremendous losses that the major commercial and investment banks were being forced to take and that these losses were spreading to institutions worldwide and to credit markets far beyond the mortgage business. We mentioned that the major impact was on market liquidity and that debt holders were being forced to sell securities and investments at prices below fair market value in an effort to deleverage their balance sheets and to meet forced margin calls. Unfortunately, all the problems that we cited have become more acute, and by now the daily news brings repeated announcements of the adverse effects the crisis is having on the general economy and of major financial institutional failures such as the collapse of Bear Stearns, Inc.

The central theme for all fixed income investments and managed funds of such investments has been the inability to refinance their investments and thus be forced to cease or eliminate interest payments and distributions. Leading the way in this category has been the area of Auction Rate Securities (ARS) which are long term municipal bonds, corporate bonds, and preferred stocks that are traded at auctions that set the instrument's interest rate and ultimately the price of the security. The market in total is somewhere around $320 billion and it is estimated that $80 billion or 25% of the market has recently failed. These investments were often marketed as substitutes for money market accounts with a higher yield. Many businesses invested their excess cash in these instruments and now find themselves not only not receiving interest, but with no access to their cash as well. The good news is that the majority of the underlying investments are still paying interest, but the funds just are not able to refinance them at rates that allow them to pay investors their principal.

Since our last communication with you, two of our investments have been forced to eliminate their dividend or cease distributions. One was a result of their loss of refinancing from a bank that was a major lender to Countrywide Credit, the country's largest sub-prime mortgage lender and who suffered major losses from that relationship and had to withdraw their commitment. The other was a holder of only AAA mortgages and who in November assured us that they were at limited risk and the dividend was safe. In February, they were forced to sell most of their portfolio to meet margin calls and suffered losses that have wiped out their earnings

GOVERNMENT
EXHIBIT

GB7

MGS0011554

and their ability to pay their dividend. This in turn has put increased pressure on our cash flow and our ability to meet our obligations. Consequently, we are being forced to eliminate the interest payment to the Junior Subordinated debt holders for this quarter.

In keeping with our goal to solve the longer term problem of capital preservation we have been working on two fronts. First, we are working with individual companies within our portfolio to help them gain access to capital that would allow them to operate during this crisis. I am pleased to report, that in two of our investments we have been successful and that I am confident that later in the year both of these companies will be successful in obtaining permanent financing that will bring liquidity back to our investment.

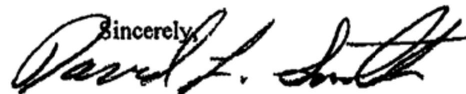
The second area is to restructure the Funds, or at least the Junior Subordinated debt, in order to have a plan that will provide investors with an eventual exit. The issues here are complex because of the need to preserve the rights of the Senior and Senior Subordinated Noteholders. We have engaged securities counsel to assist us with the restructuring, but they have not yet been willing to provide a legal opinion as to a particular course of action. One of the ideas that we are pursuing is that instead of a total restructuring that will carry the risk that the Senior Noteholders might find objectionable we will keep the structure intact, but offer Junior Subordinated Noteholders an opportunity to receive equity in other investments that will provide them an additional source of return for their investment in the FUNDS.

In addition to having the cash flow in the FUNDS recently reduced and therefore causing us to suspend the quarterly interest for the Junior Subordinated Noteholders, we have also been advised by counsel that distributions at this time quite probably reflect a return of capital and not interest, and therefore distributions might be considered an invasion of the principal due to the Senior and Senior Subordinated Noteholders. This is a result of not knowing how and where to price our investments in these very illiquid markets. We have also heard from several Junior Subordinated Noteholders that until market conditions become clearer, they would rather suspend their distributions which are taxable interest in order to preserve future distributions of return of capital which of course are not taxable.

We do expect to have a better picture by next quarter as to a specific plan of action available to us going forward and of course the hope that markets will at least stabilize and stop retreating. However, we repeat, we do not view this crisis to be easily settled or to exhaust itself anytime soon. There has been severe and long lasting damage to the U.S. and world financial markets that will require patience to work through.

As always, if there are any questions regarding your account or this memorandum, please contact your McGinn, Smith & Company representative.

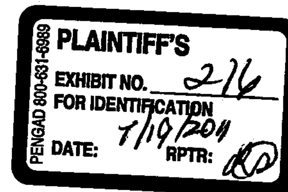
Sincerely,



David L. Smith
Managing Member
MS Advisors, LLC

DLS/gbg

Exhibit C



First Independent Income Notes, LLC
99 Pine Street
Albany, NY 12207
Phone 518-449-5131
Fax 518-449-4894

October 13, 2008

RE

Re: $5,000 First Independent Income Notes 7% due 12/15/08
Internal Investment #
Registration:

COPY

Dear Mr. & Mrs.

This communication is being sent to investors of First Independent Income Notes, LLC (the FUND) in each of the three classes of Notes, Senior, Senior Subordinated, and Junior maturing on December 15, 2008. The purpose of the communication is to apprise you of the status of your investment and also inform you of the restructuring plan that has been presented to the FUND's Trustee, McGinn, Smith Capital Holdings Corp. by the FUND's managing member, McGinn, Smith Advisors, LLC.

McGinn, Smith Advisors, LLC (MSA) has determined that as a result of losses incurred in the FUND's investments and the total illiquidity for the vast majority of the FUND's investments it is not possible to redeem the Notes on the due date of December 15, 2008 and will require a restructuring of all classes of Notes. In restructuring the notes, MSA has taken into account the responsibility of the Trustee to address both the principal and interest payments due to the Senior noteholders and therefore must reschedule future interest and principal payments for all three classes of noteholders, giving priority to the Senior noteholders. Based on best estimates of current cash flow and present liquidity, MSA has developed a plan that alters scheduled interest and principal payments for all three classes. All three classes are having their maturities extended and their interest payments reduced. MSA has the responsibility to manage the FUND consistent with the provisions of the note's indenture and in a manner that best protects the assets of the FUND. Accordingly, MSA will be presenting a plan outlined later in this communication that in its sole judgment provides for an orderly liquidation of assets, payment of reasonably expected cash flows, and gives priority to the Senior Noteholders over the Senior Subordinated Noteholders and the Junior Noteholders. The plan takes into account that current conditions in financial credit markets presently offer

no liquidity for almost any financial instrument other than U.S. Treasury Notes and Bonds. The investments in the FUND are primarily non public securities that presently have no secondary market for resale and in fact do not have the ability to even establish a fair market value. The plan makes assumptions that cannot be relied upon with any certainty. Events in the US and world financial markets have been changing with a degree of volatility never before experienced at any time in history. The Credit market crisis that started approximately 18 months ago with the troubles in the sub prime mortgage market has accelerated to the point that threatens to impair the entire world's financial foundations and has spread from Wall Street to Main Street. Under these conditions, any planning has to be subject to changing events. We have assumed that markets will continue to be unstable and primarily illiquid for at least two years. The damage to the world's banking system and investment markets is very severe and in our judgment will dramatically change the nature of markets for years to come. While governments, worldwide are rushing to shore up the system with liquidity and taking steps to restore confidence the fact is that no one knows what the ultimate impact of their actions and the reaction of markets will be. What was initially a financial crisis is now a full blown worldwide economic crisis with unknown consequences. MSA is fully confident that financial markets will eventually stabilize and that investor confidence and liquidity will be restored. Anything less is just not acceptable, and therefore the allocation of resources, new efforts of governmental oversight and regulation, and cooperation on a global scale of financial markets is expected to ultimately resolve the present crisis. But the aforementioned intervention in markets will certainly change the way markets work and with any change comes the need for patience and time for investors to first understand and then accept those changes.

