

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

-----X  
SECURITIES AND EXCHANGE COMMISSION

*Plaintiff,*

vs.

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

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

**NOTICE OF NINTH CLAIMS MOTION OF WILLIAM J. BROWN, AS  
RECEIVER, FOR AN ORDER (A) DISALLOWING CERTAIN DISPUTED  
CLAIMS, (B) RECLASSIFYING CERTAIN DISPUTED CLAIMS, (C)  
APPLYING PREFERENTIAL PAYMENT OFFSET TO CERTAIN DISPUTED  
CLAIMS, AND (D) EXPUNGING PAPER CLAIMS**

PLEASE TAKE NOTICE that upon the Ninth Claims Motion of William J. Brown, as Receiver, for an Order (A) Disallowing Certain Disputed Claims, (B) Reclassifying Certain Disputed Claims, (C) Applying Preferential Payment Offset to Certain Disputed Claims, and (D) Expunging Paper Claims (“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 November 21, 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 Disputed Claims listed on Exhibit A to the Motion, reclassifying the Disputed Claims listed on Exhibit B to the Motion, applying a Preferential Payment Offset to certain Preferred Investor Claims listed on Exhibit C-1 to the Motion, and expunging the paper claims listed on Exhibits A, C-2, D-1, D-2, and D-3 to the Motion without further notice or opportunity to be heard offered to any party.

Dated: October 9, 2019

PHILLIPS LYTTLE 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

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and

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125 Main Street

Buffalo, New York 14203

Telephone No.: (716) 847-8400

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TIMOTHY M. MCGINN, AND  
DAVID L. SMITH, GEOFFREY R. SMITH,  
Individually and as Trustee of the David L. and  
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LAUREN T. SMITH, and NANCY MCGINN,

*Defendants,*

LYNN A. SMITH and  
NANCY MCGINN,

*Relief Defendants. and*

GEOFFREY R. SMITH, Trustee of the  
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Trust U/A 8/04/04,

*Intervenor.*

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**NINTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR  
AN ORDER (A) DISALLOWING CERTAIN DISPUTED CLAIMS, (B)  
RECLASSIFYING CERTAIN DISPUTED CLAIMS, (C) APPLYING  
PREFERENTIAL PAYMENT OFFSET TO CERTAIN DISPUTED CLAIMS,  
AND (D) EXPUNGING PAPER CLAIMS**

William J. Brown, as Receiver (“Receiver”), by his counsel, Phillips Lytle LLP,  
moves (the “Motion”) for an Order (a) disallowing certain Disputed Claims, (b)

reclassifying certain Disputed Claims, (c) applying a Preferential Payment Offset to certain Disputed Claims, and (d) expunging paper claims (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 Disputed Claims listed on Exhibit A to the Motion, (b) reclassifying the Disputed Claims listed on Exhibit B to the Motion, (c) applying a Preferential Payment Offset to certain Preferred Investor Claims listed on Exhibit C-1 to the Motion, and (d) expunging the paper claims listed on Exhibits A, C-2, D-1, D-2, and D-3 to the Motion, based on the accompanying Memorandum of Law and Declaration of William J. Brown, as Receiver (“Declaration”), each dated October 9, 2019.

**RELIEF REQUESTED**

The Receiver requests that the Court enter an Order substantially in the form attached as Exhibit E (“Order”) (a) disallowing certain Disputed Claims, (b) reclassifying certain Disputed Claims, (c) applying a Preferential Payment Offset to certain Disputed Claims, and (d) expunging paper claims, together with such other and further relief as the Court deems just and proper.

Dated: October 9, 2019

PHILLIPS LYTTLE 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 #4480843.1

# *Exhibit A*

Claim No.	Last Name	First Name	Description	Amount	Paper Claims
6192	Remar & Lex	Kimellen & William F	FAIN SECURED SENIOR NOTES	\$45,997.68	Filed duplicate paper claim
6193	Remar & Lex	Kimellen & William F	FAIN SECURED SENIOR NOTES	\$18,399.07	Filed duplicate paper claim
6122	EVA	RABINOVICH	TDM CABLE TRUST 06 9.25% 48 MONTHS CONTRACT CERTIFICATES 11/15/10	\$15,000.00	Filed duplicate paper claim
6123	Eva	Rabinovich	FEIN SECURED SENIOR NOTES	\$919,953.59	Filed discrepant paper claim for \$1,000,000
6125	Stan	Rabinovich	Cruise Charter Ventures, LLC	\$100,000.00	Filed duplicate paper claim
6126	STAN	RABINOVICH	FIIN 10.25% SECURED JUNIOR NOTES DUE 12/15/2008	\$200,000.00	Filed duplicate paper claim
6127	STAN	RABINOVICH	FIRSTLINE TRUST 07 11% JUNIOR CONTRACT CERTIFICATES DUE 05/01/12	\$179,542.00	Filed discrepant paper claim for \$200,000
6128	STAN	RABINOVICH	TDM LUXURY CRUISE TRUST 07 CONTRACT CERTIFICATES 10% DUE 9/1/11	\$185,000.00	Filed discrepant paper claim for \$200,000
6129	STAN	RABINOVICH	TDM CABLE SR TRUST 09 9%	\$5,434.92	
6130	Stan	Rabinovich	FEIN SECURED SENIOR NOTES	\$919,953.59	Filed discrepant paper claim for \$1,000,000
6131	Stan	Rabinovich	McGinn, Smith Firstline Funding, LLC	\$300,000.00	Filed duplicate paper claim
6132	STANLEY	RABINOVICH	FEIN 10.25% SECURED JUNIOR NOTES DUE 01/30/2009	\$75,000.00	Filed duplicate paper claim
6133	STANLEY	RABINOVICH	PACIFIC TRUST	\$18,991.94	Filed discrepant paper claim for \$24,000
6134	STANLEY	RABINOVICH	TDM CABLE TRUST 06 9.25% 48 MONTHS CONTRACT CERTIFICATES 11/15/10	\$20,000.00	Filed duplicate paper claim
6135	Stanley B & Eva	Rabinovich	TAIN SECURED SENIOR NOTES	\$454,664.29	Filed discrepant paper claim for \$500,000
6136	STANLEY B & EVA	RABINOVICH	TDM BENCHMARK TRUST 09 08%	\$0.00	