As I write this memo the US Stock Market has just finished the day with the Dow Jones Industrial average down over 500 points and down almost 900 points for the last two days. This of course is subsequent to the "rescue bill" or formally the "Emergency Economic Stabilization Act of 2008" signed into law last Friday after several weeks of Congressional wrangling. While in my opinion this was a necessary first step, the idea in some circles that its ultimate passage would bring instant cure to what was ailing the credit markets was ill founded. The stock market's decline is just a symptom of the credit crisis, and while I am in total sympathy for all of us suffering market losses, the real issue is the total lack of liquidity in the credit markets. This is the major issue that impacts your investment in the FUND. Lack of liquidity simply means that there are no efficient markets to buy and sell investments because investors have lost confidence that they can fairly judge what those investments are worth. As the events of the mortgage markets and eventually all fixed income markets played out over the last 18 months, investors repeatedly got burned on making a decision to invest. A sophisticated hedge fund investor made a $1.8 billion investment last April in Washington Mutual, the country's largest saving bank, only to see it reduced to zero after being taken over by the FDIC last month. National political leaders assured us this summer that Fannie Mae and Freddie Mac, our two leading GSE (Government Sponsored Enterprises) mortgage lenders, were financially sound only to be declared bankrupt and taken over by the FDIC in mid September. Three of the five largest investment banks, Bear Stearns, Merrill Lynch, and Lehman Brothers no longer exist. AIG, the world's largest insurance

COH

company required an $85 billion cash infusion and equity investors were wiped out. Hundreds of banks and mortgage companies have been closed including the forced sales of Wachovia to Wells Fargo and Citi Corp. Virtually all financial institutions have had to either cut or eliminate dividends in order to strengthen their balance sheets. Other evidence of the cessation of liquidity in the credit markets include:

1.) billion dollar hedge funds such as D.B. Zwirn and Pardus Capital Management refused to allow investors to redeem because they were unable to sell assets to raise cash
2.) last week $120 billion of commercial paper not marketable, causing companies to lose liquidity for normal operating functions like payroll
3.) despite a lowering of interest rates, banks refusing to lend overnight to other banks from fear of not knowing the financial soundness of the borrower
4.) Reserve Money Market Fund assets fall below the one dollar redemption price and overnight withdrawal of $40 billion of the $60 billion in assets forces the fund to cease redemptions
5.) The College Fund, who manages assets for 1500 college endowments and their operating funds restrict access to their money market fund to 38% of their deposits and state that 100% of your capital won't be available until 2010

CM

There are hundreds of other examples that have occurred and demonstrate the liquidity crisis. Most of you are aware of this because the media has been giving this story full attention for months. The reason that it is important for you to be aware of the freezing of the credit markets is because it impacts the investments in the FUND in a variety of ways. First, if the most liquid and strongest investment assets such as money market funds, commercial paper, and mortgages are having difficulty in finding buyers, than the ability for almost all other assets to have liquidity is impossible. Second, if forced to sell these assets in order to redeem the notes, the market price would be far below fair market value. As an example, Merrill Lynch in July, in an effort to get some of these assets off their balance sheet and receive cash, sold $30 billion worth for just 22 cents on the dollar. And even then, the buyer forced Merrill Lynch to finance 75% of the purchase with a non-recourse loan which meant the true cost of the purchase was just 6 cents on the dollar. Third, many of the assets, including loans of the companies in our portfolio, were dependent on subsequent financing in order to repay us. Often, our loans were bridge loans to companies until they could get permanent financing through stock or bond offerings. The initial public offerings (IPO's) hit a 5 year low in July and included only some of the most visible companies in the world such as Visa International. Of the 25 billion dollars in offerings through July, Visa accounted for 18 billion dollars, leaving just 6 billion dollars for the other 23 companies taken public. Thus, the companies in our portfolio have been totally shut out, and in several instances the capital raises included money to satisfy their debts to us or to provide us with liquidity for our investments. When these offerings will once again be available is not determinable, but it is not likely to be anytime soon.

So what is next for what former Chairman of the Federal Reserve, Alan Grenspan, has identified as the once in a century financial crisis? First, the Federal Government continues to be active through all of its agencies. As mentioned earlier, Congress recently passed a bill that is to provide $700 billion dollars to help purchase some of these distressed assets and restore liquidity to the banks so that they can begin to make the loans and provide the credit that allows our economy to begin to function normally. The SEC has decreed that short selling in financial stocks is no longer permitted until further notice. The FDIC has instituted an insurance program for money market funds. They have raised FDIC insurance on bank deposits from $100,000 per account to $250000. This week they have opened the discount window, normally reserved only for banks, to allow for the purchase of commercial paper. Those actions are designed to both restore a semblance of confidence and provide sufficient liquidity for the most critical markets of our economy. However, time is what ultimately is required for banks and financial institutions to deleverage their balance sheets and restore sufficient liquidity that will allow them to once again start lending to businesses and consumers. J.P. Morgan, one of our leading financial institutions, believes that credit losses will eventually exceed 4 trillion dollars and that the housing price decline will bottom out down 30% from 2006 levels and last until 2010.

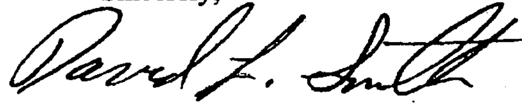
MSA has tried to evaluate and model the impact of the current crisis on its own investments and put forth a plan that provides for all classes of note holders to first get their principal back and second provide them with some return on their investment in the interim. We have communicated with some of you earlier in the year indicating that MS was working on a plan to meet those objectives, mindful of the Senior notes and the subordination issues of the other two classes. Anything that we would have proposed earlier this year certainly would have already proven to be too optimistic. Thus, our current plan we believe to be very achievable, and we are hopeful that as markets and liquidity are restored to a more normal operational mode, we in fact may be able to accelerate the repayment. However, we must emphasize that we are in unchartered waters and what we have learned from the last 18 months is to expect the unexpected.

CAH

The plan calls for immediate implementation on the next interest payment due date. We have taken great care, and with consultation with our attorneys, to present a plan that we believe to be fair, protect all classes, and still give priority to the rule of seniority. We understand that many of you have personal liquidity issues due to retirement or other financial needs and this plan may put a personal hardship on you. MSA and its affiliate McGinn, Smith & Co. will be making its own sacrifice. Management fees, commissions, and administrative fees aggregate approximately $2,750,000 per year for all of our FUNDs that are part of this reorganization. In an effort to improve liquidity we have agreed to forfeit all such future fees while this reorganization plan is in effect. Legal fees attributed to defense of our actions and fees incurred in the pursuit of recovering any of our investments will be the responsibility of the FUNDs. The plan will be implemented for the benefit of all investors. Obviously, to be fair and acceptable to all investors, we cannot entertain a different approach for individual investors. If circumstances change in the future, hopefully for the better, we reserve the right to restructure and implement a new plan.