# ***Exhibit B***



Claim No.	Last Name	First Name	Description of Claim	Amount	Current Classification	Proposed Reclassification	Explanation
4107D	ADT Security Services, Inc.	Sally Edison- McGuireWoods LLP	No Liability, TDM Cable Funding LLC	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
(Paper Claim)	ADT Security Services, Inc.		TDM Cable Funding LLC	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
(Paper Claim)	ADT Security Services, Inc.		Prime Vision Communications L	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
5328	HSK Funding Inc.		107th Associates LLC	\$1,030,000.00	Investor Claim	Secured Claim to the extent of the value of the collateral and Unsecured Claim for any deficiency	Claimant asserts a claim for secured debt obligation

# *Exhibit C-1*

## Exhibit C-1 - Preferential Payment Offset

Claim Nos.	Claim Description	Claim Amount	Proposed First Distribution (10%)	Total Preferential Payments Received	Source of Preferential Payment	Proposed First Distribution After Application of Offset
5444D	TDM Cable Funding LLC	\$50,000	\$5,000.0	\$4,098.98	TDM	\$901.02
5812D	McGinn, Smith Funding LLC	\$125,000	\$12,500.0	\$134,700.00	MSF	(\$122,200.00)
6164	McGinn, Smith Funding, LLC	\$50,000	\$5,000.0	\$4,098.96	TDM	\$901.04**
6234D	TDM Cable Funding LLC	\$25,000	\$2,500.0	\$1,983.39	TDM	\$516.61
6492D	TDM Cable Funding LLC	\$50,000	\$5,000.0	\$4,890.65	TDM	\$109.35
6312D	TDMM Benchmark Trust 09 12%	\$150,000	\$15,000.0	\$837,588.17	MSF	(\$687,588.17)

\*\*This investor also received preferential payments, as described in greater detail in the Seventh Claims Motion, and the Receiver has sought to apply an offset of \$780,435 to distributions owed in connection with all of this investor's claims

# *Exhibit C-2*

Exhibit C-2 - Preferred Investor Paper Claims

Claim Nos.	Claim Description	Claim Amount	Paper Claim	Reason for Disallowance
5444D	TDM Cable Funding LLC	\$50,000		Duplicate
6492D	TDM Cable Funding LLC	\$50,000		Discrepant**
6312D	TMMM Benchmark Trust 09	\$150,000		Duplicate

\*\*This Preferred Investor filed a discrepant paper claim reducing the principal amount of the scheduled claim to account for the Preferential Payments received. By the Motion, the Receiver proposes to reduce the distributions to be made to this Preferred Investor, rather than the principal amount of the claim.

# ***Exhibit D-1***

**Exhibit D-1 - Discrepant Paper Claims**

Claim No.	Description of Investment	Amount of Allowed Claim	Amount of Paper Claim
6491	TAIN Secured Senior Notes	\$54,559.72	\$60,000.00
6487	Integrated Excellence Sr. Trust 08	\$10,254.75	\$15,000.00

# ***Exhibit D-2***



## Exhibit D-2 - Duplicate Paper Claims

Claim No.	Description of Investment	Amount of Claim on Receiver's Website	Amount of Paper Claim
5562 **	FAIN Secured Senior Subordinated Notes	\$25,000.00	\$25,000.00
5608 **	Seton Hall Mortgage Note Holders	\$21,576.97	\$21,576.97
5779	FEIN Secured Senior Subordinated Notes Due 1/30/2009	\$10,000.00	\$10,000.00
5777	FAIN Secured Senior Subordinated Notes	\$10,000.00	\$10,000.00
5780	FEIN Secured Senior Subordinated Notes Due 1/30/2009	\$15,000.00	\$15,000.00
5778	FAIN Secured Senior Subordinated Notes	\$20,000.00	\$20,000.00
6100	FEIN 10.25% Secured Junior Notes Due 01/30/2009	\$25,000.00	\$25,000.00
6099	FEIN Secured Senior Subordinated Notes Due 1/30/2009	\$30,000.00	\$30,000.00
6101	TAIN Secured Junior Notes Due 12/15/2009	\$25,000.00	\$25,000.00
6102	FAIN Secured Senior Subordinated Notes	\$100,000.00	\$100,000.00
6103	TAIN Secured Senior Subordinated Notes 7.75% Due 12/15/2009	\$50,000.00	\$50,000.00
6751	TAIN Secured Senior Notes	\$100,026.14	\$100,026.14
6930	TDM Cable Trust 06 10% Contract Certificates Due 11/15/10	\$10,000.00	\$10,000.00

\*\* This investor has previously received a first distribution. Disallowance of this paper claim will not affect this investor's allowed claims.

# ***Exhibit D-3***

## Exhibit D-3 - Other Paper Claims

Claim No.	Description of Investment	Amount of Paper Claim	Reason for Disallowance
4111	CMS Financial	\$31,000.00	Non-Receivership
	Atlantis Strategic	\$25,000.00	Non-Receivership
	SASB Int A/O 1/2	None given	Non-Receivership
	Integrated Alarm	\$10,100.00	Non-Receivership
	Federated Premier Muni	\$26,969.00	Non-Receivership
	Integrated Alarm	\$19,274.44	Non-Receivership
	Aim Invesco High Yield	\$13,393.00	Non-Receivership
	Evergreen Income Advantage	\$6,584.09	Non-Receivership
	FLB	\$41,000.00	Non-Receivership
	MS Real Estate Capital Partners	\$15,000.00	Non-Receivership
	Unknown	\$33,232.00	No liability
	SAI Trust	\$10,000.00	Excluded Entity
	SAI Trust	\$15,000.00	Excluded Entity
	SAI Trust	\$8,634.00	Excluded Entity
4355 **	CMS Financial	\$100,000.00	Non-Receivership
	CMS Financial	\$40,274.32	Non-Receivership
	Integrated Alarm	\$21,000.00	Non-Receivership
	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 00	\$8,707.70	Excluded Entity
	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 03	\$20,076.06	Excluded Entity
5401	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 00	\$16,535.40	Excluded Entity
5527	TDM Verifier Trust 09 10% Contract Certificates		
	Due 12/31/11	\$10,000.00	Untimely Filed
	Christian Values Network, Inc.	\$25,000.00	Non-Receivership
	Faith and Family Values Network, Inc.	\$25,000.00	Non-Receivership
	SAI Trust	\$20,000.00	Excluded Entity
	CMS Financial	\$109,350.00	Non-Receivership
	CMS Financial	\$109,350.00	Non-Receivership
	CMS Financial	\$30,000.00	Non-Receivership

	SAI Trust 00		\$20,000.00	Excluded Entity
	CMS Financial		\$155,000.00	Non-Receiverhsip
6192	FIIN Secured Senior Note		\$22,733.21	No liability
	MS Real Estate Capital Partners		\$30,000.00	Non-Receiverhsip
	CMS Financial		\$30,000.00	Non-Receiverhsip
	CMS Financial		None given	Non-Receiverhsip
	CMS Financial		None given	Non-Receiverhsip
6453	SAI Trust 00		\$16,660.12	Excluded Entity
	SAI Trust		\$8,707.76	Excluded Entity
	SAI Trust 00		\$10,000.00	Excluded Entity
	CMS Financial		\$38,100.00	Non-Receiverhsip
	First Independent Income Notes LLC		\$25,000.00	No liability

\*\* This investor has previously received a first distribution. Disallowance of this paper claim will not affect this investor's allowed claims.

# ***Exhibit E***

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

-----X  
SECURITIES AND EXCHANGE COMMISSION

*Plaintiff,*

vs.

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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

**ORDER APPROVING NINTH CLAIMS MOTION OF WILLIAM J. BROWN,  
AS RECEIVER, FOR AN ORDER (A) DISALLOWING CERTAIN DISPUTED  
CLAIMS, (B) RECLASSIFYING CERTAIN DISPUTED CLAIMS, (C)  
APPLYING PREFERENTIAL PAYMENT OFFSET TO CERTAIN DISPUTED  
CLAIMS, AND (D) EXPUNGING PAPER CLAIMS**

Upon the Ninth Claims Motion of William J. Brown, as Receiver, for an  
Order (A) Disallowing Certain Disputed Claims, (B) Reclassifying Certain Disputed  
Claims, (C) Applying Preferential Payment Offset to Certain Disputed Claims, and (D)  
Expunging Paper Claims; and notice of the Motion having been given to the Securities and  
Exchange Commission, each of the claimants listed on each Exhibit 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 Remar-Lex Claim, together with each Remar-Lex Paper Claim, listed on Exhibit A to the Motion is disallowed; and it is further

ORDERED, that each Rabinovich Claim, together with each Rabinovich Paper Claim, listed on Exhibit A to the Motion is disallowed; and it is further

ORDERED, that the ADT Claims listed on Exhibit B to the Motion are reclassified to unsecured claims and are disallowed; and it is further

ORDERED, that the HSK Claim is reclassified to a secured claim to the extent of the value of the collateral and as an unsecured claim for any deficiency in accordance with the Plan of Distribution; and it is further

ORDERED, that the application of the Preferential Payment Offset to reduce the distributions to Preferred Investors is approved as set forth on Exhibit C-1 to the Motion and each of the Preferred Investor Paper Claim listed on Exhibit C-2 to the Motion is disallowed; and is further

ORDERED, that each of the paper claims listed on Exhibits D-1, D-2, and D-3 to the Motion are disallowed; and the rights of the Receiver to object on any other basis to the claims of all investors or claimants is expressly preserved.

Dated: \_\_\_\_\_, 2019

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HON. CHRISTIAN F. HUMMEL

Doc #4480968.2



UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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McGINN, SMITH CAPITAL HOLDINGS CORP., :  
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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,* :

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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

**DECLARATION OF WILLIAM J. BROWN, AS RECEIVER, IN SUPPORT  
OF NINTH CLAIMS MOTION FOR AN ORDER (A) DISALLOWING  
CERTAIN DISPUTED CLAIMS, (B) RECLASSIFYING CERTAIN  
DISPUTED CLAIMS, (C) APPLYING PREFERENTIAL PAYMENT OFFSET  
TO CERTAIN DISPUTED CLAIMS, AND (D) EXPUNGING PAPER  
CLAIMS**

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. (“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 Ninth Claims Motion (“Motion”) for an Order (a) disallowing certain Disputed Claims, (b) reclassifying certain Disputed Claims, (c) applying a Preferential Payment Offset to certain Disputed Claims, and (d) expunging paper claims.

### **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” or “David 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

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 2015 (Docket Nos. 835, 836, 837). The MDO was affirmed on appeal in June 2016.

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.

**A. Claims Procedure**

8. 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.

9. 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](http://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.

10. The Claims Procedure Order established June 19, 2012 (“Bar Date”) as the deadline for creditors and investors to file claims (if required) against the MS Entities. Claims Procedure Order at 2. Any investor who was required to file a paper claim and who failed to do so on or before the Bar Date is barred, estopped, and enjoined from asserting such claim. *Id.*

11. 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.