In conclusion, we thank you in advance for your patience and understanding of the very difficult position that we are in. If there are any questions regarding your accounts or this memorandum, please contact your McGinn, Smith & Company representative.

Sincerely,



David L. Smith
Managing Partner
McGinn, Smith Advisors

DLS/gg

COM

The attached is the restructuring plan for First Independent Income Notes, LLC (FIIN) for the Senior, Senior Subordinated, and Junior Noteholders. This Schedule makes no attempt to configure the benefit of asset sales beyond approximately 8% per year of the capital base for the first 6 years due to the manager's inability to predict the timing and price received for asset sales. While we believe that the market environment will remain difficult for the first 2-3 years for asset sales, we remain optimistic that the market should improve subsequent to that period. Fifty percent of the proceeds of those sales will be a return of principal to the Senior noteholders until they are paid in full. Subsequently, the same 50% of asset sales will be returned as principal to the Senior Subordinated noteholders. When both Senior and Senior Subordinated noteholders are paid out in full, distribution of future sales to the Junior noteholders will be at the discretion of MSA, deemed to be consistent with successfully being able to return full principal to those Junior noteholders.

Co11

The attached is the restructuring plan for First Independent Income Notes, LLC (FIIN) for the Senior, Senior Subordinated, and Junior Noteholders. This Schedule makes no attempt to configure the benefit of asset sales beyond approximately 8% per year of the capital base for the first 6 years due to the manager's inability to predict the timing and price received for asset sales. While we believe that the market environment will remain difficult for the first 2-3 years for asset sales, we remain optimistic that the market should improve subsequent to that period. Fifty percent of the proceeds of those sales will be a return of principal to the Senior noteholders until they are paid in full. Subsequently, the same 50% of asset sales will be returned as principal to the Senior Subordinated noteholders. When both Senior and Senior Subordinated noteholders are paid out in full, distribution of future sales to the Junior noteholders will be at the discretion of MSA, deemed to be consistent with successfully being able to return full principal to those Junior noteholders.

CoH

First Independent Income Notes, LLC
Restructuring Plan of October 2008

I. Senior Notes 7%, due December 15, 2008

Payments: October 15th
January 15th
April 15th
July 15th

1. Starting October 15, 2008 through July 15, 2009
   Annual rate of 5%, interest only
2. Starting October 15, 2009 through October 15, 2014
   Annual rate of 5%
   10 year amortization
3. Maturity – October 15, 2014

Example of $100,000 note:

1st year: 5% interest
4 quarterly payments of $1,250

2nd – 6th year - 5% interest, 10 year amortization
20 quarterly payments of $3,192.14

Maturity payment - $56,179.51

Note: 50% of all liquidated investment proceeds will be applied immediately to principal.

II. Senior Subordinated Notes 7.5%, due December 15, 2008

Payments: October 15th
January 15th
April 15th
July 15th

Copy

1. 1st payment October 15, 2010 through July 15, 2013
   Annual rate of 3%,
   10 year amortization

2. Starting October 15, 2013 through July 15, 2020
   Annual rate of 6%
   7 year amortization

   Final payment July 15, 2020

   Example of $100,000 note:

Year 1-2	no payments
Year 3-5	3% interest, 10 year amortization
	12 quarterly payments of $2,903.02
Year 6-12	6% interest, 7 years amortization
	28 quarterly payments of $3,215.20

Note: Starting in year 7, 50% of all liquidated investment proceeds will be applied immediately to principal.

III. Junior Subordinated Notes 10.25%, due December 15, 2008

Payments: October 15th
January 15th
April 15th
July 15th

1. 1st payment October 15, 2010 through July 15, 2014
   5% principal only

2. Starting October 15, 2014 through July 15, 2023
   Annual rate of 5%,
   15 year amortization

3. Maturity July 15, 2003

   Example of $100,000 note:

COPY

Year 1-2	no payments
Year 3-6	5% principal only 16 quarterly payments of $1,250
Year 7-15	5% cpn, 15 year amortization
	36 payments of $1,903.19

Maturity payment - $39,251.93

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

vs.

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, AND
DAVID L. SMITH, GEOFFREY R. SMITH,
Individually and as Trustee of the David L. and
Lynn A. Smith Irrevocable Trust U/A 8/04/04,
LAUREN T. SMITH, and NANCY McGINN,

Defendants,

LYNN A. SMITH and
NANCY McGINN,

Relief Defendants. and

GEOFFREY R. SMITH, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

Case No. 1:10-CV-457
(GLS/CFH)

**MEMORANDUM OF LAW IN SUPPORT OF
SEVENTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER,
FOR AN ORDER (A) DISALLOWING PREFERRED INVESTOR PAPER
CLAIMS AND (B) APPLYING RECOVERY OFFSET TO PREFERRED
INVESTOR CLAIMS (INVESTMENT FUND REDEMPTIONS)**

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT 1

STATEMENT OF FACTS 2

A. The Four Funds 4

B. Exchanges for Fund Investments 5

C. Claims Procedure 7

D. Paper Claims 8

E. Plan of Distribution Process 8

F. Claims Motions 9

ARGUMENT 11

A. The Paper Claims Should be Expunged 11

B. Rising Tide Accounting Methodology Should be Applied to Promote Equality Among Investors 13

C. Preferred Investor Distributions Should be Adjusted with the Rising Tide Methodology 15

D. Summary Proceedings are Appropriate 18

CONCLUSION 20

TABLE OF AUTHORITIES

Page(s)

Cases

In re Receiver,
No. 3:10-3141-MBS, 2011 WL 2601849 (D.S.C. July 1, 2011)....................................14

S.E.C. v. Basic Energy & Affiliated Res., Inc.,
273 F.3d 657 (6th Cir. 2001)..13

S.E.C. v. Byers,
637 F. Supp. 2d 166 (S.D.N.Y. 2009)..15

S.E.C. v. Detroit Mem'l Partners, LLC,
No. 1:13-cv-1817-WSD, 2016 WL 6595942 (N.D. Ga. Nov. 8, 2016) 13

S.E.C. v. Elliott,
953 F.2d 1560 (11th Cir. 1992) 13, 19

S.E.C. v. Huber,
702 F.3d 903 (7th Cir. 2012)... 14, 15

U.S. Commodity Futures Trading Comm'n v. Barki, LLC,
No. 3:09 CV 106-MU, 2009 WL 3839389 (W.D.N.C. Nov. 12, 2009) 15

U.S. Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.,
No. 07 C 3598, 2010 WL 960362 (N.D. Ill. Mar. 15, 2010) 14

United States v. Fairway Capital Corp.,
433 F. Supp. 2d 226 (D. R.I. 2006) 19

Statutes

Fed. R. Bankr. P. 3007(a)(1), (2) 18

Rule 7.1 of the Local Rules of Practice of the United States District Court
for the Northern District of New York 18

William J. Brown, as Receiver ("Receiver") of McGinn, Smith & Co., Inc. ("MS & Co."), respectfully submits this Memorandum of Law in support of his Seventh Claims Motion ("Motion") for an Order (a) disallowing the Preferred Investors' paper claims listed on Exhibits A-1 through A-3 to the Motion and (b) applying the Preferential Payment Offset to certain Preferred Investor Claims (each as defined in this Memorandum) as set forth on Exhibit B to the Motion.[1]

PRELIMINARY STATEMENT

From 2003 to 2010, David L. Smith and Timothy M. McGinn orchestrated an elaborate Ponzi scheme through which more than 900 investors were defrauded. Investors in MS & Co., including those who invested in the Four Funds, now stand to recover only a small fraction of the principal amount of their investments.