12. 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.

**B. Plan of Distribution Process**

13. On December 30, 2015, in my capacity as Receiver, I 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.

14. 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.

15. Among other things, the Plan of Distribution sets forth the following priority of claims: (1) administrative expenses; (2) secured creditors; and (3) investors. Further, 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 July 25, 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).*

**C. Claims Motions**

16. 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, 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).

17. 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.

18. 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 (Docket No. 1043) (“Broker Claims Order”).

19. 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 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.

20. 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.

21. 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”).

22. On April 25, 2019, in my capacity as Receiver, I 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.

23. On May 22, 2019, in my capacity as Receiver, I filed a Motion (Docket No. 1056) (“Seventh Claims Motion”) to seek to apply a preferential payment offset to the distributions to be made to certain preferred investors that received certain fund redemptions.

24. The Sixth and Seventh Claims Motions remain *sub judice*.

25. On September 12, 2019, in my capacity as Receiver, I filed a Motion (Docket No. 1067) (“Eighth Claims Motion”) to seek to disallow certain claims asserted by

the Smith family, or, in the alternative, offset their outstanding judgment obligations by any distributions owed in connection with such claims. The return date of the Eighth Claims Motion is October 31, 2019.

**D. Remaining Disputed Claims**

26. The remaining Disputed Claims may be described as follows: (1) claims that should be disallowed due to the claimants' inequitable and/or fraudulent conduct; (2) claims improperly classified as investor claims and requiring reclassification and/or disallowance; (3) claims asserted by recipients of preferential payments that should be offset by such preferential payments; and (4) paper claims for which there is no basis for payment in the Receiver's books and records.

**CLAIMS TO BE DISALLOWED DUE TO INEQUITABLE OR FRAUDULENT CONDUCT**

**A. Remar-Lex Claims**

27. Among the claims disallowed by the Broker Claims Order were those asserted by William F. Lex ("Lex"). Lex was a registered representative at MS & Co. who sold \$45,536,000 of MS & Co. private placements between September 2003 and July 2009. Third Claims Motion at 6. The Court disallowed Lex's claims, as described in the Third Claims Motion, based on Lex's violations of the Securities Act. Broker Claims Order at 8.

28. Following the entry of the Broker Claims Order, I discovered that Lex holds two additional disputed claims that were not included in the Third Claims Motion ("Remar-Lex Claims"). The Remar-Lex Claims are held jointly by Lex and Kimellen Remar ("Remar") and are described in greater detail on Exhibit A to the Motion. Presumably in accordance with the instructions set forth in the Claims Procedure Order, Remar and Lex filed a paper claim for each Remar-Lex Claim ("Remar-Lex Paper



Claims”), which paper claims are exactly duplicative of the Remar-Lex Claims and are described on Exhibit A to the Motion.

**B. Stanley Rabinovich Claims**

29. In the Broker Claims Order, the Court also disallowed the claims of Philip S. Rabinovich (“Philip Rabinovich”), who was a senior vice president, registered representative, and an investment advisor with MS & Co. As with Lex, the Court disallowed Philip Rabinovich’s claims based on his violations of the Securities Act. Broker Claims Order at 8.

30. As described in more detail below, in 2007 and 2009, Phillip Rabinovich arranged for his father, Stanley Rabinovich (“Stanley Rabinovich”), to provide so-called “bridge loans” to allow McGinn and Smith to close private placement offerings. By providing bridge loans, Stanley Rabinovich allowed certain offerings to close, at which time escrow could be broken and McGinn and Smith could access investor funds. *See* Palen Dec’1. ¶¶66, 99 (describing how, after investor funds left the escrow account, they were used to enrich McGinn and Smith personally, or to support MS & Co. or other MS & Co. entities).<sup>1</sup> In October 2007, McGinn approached Philip Rabinovich about a “bridge loan” necessary to secure an asset for the First Line 07 Series B private placement. *See* Broker Trial Tr. 2091:14-18.<sup>2</sup> Philip Rabinovich arranged for Stanley Rabinovich to make a \$600,000 loan to satisfy the shortfall, which McGinn promised to repay two to three months later. *Id.* 2091:22-25. Although this transaction was characterized as a “loan” by McGinn

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<sup>1</sup> “Palen Dec’1” refers to the Declaration of Kerri L. Palen, dated January 10, 2014, submitted in support of the SEC’s allegations in the Broker Proceeding, which is attached here as Exhibit 1.

<sup>2</sup> “Broker Trial Tr.” refers to the transcript of the public hearing held before the Chief Administrative Law Judge (“ALJ”) in the Administrative Proceeding commenced by the SEC on September 23, 2013 as to certain MS & Co. brokers (including Philip Rabinovich) (“Broker Proceeding”), an excerpt of which is attached here as Exhibit 2.

and Philip Rabinovich, there was no loan documentation and Stanley Rabinovich executed a subscription agreement as if he were an investor and received the same interest payments as other investors in Firstline 07 Series B. *Id.* 3409:17-3410:5.

31. When new investors purchased Firstline 07 Series B notes, the incoming funds were improperly funneled directly to Stanley Rabinovich to pay off his loan. In total, between April 23, 2008 and June 16, 2008, MS & Co. brokers made twenty sales of Firstline 07 Series B notes to pay back Stanley Rabinovich's \$600,000 loan in its entirety. *Id.* 2101: 14-24; *see also* Palen Dec'1. ¶ 89, Ex. 21. At the time, the Firstline 07 Series B notes were more than four years away from maturing. *Id.* 2109: 24-2110: 4.

32. McGinn approached Philip Rabinovich for another bridge loan in January 2009 to close the TDMM Cable 09 private placement. Broker Trial Tr. 2115: 14-22. Stanley Rabinovich "loaned" \$250,000 to TDMM Cable 09, which, again, was treated like an investment, although characterized as a loan. *Id.* 2116:23 - 2117:2. As with the Firstline 07 Series B transaction, McGinn agreed to put \$250,000 worth of TDMM Cable 09 notes out for secondary market sales in order to improperly repay Stanley Rabinovich's loan. *Id.* 2117: 3-7.<sup>3</sup> Stanley Rabinovich's loan to TDMM Cable 09 was improperly repaid in full from the secondary sales. *Id.* 2122: 6-12. Both improper and illegal repayments of more than \$850,000 to Stanley Rabinovich deceived legitimate investors that the minimum

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<sup>3</sup> In the Broker Proceeding, the ALJ found in the Initial Decision entered on February 25, 2015 that Stanley Rabinovich made the \$600,000 bridge loan to purchase an asset for the Firstline 07 Series B transaction and the \$250,000 bridge loan to TDMM Cable 09 to close the offering. *Donald J. Anthony, Jr., et al.*, Initial Decision Release No. 745 (Feb. 25, 2015), 110 SEC Docket 19, modified by Order on Motions to Correct Manifest Errors of Fact in the Initial Decision, Administrative Proceedings Release No. 2528 (Apr. 9, 2015), 111 SEC Docket 5, at 59. As a result of the Supreme Court of the United States' opinion in *Lucia v. S.E.C.*, 138 S.Ct. 2044 (2018), the Initial Decision was vacated and the Broker Proceeding was remanded for reassignment to a new administrative law judge. The SEC subsequently entered into a settlement with the brokers to avoid a re-trial.

funding for those investments had been achieved and allowed Stanley Rabinovich to be repaid when legitimate investors were not repaid.

33. Stanley Rabinovich and his wife, Eva Rabinovich, collectively assert fourteen disputed claims against the Receivership in an aggregate amount of \$3,393,540.33 (collectively, the “Rabinovich Claims”), as described in greater detail on Exhibit A to the Motion. Stanley and Eva Rabinovich filed twelve paper claims (collectively, the “Rabinovich Paper Claims”), also described on Exhibit A to the Motion, presumably in accordance with the instructions in the Claims Procedure Order.

### **IMPROPERLY CLASSIFIED CLAIMS**

34. In reviewing the records and records of MS & Co., I have discovered that certain Disputed Claims were classified incorrectly as investor claims at the time that the Claims Procedure Order was entered. Those claims requiring reclassification are described in greater detail below and are set forth on Exhibit B to the Motion.

#### **A. ADT Claims**

35. ADT Security Services, Inc. (“ADT”) filed two paper claims (collectively, the “ADT Claims”), as described on Exhibit B to the Motion, asserting claims against TDM Cable Funding LLC (“TDM”) and Prime Vision Communications LLC (“Prime Vision”) arising out of a certain Assignment Agreement dated October 6, 2006 between ADT and TDM (“Assignment Agreement”). Pursuant to the Assignment Agreement, TDM purchased from ADT a certain Balloon Promissory Note for \$3,165,762 made by Prime Vision to ADT (“ADT Note”). The Assignment Agreement included an agreement that, if the ADT Note were paid or subsequently sold, the proceeds would be divided and a portion would be paid to ADT Security. The ADT Note has not been paid or sold. Consequently, ADT does not hold or assert any other claims against the Receivership.

**B. HSK Claim**

36. 107th Street Associates, LLC (“107th Street”), a Receivership entity, borrowed one million dollars (“Loan”) from HSK Funding, Inc. (“HSK”) pursuant to a certain Promissory Note dated October 9, 2007. The Loan was secured by a pledge of stock in an entity called United Security Assurance, Inc. The debt obligation owing to HSK was mistakenly described as an investor claim and was assigned claim number 5328D (“HSK Claim”), as shown on Exhibit B to the Motion. The HSK Claim is a loan secured by collateral and should be reclassified as such and as an unsecured claim for any deficiency.

**PREFERENTIAL PAYMENTS**

37. Certain investors (“Preferred Investors”) received preferential payments in the form of interest payments and redemptions (“Preferential Payments”) made by two MS Entities, McGinn Smith Funding LLC (“MSF”) and TDM. MSF and TDM were essentially “conduit entities”: funds raised from investors in various Trust Offerings would first be deposited into an escrow account and net proceeds then advanced to MSF or TDM, which was supposed to then purchase the underlying investment. Palen Dec’1. ¶ 64. MSF and TDM, however, were used by McGinn and Smith to facilitate “improper and fraudulent transfers” between and among McGinn and Smith, personally, and other MS & Co. Entities. *Id.* ¶ 64, 66.

38. The Preferential Payments were made in late 2009 and early 2010, at the height of the Ponzi scheme and when many other MS & Co. investors ceased receiving any payments on account of their investments. Four of the Preferred Investors received preferential interest payments from TDM starting in January 2010, going through to April 2010. Two of the Preferred Investors received preferential interest payments and

redemptions from MSF starting in November 2009, through to April 2010. The funds used to make these Preferential Payments were not generated through the legitimate investment operations of TDM or MSF but instead were amounts raised from certain Trust Offerings or deposited directly by other investors or MS & Co. Entities. Consequently, the Preferred Investors received Preferential Payments comprised of funds that they were not entitled to receive, at a time when most other investors in MS & Co. were no longer receiving payments on account of their investments.

39. The Preferential Payments are set forth in greater detail on Exhibit C-1 to the Motion. Presumably in accordance with the instructions in the Claims Procedure Order, three of the Preferred Investors filed paper claims (collectively, the “Preferred Investor Paper Claims”), which are set forth in greater detail on Exhibit C-2 to the Motion.