The Receiver's due diligence revealed that, in late 2007, a certain subset of Preferred Investors exchanged their Four Funds Notes (which were virtually worthless at the time) for investments in a third-party, independently controlled Delaware limited partnership investment fund (the "Fund"), which was a legitimate and well-performing investment fund.[2] For no legitimate reason, McGinn and Smith elevated the Preferred Investors to a "preferred" status by allowing them to convert their Four Funds Notes into valuable investments in the Fund, which investments had a return of approximately 10.7%. It is inequitable to permit the Preferred Investors to recover distributions on their Receiver-granted claims when the Preferred Investors also received distributions from the Fund investments exchanged for their virtually worthless Four Funds Notes. Accordingly, the

---

[1] Exhibits A-1 through A-3 and Exhibit B have been redacted to contain only claim numbers which have previously been provided to each investor in accordance with this Court's previous direction that investor names remain confidential.

[2] David Smith held a "carried interest" in the Fund as a general partner of the Fund, but he did not control the management of the Fund which was controlled by four other general partners.

Receiver proposes to reduce the distributions made to the Preferred Investors on account of their Receiver-granted claims on a dollar-for-dollar basis by the amounts received from their investments in the Fund resulting from the exchange of Four Funds Notes. Such a reduction would return the Preferred Investors to the position they would have otherwise occupied had they been treated like the majority of investors that McGinn and Smith defrauded.

The Receiver also seeks to disallow the paper claims filed by the Preferred Investors. The Preferred Investors filed paper claims which are exact duplicates of Receiver-granted claims, paper claims which vary in amount from Receiver-granted claims, and/or paper claims for which there is no basis for the Receiver to make a distribution. If the paper claims filed by the Preferred Investors are not disallowed, then the Preferred Investors who filed such paper claims would receive additional distributions to which they are not entitled to the detriment of investors with Receiver-granted claims.

STATEMENT OF FACTS

MS & Co. was a broker-dealer registered with the Securities and Exchange Commission ("SEC") with its headquarters in Albany, New York from 1981 to 2009. From 2003 through 2010, the broker-dealer was owned by David L. Smith ("Smith"), Timothy M. McGinn ("McGinn"), and Thomas E. Livingston.

On April 20, 2010, the SEC filed a Complaint initiating the above-captioned action (Docket No. 1). Also, on April 20, 2010, this Court granted a Temporary Restraining Order (Docket No. 5), which, among other things, froze certain assets of the above-captioned Defendants and Relief Defendants, and appointed the Receiver as temporary receiver with respect to numerous entities controlled or owned by Defendants

McGinn and Smith, including those listed on Exhibit A to the Preliminary Injunction Order entered in this action (Docket No. 96) (collectively, the "MS Entities"). Brown Dec'l. ¶4.[3]

On July 26, 2010, following a hearing, the Court entered an order granting the SEC's Motion for a Preliminary Injunction and appointing the Receiver as receiver, pending a final disposition of the action ("Preliminary Injunction Order") (Docket No. 96).

On August 3, 2010, the SEC filed an Amended Complaint (Docket No. 100). On June 8, 2011, the SEC filed a Second Amended Complaint (the "Complaint") (Docket No. 334). On February 17, 2015, the Court issued its Memorandum-Decision and Order (Docket No. 807) ("MDO") granting the SEC's motion for summary judgment. The Court entered judgments in favor of the SEC in 2016 (Docket Nos. 835, 836, 837).

Generally, McGinn and Smith "orchestrated an elaborate Ponzi scheme, which spanned over several years, involved dozens of debt offerings, and bamboozled hundreds of investors out of millions of dollars." MDO at 7. McGinn and Smith raised over $136 million between 2003 and 2010 in over twenty unregistered debt offerings, including the Four Funds -- FAIN, FEIN, FIIN, and TAIN -- and various Trust Offerings, by representing that investor money would be "invested," when instead it was "funneled" into various entities owned or controlled by McGinn and Smith. That money was then used to fund unauthorized investments and unsecured loans, make interest payments to investors in other entities and offerings, support McGinn's and Smith's "lifestyles," and cover the payroll at MS & Co. MDO at 7.

---

[3] "Brown Dec'l. ¶ __" refers to the Declaration of William J. Brown dated May 22, 2019 filed in support of the Motion.

A. The Four Funds

The Four Funds—FAIN, TAIN, FIIN, and FEIN— were single-purpose, New York limited liability companies formed between September 2003 and October 2005. The private placement memoranda ("PPMs") for each of the Four Funds were substantively identical, and each offered $20 million worth of Notes, with the exception of TAIN, which offered $30 million. The offerings had three tranches of Notes, which paid quarterly interest of 5% to 10.25%, and promised a return of principal at maturity in one, three or five years. MDO at 10.

McGinn and Smith engaged in a course of conduct and dealings that were contrary to the PPMs issued for the Four Funds. First, investor proceeds from the Four Funds were used to purchase contracts from pre-2003 trusts for the purpose of redeeming or making interest payments to investors. Second, the Four Funds used investor money to directly invest in, rather than purchase investments from, affiliates. Many of the affiliated investments provided no cash flow to the Four Funds and were ultimately considered worthless. Finally, proceeds from the Four Funds were funneled through McGinn Smith Transaction Funding Corporation ("MSTF") and then used to pay MS & Co.'s payroll. MDO at 11-12.

In late 2007, David Smith received an e-mail from David Rees, MS & Co.'s comptroller, which showed a $48.8 million deficit in the Four Funds. Notwithstanding that deficit, Smith continued to solicit new investments in the Four Funds. MDO at 12. In January 2008, Smith sent a letter to investors in the Four Funds notifying investors that interest payments on the junior tranches of Notes were being reduced from 10.25% to 5%. *See* Exhibit A to Brown Dec'l; *see also* MDO at 12. By April 2008, interest payments on the

junior tranches of Notes were eliminated entirely. *See* Exhibit B to Brown Dec'l; *see also* MDO at 12. The reduction, and subsequent elimination, of interest payments were attributed by McGinn and Smith to the collapse of various debt and credit markets and the "sub prime mess." In October 2008, David Smith sent a letter to all Note holders in the Four Funds outlining a restructuring plan which extended the maturity dates of the Notes, reduced interest payments for all tranches, and forfeited all future fees due to MS & Co. *See* Exhibit C to Brown Dec'l; *see also* MDO at 12-13.