#### **PAPER CLAIMS**

40. Generally, most investors holding Disputed Claims followed the Receiver’s instructions in the Claims Procedure Order and submitted paper claims exactly duplicative of their claims marked “Disputed” on the Receiver’s website. In addition, other investors who do not hold Disputed Claims also filed paper claims, either in the exact amount of their Receiver-granted claims shown on the Receiver’s Website, or presumably because they disagreed with the amounts of their claims as set forth on the Receiver’s Website or because they assert claims which were not shown on the Receiver’s Website. These paper claims may be categorized as Discrepant Claims, Duplicate Claims, No Liability Claims, Non-Receivership Claims, Excluded Claims, and Untimely Claims. I have examined these paper claims and have determined that there is no basis in the books and records of McGinn Smith to make distributions on account of these paper claims.

**APPLICATION OF THE PREFERENTIAL PAYMENT OFFSET**

41. To apply the Preferential Payment Offset, I have used the books and records of MS & Co. to determine when the Preferential Payments were made, to whom, and from which MS & Co. entity. The Preferential Payment Offset was then applied to the aggregate first distribution which would otherwise be made on account the Preferred Investors' claims in TDM or MSF, as applicable. If the Preferred Investor does not hold a corresponding claim in TDM or MSF, I applied the Preferential Payment Offset to their other claims asserted against MS & Co.

**NOTICE**

42. In connection with the service of the Motion and all accompanying papers, including this Declaration, I will cause to be mailed to each claimant listed on the Exhibits attached to the Motion a copy of the Motion and related pleadings.

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Dated: October 9, 2019

/s/ William J. Brown  
William J. Brown

Doc #4480144.1

# *Exhibit 1*



**UNITED STATES OF AMERICA**  
**Before The**  
**SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15514**

**In the Matter of**

**DONALD J. ANTHONY, JR.,  
FRANK H. CHIAPPONE,  
RICHARD D. FELDMANN,  
WILLIAM P. GAMELLO,  
ANDREW G. GUZZETTI,  
WILLIAM F. LEX,  
THOMAS E. LIVINGSTON,  
BRIAN T. MAYER,  
PHILIP S. RABINOVICH, and  
RYAN C. ROGERS,**

**Respondents.**

**DECLARATION OF KERRI L. PALEN**

I, Kerri L. Palen, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am a Staff Accountant in the Enforcement Division of the New York Regional Office of the Securities and Exchange Commission. My duties include providing professional and technical advice and assistance in financial analyses, accounting principles and auditing standards, and research in relation to Commission investigations and litigations to enforce the federal securities laws.
2. I received a B.S. in Accounting from Florida Atlantic University in 1994. Prior to joining the Commission, I worked for over 16 years as an auditor and financial

fraud investigator. I am a Certified Public Accountant in New York and New Jersey, and am also a Certified Fraud Examiner.

3. This Declaration was written in support of the Division of Enforcement's allegations in *Matter of Anthony, et al.*, File No. 3-15514, and is based on my personal knowledge, information and belief.

4. This Declaration concerns certain unregistered securities offered by McGinn, Smith & Co., Inc. ("MS&Co.") and the entities set forth in Paragraphs 11 through 19 of the *Order Instituting Administrative and Cease-and-Desist Proceedings* dated September 23, 2013 ("OIP"). The descriptions of those offerings and entities in the OIP are incorporated herein. The 26 offerings are summarized in the "Listing of Offerings" at Exhibit 3 and are referred to as "The Offerings" in this document.

5. This Declaration covers two primary areas. First, I summarize the Respondents' sales of, and related commissions paid for, The Offerings from 2003 through 2009 (§§ 11-18). Second, I describe how the investor funds—the proceeds from the sales made by the Respondents—were actually used (§§ 19-102).

6. My primary source material for the first section of my declaration was a MS&Co. maintained investor database and MS&Co. payroll records. My primary source material for the second section of my declaration was bank records. I reviewed and analyzed relevant records for 248 bank accounts listed on the "List of Financial Accounts" (*See Ex. 1*). These records were voluminous and included monthly account statements, account opening documents, transfer records, deposit, check and withdrawal records.

7. I also reviewed MS&Co.'s financial and accounting records and documents pertaining to the relevant MS&Co. offerings. I also reviewed the tax workpapers and tax returns prepared by Piaker & Lyons, Certified Public Accountants ("Piaker"), the tax accountant for MS&Co. and numerous entities affiliated with MS&Co., which were controlled by Timothy McGinn ("McGinn") and David Smith ("Smith").

8. I reviewed deposition transcripts and exhibits from *SEC v. McGinn, Smith & Co., Inc.*, 10-cv-457 (N.D.N.Y.) (the "NDNY Action"), and reviewed reports and documents filed by the Court-appointed Receiver in the NDNY Action, William Brown.

9. I also reviewed documents that were obtained by the Commission staff from the Financial Industry Regulatory Authority ("FINRA") prior to the filing of the NDNY Action. The FINRA records that I reviewed include Quicken files maintained by MS&Co. for 45 entities listed at Exhibit 2. Quicken is a single-entry accounting software that functions much like a check register, and can be used to generate financial reports, such as balance sheets, income statements, and schedules that show the source and use of funds. The original files were obtained by FINRA, and the entities they controlled, and were provided to the Commission. Subsequently, Brian Shea, a former MS&Co. accountant who is now working for the Receiver, updated the Quicken files to include missing bank transactions and provided me with updated versions.

10. In addition, I had telephone discussions and meetings with a number of people associated with MS&Co. or the relevant offerings and entities, including Renney Thomas (former contractor for MS&Co.); Brian Shea; Doug Keenholts (former Vice President of McGinn Smith Alarm Traders); Joe Carr (MS&Co.'s former in-house

counsel); and Brian Cooper (former MS&Co. accountant). I also spoke with individuals associated with varied MS&Co. affiliated entities, including Mario Bustamante (associated with TDM Cable Funding LLC and TDMM Cable Funding LLC); John Stuart (associated with Full Circle Capital), Mike Moscinsky (Chief Financial Officer of Integrated Alarm Services Group, Inc. [“IASG”]); Addi Aloya (President of Verifier Capital LLC); Mark Guidry (associated with TDMM Cable Funding LLC); Paul Andreasson (associated with Luxury Cruise, LLC); and William Lipman (associated with Integrated Excellence, LLC). I also spoke with the auditors for IASG’s initial public offering, Steve Jacques and Andrew Plunkett (PriceWaterhouseCoopers), and Timothy Paventi and Ronald Simons (Piaker).

#### **METHODOLOGY FOR RESPONDENT SALES AND COMMISSIONS LIST**

11. Exhibit 4, “Summary of Sales Made by Respondents and Commissions Paid,” sets out the total sales made by, and commissions paid to, each of the Respondents. Exhibits 4a through 4t are the detail schedules for each Respondent that feed up to the “Summary of Sales Made by Respondents and Commissions Paid” at Exhibit 4. Each Respondent’s detail schedule, called “Summary of Sales” includes the customer name, the date, amount and product invested in. Each Respondent’s “Commissions Paid” schedule includes the date the commission was paid, the description used in the payroll records and the amount of the net commission paid.

12. The source for the Respondent’s Summary of Sales was MS&Co.’s investor database. The investor database provided the customer name, customer address, product purchased, date of purchase, broker responsible for the sale, amount invested, status of the sale (i.e., closed, cancelled, open) and the certification date. The investor

database did not include commission information. I received a Microsoft Excel version of the investor database from Brian Shea. Brian Shea also provided me with a “System Summary by Product” which indicates the full name of the product offering for the abbreviated codes used in the investor database. (See Div. Ex. 470.)

13. From the investor database Excel file, I extracted the sales by each Respondent for The Offerings and created a “Summary of Sales” chart for each Respondent. I filtered out sales that the investor database indicated as being cancelled or sales that were in other ways duplicative, for example, a transfer of one investment made from a customer’s individual account to the individual’s IRA account.

14. Finally, I manually reviewed the Four Funds transactions to eliminate rollovers that occurred from one product to the next (for example, when the same customer rolled funds used to purchase a one year FAIN note into a new FAIN note with an extended maturity date). In cases where I had customer account lists maintained by the Respondents, for example, for Lex and Chiappone, I compared the Respondent’s “Summary of Sales” to lists they maintained. In cases where I did not have customer account lists maintained by the Respondents, I reviewed, on a sample basis, other supporting documentation for the sale, including bank records indicating cash receipt, copies of the sales tickets or the customer subscription agreements, and other documents maintained by MS&Co. in each customer’s file.

15. The source for the Respondent’s “Commissions Paid” schedules includes information obtained from the monthly and annual payroll records for the period October 2003 through October 2009.

16. The monthly payroll records contain line items identifying the type of offering or product for which the Respondents were paid commissions. In some cases, these line items were descriptive enough for me to determine whether the Respondents received commissions for selling The Offerings. In other cases the line items were not descriptive enough. In most cases, however, underlying records, which tied back to the payroll records allowed me to identify the specific products that the Respondents received commission payments for.

17. For the limited number of instances where no further detail beyond the monthly payroll summary schedules was available, I reviewed the investor database for sales made by the Respondent for the time period commissions were being paid. Typically, MS&Co. paid commissions on the 15th of each month for sales made the month prior. (For example, on February 15, commissions were paid on sales made from December 15 through January 15.) Reviewing the investor database allowed me to determine whether, during the pay period, the Respondent made sales of products other than The Offerings and, therefore, allowed me to adjust the commission payment appropriately so as only to include the relevant commission amount.

18. Gross commission rates varied from 2% to 9.5% of the sale amount on the Trust offerings and were typically paid to the broker at the time of the sale. Gross annual commission rates for the Four Funds were 1% for the one and three year senior notes and 2% for the five year junior notes. Four Funds commissions were paid annually based on the brokers' customer's total holdings. The broker was paid out 60% to 100% of gross commission depending on the offering and on the broker.

### **OVERVIEW OF THE MS&CO. OFFERINGS**

19. From on or about September 2003 through April 2010, MS&Co. and various issuers owned or controlled by McGinn and Smith raised approximately \$127 million through three types of unregistered debt offerings: (a) at least approximately \$86 million through the Four Funds offerings; (b) approximately \$34 million through the Trust offerings and (c) approximately \$7 million through MSTF.<sup>1</sup> (*See* Ex. 3.)

20. The Respondents were the top selling brokers of The Offerings. They were collectively paid nearly \$4 million in commissions to sell approximately \$100.6 million of The Offerings.<sup>2</sup> (*See* Ex. 4)

21. As discussed in detail below, the proceeds from the 26 offerings were used to pay investor redemptions and interest for other MS&Co. offerings; to enrich Smith, McGinn and Matthew Rogers (“Rogers”), a Senior Vice President at MS&Co.; to make loans to entities controlled by McGinn and Smith; and to invest in some performing and other non-performing assets. Proceeds from these offerings were also used to support MS&Co.

### **THE FOUR FUNDS OFFERINGS MISUSED INVESTOR FUNDS**

22. The PPMs for the Four Funds offerings stated broadly that the offering proceeds would be used to “to acquire various public and private investments, which may include, without limitation, debt securities, collateralized debt obligations, bonds, equity securities, trust preferreds, collateralized stock, convertible stock, bridge loans, leases, mortgages, equipment leases, securitized cash flow instruments, and any other

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<sup>1</sup> The total raised figure for the Four Funds exclude rollovers, replacement and secondary sales.

<sup>2</sup> The sales figures for the Respondents may also include replacement sales.

investments that may add value to our portfolio (individually an “Investment” and collectively, the “Investments”).”