B. Exchanges for Fund Investments

In late 2007, at the same time that the problems within the Four Funds first publicly emerged, the Preferred Investors were permitted to exchange their virtually worthless Four Funds Notes for par value investments in the Fund, which was a successful investment fund not controlled by Smith or McGinn and expressly not a part of their Ponzi scheme.[4] Brown Dec'l. ¶ 11. The Fund was a substantial investment fund which (unlike MS & Co.) conducted extensive due diligence, closely monitored its investments, and conducted itself as a legitimate business. In 2013, the Fund exited from its investments and in 2014, the Fund made its final distributions to investors. *Id.*

Investors in the Fund, including the Preferred Investors, received a substantial return of one hundred percent of their principal investment plus a net rate of return of approximately 10.7% (collectively, the "Fund Recoveries").[5] Brown Dec'l. ¶ 12. The Preferred Investors began receiving distributions from the Fund in 2008, when other Four Funds investors saw their interest payments cease. While the Preferred Investors were given par value for the exchange of their virtually worthless Four Funds Notes for Fund

---

[4] The Fund was voluntarily dismissed from this action per Order entered on June 9, 2010 (Docket No. 68).
[5] This data was provided to the Receiver by the former manager of the Fund.

investments and eventually recovered handsomely from the Fund, similarly situated Four Funds investors now stand to recover only a small percentage of their principal investment. *Id.*

Three of the Four Funds - FAIN, FEIN and TAIN - held investments in the Fund in 2007. When the Preferred Investors exchanged their Four Funds Notes, they received a corresponding portion of a Four Funds investment in the Fund. In certain instances, the Preferred Investors were able to exchange FIIN Notes for a Fund investment held by FEIN or TAIN through a series of intercompany accounting transfers. Brown Dec'l. ¶13.

Five Preferred Investors received Fund Recoveries in the aggregate amount of $1,876,573.75. Brown Dec'l. ¶ 14. The exchanges of the Preferred Investors' Four Funds Notes for investments in the Fund took place between September 2007 and December 2007. *Id.* The Preferred Investors hold claims against MS & Co. on account of other investments which were not exchanged for investments in the Fund (collectively, the "Preferred Investor Claims") in the aggregate amount of $610,919.93. *Id.*

The Receiver's Claims Website (defined below) includes all of the Preferred Investor Claims. The Preferred Investor Claims have been adjusted for pre-Receivership distributions of principal and interest like all other investor claims. The Preferred Investor Claims, however, have not been adjusted to account for the Fund Recoveries. Brown Dec'l. ¶ 15.

C. Claims Procedure

On March 9, 2012, the Receiver filed a Motion ("Claims Procedure Motion") (Docket No. 466) for entry of an Order approving, among other things, the Receiver's proposed procedure for the administration of claims against the MS Entities.

On March 27, 2012, the Court entered an Order granting the Claims Procedure Motion (Docket No. 475), which was subsequently amended by an Order dated April 17, 2012 ("Claims Procedure Order") (Docket No. 481). Each investor and known creditor of the MS Entities was mailed on May 1, 2012 an Access Notice describing the claims process and enclosing (i) Notice of the Claims Bar Date and Claims Procedure and (ii) a Claim Form. Brown Dec'l. ¶17. A confidential password providing access to the Receiver's Claims Website at www.mcginnsmithreceiver.com ("Claims Website") was also provided. *Id.* If an investor or creditor agreed with the description and amount of their claim(s) as listed on the Claims Website and the claim(s) were not listed as disputed, contingent or unliquidated, the investor or creditor did not need to take any further action. *Id*. All other investors and creditors needed to timely file a paper claim before the bar date of June 19, 2012, as further described in detail on the Claim's Website. The Receiver listed each Preferred Investor's claim as "Disputed." *Id.*

The Claims Procedure Order established June 19, 2012 ("Bar Date") as deadline for creditors and investors to file claims against the MS Entities. Brown Dec'l. ¶18.

In accordance with the Claims Procedure Order, nearly six hundred creditors and investors timely filed paper claims prior to the Bar Date. Brown Dec'l. ¶19. In addition, more than 3,127 claims of investors and creditors were included on the schedules

posted by the Receiver on the Claims Website in accordance with the Claims Procedure Order. *Id.*

The Receiver conducted an initial review of the paper claims timely filed by creditors and investors in accordance with the Claims Procedure Order and determined it was necessary to establish a reserve as to investor claims totaling approximately $23,617,190 since those claims have been listed by the Receiver as disputed, contingent or unliquidated. Brown Dec'l. ¶20.

D. Paper Claims

Certain of the Preferred Investors submitted paper claims ("Paper Claims") because they did not agree with the claims granted by the Receiver and listed on the Claims Website and presumably also because the Claims Procedure Order required a claimant to file a Paper Claim to have their claim considered if it had been categorized as disputed, contingent, or unliquidated on the Receiver's Claims Website. The Preferred Investors submitted a total of twenty Paper Claims, which are described on Exhibits A-1, A-2 and A-3 to the Motion. Brown Dec'l. ¶ 21. The Paper Claims can be categorized as Duplicate Claims, Discrepant Claims, Non-Receivership Claims, No Liability Claims, and Excluded Claims, as described in further detail below.

E. Plan of Distribution Process

On December 30, 2015, the Receiver filed a Motion (Docket No. 847) ("Plan Distribution Motion") to seek approval of (i) a plan of distribution of assets of the MS Entities to investors ("Plan of Distribution"); and (ii) interim distributions to investors with allowed claims scheduled or timely filed in accordance with the Claim Procedure Order.

On October 31, 2016, the Court entered a Memorandum-Decision and Order (Docket No. 904) ("Plan Distribution Order") granting the Plan Distribution Motion, overruling objections, approving the Plan of Distribution, and allowing the Receiver to make interim distributions as set forth in the Plan Distribution Motion.

Among other things, the Plan of Distribution provides for a reserve for disputed claims to allow the Receiver to make initial distributions, but to also provide for funds to be reserved until any objections to disputed claims can be heard and decided by final order of the Court. As of April 15, 2019, $6,578,150.28 has been distributed to investors with allowed claims as a First Distribution. Brown Dec'l. ¶24. The Receiver estimates that investors will receive, at most, a recovery ranging from approximately 13.5% to 21.7%, depending upon the outcome of certain claim objections. *See* Third Written Status Report of the Receiver (Docket No.925).

The Plan of Distribution provides that all investor claims would be calculated by using the "Net Investment" methodology, i.e., the claim amount is equal to the amount of the initial investment made less any distributions received prior to the appointment of the Receiver, including any distributions of principal or interest. Plan of Distribution, Art. IV. The Plan of Distribution further provides for a collateral recovery offset ("Collateral Recovery Offset"), where distributions made on account of investor claims will be reduced on a dollar-for-dollar basis to the extent the investor has received a recovery from a source other than the Receivership in connection with their claimed loss. *Id.* Art. II.

F. Claims Motions

On September 21, 2017, the Receiver filed a Motion (Docket No. 937) ("First Claims Motion") to seek disallowance of certain filed paper claims that were duplicative of

the corresponding claims granted by the Receiver. On November 9, 2017, the Receiver filed a Statement (Docket No. 957) in furtherance of the First Claims Motion, adjourning the First Claims Motion with respect to those duplicative investor paper claims filed by investors whose Receiver-granted claims have been disputed by the Receiver. On December 28, 2017, the Court entered an Order granting the First Claims Motion and disallowing the duplicative paper claims other than with respect to those filed by investors with disputed claims (Docket No. 966).

On February 15, 2018, the Receiver filed a Motion (Docket No. 974) ("Second Claims Motion") to seek disallowance of certain filed paper claims for which there is no basis for payment in the books and records of MS & Co. On April 13, 2018, the Court entered an Order granting the Second Claims Motion and disallowing the paper claims.

On March 19, 2018, the Receiver filed a Motion (Docket No. 984) ("Third Claims Motion") to seek disallowance of certain claims of former MS & Co. brokers. On May 4, 2018, the Receiver filed a Reply (Docket No. 1002) to the Response of Frank Chiappone (Docket No. 995) to the Third Claims Motion. On March 6, 2019, the Court entered an Order granting the Third Claims Motion and disallowing the brokers' claims.

On July 6, 2018, the Receiver filed a Motion (Docket No. 1009) ("Fourth Claims Motion") to seek disallowance of paper claims filed by certain preferred investors and to apply a preferential payment offset to the distributions to be made to preferred investors. On August 27, 2018, the Receiver filed a Reply (Docket No. 1020) ("Reply") to the Opposition filed by certain preferred investors (Docket No. 1019) to the Fourth Claims Motion.

On October 16, 2018, the Receiver filed a Motion (Docket No. 1025) ("Fifth Claims Motion") to seek to apply a preferential payment offset to the distributions to be made to preferred investors One City Center Associates and Burton Fisher.

On March 6, 2019, the Court entered an Order granting the Fourth Claims Motion and the Fifth Claims Motion, and disallowing the Preferred Investors' paper claims and applying the preferential payment offset (Docket No. 1042) ("Preferential Offset Order").

On April 25, 2019, the Receiver filed a Motion (Docket No. 1052) ("Sixth Claims Motion") to seek to apply a preferential payment offset to the distributions to be made to investor Lesley Levy and equitably subordinating the claims of Lesley Levy.

ARGUMENT

A. The Paper Claims Should be Expunged

The Paper Claims should be expunged because there is no basis in the books and records of MS & Co. to justify a distribution on account of the Paper Claims. Expunging the Paper Claims will further the main objective of equality in Receivership distributions by preserving amounts for distribution to investors with legitimate claims.

Exhibit A-1 is comprised of Duplicate Claims, which represent Paper Claims filed by Preferred Investors that are exactly duplicative and are in the exact amount of the Preferred Investor Claims listed on the Claims Website. The Duplicate Claims should be disallowed because there is no legal or equitable basis for payment of the same claim more than once. The Duplicate Claims can be disallowed since the Motion deals with the claims of those Preferred Investors who are scheduled on the Receiver's Claims Website, as described in Section C below.

Exhibit A-2 is comprised of Discrepant Claims, which are paper claims filed by Preferred Investors for the same investments as their Receiver-granted Preferred Investor Claims but in different amounts. Like all other investors, the Preferred Investor Claims are based upon the records of McGinn Smith and represent principal balances.[6] The differences in the amounts of the Preferred Investor Claims and the Discrepant Claims filed by Preferred Investors are likely due to one or more payments previously received by the Preferred Investor in the form of principal or interest (exclusive of any Fund Recoveries). If the Discrepant Claims are not disallowed, the Preferred Investors will receive distributions in excess of the principal balance of their investments reflected in the books and records of McGinn Smith. This will dilute the pool of receivership funds available to pay investors with valid claims and will result in disparate treatment of Preferred Investors holding Discrepant Claims as compared to other investors. As such, the Discrepant Claims should be disallowed.

Exhibit A-3 is comprised of No Liability Claims, Non-Receivership Claims, and Excluded Claims. No Liability Claims represent filed paper claims for investments which are not reflected in the books and records of McGinn Smith for a variety of reasons, including investments that were redeemed before the Receivership and claims for investments for which there is no record. No Liability Claims should be disallowed because there is no basis in the books and records of McGinn Smith for the payment of such claims.

Non-Receivership Claims represent filed paper claims for investments in entities that are not part of the Receivership. Because these entities are not included in the

[6] The Preferred Investor Claims do not reflect any adjustment or offset in connection with the Fund Recoveries received by the Preferred Investors. To account for the receipt of Fund Recoveries, the Receiver is seeking to adjust the *distributions* made on account of the Preferred Investor Claims by applying the Recovery Offset, as described with greater detail in Section C.

Receivership, the Receiver cannot make distributions on account of these claims with Receivership funds. Accordingly, Non-Receivership Claims should be disallowed.

Finally, Excluded Claims represent paper claims filed for investments in entities that were excluded from the Receivership by the Plan Distribution Order. These entities include SAI Trust 00 and SAI Trust 03, which were foreclosed on and liquidated before the commencement of the Receivership. The Excluded Claims should be disallowed because holders of such claims are not entitled to any further distribution following the foreclosure and liquidation of these entities.

Elimination of the Paper Claims furthers the main objective of equality in the distribution of Receivership assets because there is no legal or equitable basis to make distributions to Preferred Investors on account of the Paper Claims. It would be inequitable and inappropriate for Preferred Investors to receive any distributions on account of the Paper Claims because such recoveries would dilute the pool of receivership funds available to pay investors with valid claims in Receivership entities. Further, any such distributions would be in contravention of the procedures for calculating investor claims set forth in the Plan of Distribution and the Plan Distribution Order.

B. Rising Tide Accounting Methodology Should be Applied to Promote Equality Among Investors

The district court has broad power and discretion to determine relief in an equity receivership. *See S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992); *S.E.C. v. Basic Energy & Affiliated Res., Inc.*, 273 F.3d 657, 668 (6th Cir. 2001). "In equity receiverships resulting from SEC enforcement actions, district courts have very broad powers and wide discretion to fashion remedies and determine to whom and how the assets of the Receivership Estate will be distributed." *S.E.C. v. Detroit Mem'l Partners, LLC*, No. 1:13-cv-

1817-WSD, 2016 WL 6595942 at *5 (N.D. Ga. Nov. 8, 2016) (internal quotation omitted). A receiver's choice among allocation schemes in the course of administering a receivership is within the discretion of the district court to approve or disapprove. *S.E.C. v. Huber*, 702 F.3d 903, 908 (7th Cir. 2012).

The Rising Tide method is a common methodology used for determining the distribution of assets in a Receivership. Recently, in the Preferential Offset Order, the Court approved the application of an offset calculated using the Rising Tide methodology to reduce the distributions made by the Receiver to certain investors who received preferential interest payments and supplemental payments in the Preferential Offset Order. *See* Preferential Offset Order at 6-7. The Court has also approved the use of the Rising Tide methodology in the calculation of the Collateral Recovery Offset. *See* Plan Distribution Order at 12-13.

The Rising Tide method subtracts pre-receivership payments received by an investor from the investor's pro rata distribution, reducing that investor's pro rata distribution on a dollar-for-dollar basis. *U.S. Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.*, No. 07 C 3598, 2010 WL 960362 at *7 (N.D. Ill. Mar. 15, 2010). The Rising Tide methodology "brings the recovery of claimants who received no payments during the course of the Ponzi Scheme equal to those claimants who did receive payments during the course of the Ponzi Scheme." *In re Receiver*, No. 3:10-3141-MBS, 2011 WL 2601849 at *2 (D.S.C. July 1, 2011). Otherwise, a straight pro rata distribution of funds, irrespective of pre-receivership payments, "would be inequitable because it would unfairly elevate investors who received those pre-receivership payments." *Lake Shore*, No. 07 C 3598, 2010 WL 960362 at *9.

Courts have not approved the use of the Rising Tide methodology where a significant amount of investors would not recover any distribution as a result of applying that methodology. *S.E.C. v. Huber*, 702 F.3d 903, 907 (7th Cir. 2012) (approving Rising Tide where only 18% of investors would receive no recovery); *U.S. Commodity Futures Trading Comm'n v. Barki, LLC*, No. 3:09 CV 106-MU, 2009 WL 3839389 (W.D.N.C. Nov. 12, 2009) (refusing to approve Rising Tide where 55% of investors would receive no recovery); *see also S.E.C. v. Byers*, 637 F. Supp. 2d 166, 182 (S.D.N.Y. 2009) (approving the Net Investment methodology after receiver did not recommend using Rising Tide because 45% of investors would not receive a recovery). In this Receivership, the Receiver is making distributions to all investors with allowed claims. *See* Third Written Status Report of the Receiver, at 6 (Docket No. 925).

C. Preferred Investor Distributions Should be Adjusted with the Rising Tide Methodology

Distributions made to Preferred Investors on account of their Preferred Investor Claims should be adjusted to account for the receipt of the Fund Recoveries using the Rising Tide methodology ("Recovery Offset"). In late 2007, just as the troubled status of the Four Funds was coming to light, this small group of Preferred Investors was permitted to exchange their virtually worthless investments in the Four Funds for valuable investments in the Fund. Although the Preferred Investors did not immediately receive a cash payment in exchange for their Four Funds Notes, the Preferred Investors did receive valuable investments that generated distributions beginning in 2008, at a time when similarly situated investors in the Four Funds ceased receiving payments from MS & Co. Ultimately, Preferred Investors recovered the entire principal of their Fund investments plus a net rate of return of 10.7%. By comparison, the other investors in the Four Funds who did

not receive the same preferential treatment, will only recover between approximately 13.5% to 21.7% of their original principal investment.

It would be inequitable to allow the Preferred Investors to retain all of their Fund Recoveries and to receive distributions on their Preferred Investor Claims. Applying the Recovery Offset to the Preferred Investor Claims will put *all* investors in a more equal position. The Recovery Offset has a similar effect as the Collateral Recovery Offset, which reduces investor distributions on a dollar-for-dollar basis based on amounts recovered on account of their claims from sources other than the Receivership. The Recovery Offset will reduce distributions to the Preferred Investors by amounts recovered from the Fund, which investments the Preferred Investors received only due to the preferential treatment of their Four Funds Notes. The Recovery Offset will remedy this unfair and preferential treatment of the Preferred Investors.

Although courts have not approved the use of the Rising Tide methodology where a large percentage of investors would not receive a recovery as a result of the application of Rising Tide, this is not the case here. Application of the Recovery Offset will result in only five investors, less than 1% of all MS & Co. investors, who would not receive an interim first distribution on certain of their Preferred Investor Claims. The Preferred Investors instead would have a credit against future distributions in the amount of the excess of the Fund Recovery over the amount of the interim first distribution. This credit would not prevent them from receiving further distributions if the credit were to be consumed by the amount of the distribution.

To permit the Preferred Investors to retain the Fund Recoveries, without a corresponding dollar-for-dollar reduction in the amount of their pro rata distribution on

account of their Preferred Investor Claims, would result in the Preferred Investors retaining excess amounts for no reason other than that MS & Co. arbitrarily permitted the Preferred Investors to convert their valueless Four Funds Notes to valuable Fund investments. The Recovery Offset promotes equality among all investors by accounting for this arbitrary treatment.

To calculate the Recovery Offset, the Receiver first used the books and records of MS & Co. to determine the principal amount of Four Funds Notes that each Preferred Investor exchanged for a corresponding investment in the Fund. The Receiver then applied the net rate of return of 10.7% to the principal amount of the Fund investment received in exchange for the Four Funds Notes. Brown Dec'l. ¶ 33. The Recovery Offset represents the aggregate distribution received by each Preferred Investor by the time the Fund wound up in 2014, comprised of the principal amount of each Preferred Investor's Fund investment plus the net return on the Fund investment. The Recovery Offset was then applied to the estimated first distribution for each Preferred Investor's aggregate Preferred Investor Claims using the Rising Tide methodology, as shown in Exhibit B to the Motion. Brown Dec'l. ¶ 33.

The Preferred Investor holding Receivership claim number 6658D ("Preferred Investor 6658D") held an initial investment in the Fund that does not appear to have resulted from exchanges of MS & Co. investments. The books and records of MS & Co. indicate, however, that in September 2007, Preferred Investor 6658D increased by at least $250,000 their initial Fund investment as a result of an exchange of FIIN and TAIN Notes. Accordingly, the Receiver has calculated Preferred Investor 6658D's Recovery Offset to be the amount of distributions received by Preferred Investor 6658D from the Fund attributable

only to the incremental increase in the Fund investment that occurred in September 2007.[7] Brown Dec'l. ¶34.

D. Summary Proceedings are Appropriate

The Receiver has sought to provide the Preferred Investors with appropriate notice and sufficient time to respond to the Motion. Accordingly, the Receiver has complied with the claim objection and notice procedures set forth in the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") as a form of best expression of law. Bankruptcy Rule 3007 requires that a claim objection must be filed and served at least thirty days before any scheduled hearing and that the objection must be served on the claimant by first class mail. Fed. R. Bankr. P. 3007(a)(1), (2).

In accordance with Rule 7.1 of the Local Rules of Practice for the United States District Court for the Northern District of New York, the Receiver has filed and will serve the Motion on each of the Preferred Investors at least thirty-one days in advance of the scheduled return date of July 18, 2019. The Receiver will give notice of the Motion to the Securities and Exchange Commission, all parties who have filed a Notice of Appearance in this action by ECF, and all creditors and parties in interest via the Receiver's website (www.mcginnsmithreceiver.com), as well as posting at the top of the Receiver's website an explanation of the Motion. Additionally, notice by first class mail will be given to each of the Preferred Investors. Brown Dec'l. ¶35.

The Receiver requests that the Court enter an order granting the relief requested in this Motion without a hearing with respect to those Preferred Investor Claims for which an objection is not timely interposed. Disallowance or adjustment of a claim without a hearing where there is no factual dispute is an appropriate and preferred

[7] This data was provided to the Receiver by the former manager of the Fund.

procedure in federal receivership cases. *See S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992) (holding that summary proceedings are favored in federal receivership cases because a summary proceeding "reduces the time necessary to settle disputes, decreases litigation costs, and prevents further dissipation of receivership assets"); *United States v. Fairway Capital Corp.*, 433 F. Supp. 2d 226, 241 (D. R.I. 2006) ("Receivership courts can employ summary procedures in allowing, disallowing and subordinating claims of creditors").

CONCLUSION

The Receiver requests that the Court enter an Order substantially in the form attached to the Motion as Exhibit C (a) disallowing the Paper Claims and (b) applying the Recovery Offset to Preferred Investor distributions, together with such other and further relief as the Court deems just and proper.

Dated: May 22, 2019

PHILLIPS LYTLE LLP

By /s/ Catherine N. Eisenhut
William J. Brown (Bar Roll #601330)
Catherine N. Eisenhut (Bar Roll #520849)
Attorneys for Receiver
Omni Plaza
30 South Pearl Street
Albany, New York 12207
Telephone No. (518) 472-1224

and

One Canalside
125 Main Street
Buffalo, New York 14203
Telephone No.: (716) 847-8400

Doc #01-3662199.3

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION *Plaintiff,* vs. McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC, TIMOTHY M. McGINN, AND DAVID L. SMITH, GEOFFREY R. SMITH, Individually and as Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, LAUREN T. SMITH, and NANCY McGINN, *Defendants,* LYNN A. SMITH and NANCY McGINN, *Relief Defendants. and* GEOFFREY R. SMITH, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, *Intervenor.*	Case No. 1:10-CV-457 (GLS/CFH))

CERTIFICATE OF SERVICE

I, Karen M. Ludlow, being at all times over 18 years of age, hereby certify that on May 22, 2019, a true and correct copy of the (i) Notice of Motion and Seventh Claims Motion of William J. Brown, as Receiver, for an Order (A) Disallowing Preferred Investor Paper Claims and (B) Applying Recovery Offset to Preferred Investor Claims (Investment Fund Redemptions) ("Seventh Claims Motion"), (ii) Declaration of William J. Brown, as Receiver, in Support of Seventh Claims Motion, and (iii) Memorandum of Law in Support of Seventh Claims Motion (collectively, "Seventh Claims Motion Documents") were caused to be served by e-mail upon all parties who receive electronic notice in this case pursuant to the Court's ECF filing system, and by First Class Mail to the parties indicated below:

- **William J. Brown** wbrown@phillipslytle.com,khatch@phillipslytle.com
- **Roland M. Cavalier** rcavalier@tcglegal.com
- **Certain McGinn Smith Investors** apark@weirpartners.com
- **Frank H. Chiappone** chiappone55@gmail.com
- **Linda J. Clark** lclark@barclaydamon.com,jsmith@hiscockbarclay.com

- **Elizabeth C. Coombe** elizabeth.c.coombe@usdoj.gov, CaseView.ECF@usdoj.gov, kelly.ciccarelli@usdoj.gov
- **William J. Dreyer** wdreyer@dreyerboyajian.com, lburkart@dreyerboyajian.com, bhill@dreyerboyajian.com,lowens@dreyerboyajian.com,coconnell@dreyerboyajian.com
- **Catherine N. Eisenhut** ceisenhut@phillipslytle.com
- **Scott J. Ely** sely@elylawpllc.com,shm@fwc-law.com
- **James D. Featherstonhaugh** jdf@fwc-law.com,jsm@fwc-law.com,cr@fwc-law.com,shm@fwc-law.com
- **Brad M. Gallagher** bgallagher@barclaydamon.com
- **James H. Glavin , IV** hglavin@glavinandglavin.com
- **Bonnie R. Golub** bgolub@weirpartners.com
- **James E. Hacker** hacker@joneshacker.com, sfebus@joneshacker.com, thiggs@joneshacker.com
- **Erin K. Higgins** EHiggins@ckrpf.com
- **Benjamin W. Hill** ben@benhilllaw.com, rmchugh@dreyerboyajian.com, coconnell@dreyerboyajian.com
- **E. Stewart Jones , Jr** esjones@joneshacker.com,m leonard@joneshacker.com,pcampione@joneshacker.com,kjones@joneshacker.com
- **Edward T. Kang** ekang@khflaw.com, zbinder@khflaw.com, jarcher@khflaw.com,kkovalsky@khflaw.com
- **Nickolas J. Karavolas** nkaravolas@phillipslytle.com
- **Jack Kaufman** kaufmanja@sec.gov
- **Michael A. Kornstein** mkornstein@coopererving.com
- **James P. Lagios** james.lagios@rivkin.com, kathyleen.ganser@rivkin.com, Stanley.Tartaglia@rivkin.com
- **Kevin Laurilliard** laurilliard@mltw.com
- **James D. Linnan** jdlinnan@linnan-fallon.com,lawinfo@linnan-fallon.com
- **Haimavathi V. Marlier** marlierh@sec.gov
- **Jonathan S. McCardle** jsm@fwc-law.com
- **Kevin P. McGrath** mcgrathk@sec.gov
- **Lara S. Mehraban** mehrabanl@sec.gov,marlierh@sec.gov
- **Michael J. Murphy** mmurphy@carterconboy.com, epappas@carterconboy.com, abell@carterconboy.com
- **Craig H. Norman** cnorman@chnesq.com, jbugos@coopererving.com
- **Andrew Park** apark@weirpartners.com,imarciniszyn@weirpartners.com
- **Thomas E. Peisch** TPeisch@ckrpf.com,apower@ckrpf.com
- **Terri L. Reicher** Terri.Reicher@finra.org
- **Sheldon L. Solow** sheldon.solow@kayescholer.com, kenneth.anderson@kayescholer.com
- **David P. Stoelting** stoeltingd@sec.gov, mehrabanl@sec.gov,mcgrathk@sec.gov,paleym@sec.gov,wbrown@phillipslytle.com
- **Charles C. Swanekamp** cswanekamp@bsk.com,mhepple@bsk.com
- **Bryan M. Westhoff** bryan.westhoff@kayescholer.com
- **Benjamin Zelermyer** bzlaw@optonline.net,seincav@aol.com

And, I hereby certify that on May 22, 2019, I mailed, via first class mail using the United States Postal Service, copies of the Seventh Claims Motion Documents to the individuals listed below:

Nancy McGinn
426-8th Avenue
Troy, NY 12182

Thomas J Urbelis
Urbelis & Fieldsteel, LLP
155 Federal Street
Boston, MA 02110-1727

Michael L. Koenig, Esq.
Greenberg Traurig, LLP
54 State Street, 6th Floor
Albany, NY 12207

Martin H. Kaplan, Esq.
Gusrae, Kaplan, Bruno & Nusbaum PLLC
120 Wall Street
New York, NY 10005

RBS Citizen, N.A.
Cooper Erving & Savage LLP
39 North Pearl Street
4th Floor
Albany, NY 12207

Iseman, Cunningham, Riester & Hyde, LLP
9 Thurlow Terrace
Albany, NY 12203

Charles C. Swanekamp, Esq.
Bond, Schoeneck & King PLLC
Avant Building - Suite 900
200 Delaware Avenue
Buffalo, NY 14202-2107

David G. Newcomb
Judith A. Newcomb
224 Independence Way
Mount Bethel, PA 18343

Deborah Urbelis
6 Eastman Road
Andover, MA 08010

Thomas Urbelis
6 Eastman Road
Andover, MA 08010

Robert Thrasher
2667 Caladium Way
Naples, FL 34105

Michael Reilly
c/o Energy Insurance Brokers
73 Troy Road
East Greenbush, NY 12061

Kathleen Meier
82 Blue Spruce Lane
Ballston Lake, NY 12019

Dated: May 22, 2019

/S/ Karen M. Ludlow
Karen M. Ludlow