23. Each offering had three tranches of notes paying 5%, 7.5% and 10.25%. Investors were to receive quarterly interest payments and a return of principal at the end of one, three or five years.

24. As will be described below, contrary to the PPMs, investor proceeds from the Four Funds offerings were used to pay investor redemptions or interest to investors of pre-2003 McGinn Smith offerings and to make loans to entities controlled by McGinn and Smith. The Four Funds also invested in other performing and non-performing assets and paid fees to MS&Co. By the end of 2007, Smith and David Reese of MS&Co. valued the Four Funds’ assets at less than half of the amount owed to Four Funds investors and concluded that the assets did not generate enough income to pay investor redemptions, interest and broker commissions.

**MONEY RAISED FROM FOUR FUNDS INVESTORS WAS USED TO REDEEM INVESTORS OF PRE-2003 MS ALARM TRUSTS**

25. In the ten years prior to the launch of the Four Funds in September 2003, McGinn and Smith had created and sold “Participation Certificates” in dozens of trusts with the disclosed purpose being to invest in security alarm contracts (the “Pre-2003 MS Alarm Trusts”). The Trustee was typically MS&Co. Most of the alarm contracts owned by the Pre-2003 MS Alarm Trusts were rolled into the IASG initial public offering and the Trust investors were paid from the proceeds of the initial public offering. However, several Pre-2003 MS Alarm Trusts were not rolled into this public offering. As described below, the remaining trusts relied on significant financial support from the Four Funds offerings.



26. As demonstrated in the “Four Funds Support to Pre-2003 MS Alarm Trusts,” *see* Exhibit 8, and explained below, a substantial amount of Four Fund offering proceeds (approximately \$12.8 million in total) was used to support the Pre-2003 MS Alarm Trusts. The Four Funds provided this support in one of two ways: 1) by purchasing the underlying alarm contracts from the Pre-2003 MS Alarm Trusts for more than the initial cost, thereby providing the funds to redeem investors; or b) by making loans to the Pre-2003 MS Alarm Trusts in order for them to redeem or make interest payments to investors. These type of investments were not disclosed in the Four Funds PPMs, and were a contributing factor to the failure of the Four Funds. The Four Funds PPMs state:

“We may acquire such Investments directly, or from our managing member or an affiliate of us or our managing member that has purchased the Investment. If the Investment is purchased from our managing member or an affiliate, we will not pay above the price paid by our managing member or such affiliate for the Investment, other than to reimburse our managing member or such affiliate for its costs and any discounts that it may have received by virtue of a special arrangement or relationship. In other words, if we purchase an Investment from our managing member or any affiliate, we will pay the same price for the Investment that we would have paid if we had directly purchased the Investment.” (*See* Div. Ex. 5, 6, 9 and 12, emphasis added.)

27. Smith acknowledged the use of Four Funds proceeds to support the Pre-2003 MS Alarm Trusts in an internal memorandum dated November 25, 2007. (*See* Div. Ex. 363 and 305) In the letter, Smith made the following observation with respect to the Four Funds investment in the Pre-2003 MS Alarm Trusts:

“A substantial amount of investment dollars went to refinance alarm contracts that were due in 2003. The income from these contracts had been substantially reduced due to attrition, but the investment rationale was that attrition would slow and that as a long term investment they would be okay. In addition, we felt that other investment returns would make up for the shortfall in cash flow from the alarm contracts. That proved not to be the case.”

28. Exhibit 9 shows that as four of the Pre-2003 MS Alarm Trusts (known as Security Participation Trust 1 (“SPT 1”), Security Participation Trust 2 (“SPT 2”), Security Participation Trust 3 (“SPT 3”), and Security Participation Trust 4 (“SPT 4”)) matured, the Four Funds purchased the alarm contracts held by the SPT trusts for an amount approximately equal to the amount needed to redeem the SPT investors. The following discussion details the transactions and provides evidence that the Four Funds paid more for the alarm contracts than SPT had initially paid for them years earlier, despite the fact that the income from those same contracts had, in Smith’s words, “been substantially reduced due to attrition.” (*See* Div. Ex. 305 and 363)

29. SPT 1 offered \$3,090,000 of participation certificates pursuant to a PPM dated October 18, 2000. (*See* Div. Ex. 355) According to the PPM, the net proceeds of the offering (\$2,954,813) were to be used “to acquire both new and existing portfolios of [residential security alarm] contracts”. SPT 1 paid approximately \$1.2 million (*See* Div. Ex. 362), for the alarm contracts that it purchased from January 2001 through May 2003. The actual amount invested by SPT 1 in alarm contracts was only 40% of the over \$2.9 million that should have been invested according to the SPT 1 PPM.

30. On November 1, 2003, right after FIIN started raising investor funds, FIIN purchased the alarm contracts from SPT 1 for \$2,090,000. (*See* Div. Ex. 354 and 475.) Accounting and bank records reflect that the FIIN funds, along with approximately \$1 million from another affiliated entity, Capital Center Credit Corp. (“CCCC” or “C4”), were used to redeem SPT 1 investors. FIIN recorded an investment in alarm contracts totaling \$2,090,000, which had been amortized down to a book value of approximately \$1 million as of December 31, 2007. (*See* Ex. 10 through 14).

31. As of December 2, 2007, MS&Co. estimated that the alarm contracts had a “net realizable value” of \$527,943 and provided \$154,275 of annual cash flow. (*See* Div. Ex. 363 and 408) The annual income generated by the contracts is approximately 7% of FIIN’s investment and not sufficient to cover the cost of capital.

32. SPT 2 offered \$5 million of participation certificates pursuant to a PPM dated February 8, 2001. (*See* Div. Ex. 357) According to the PPM, the net proceeds of the offering (\$4.7 million) were to be used “to acquire both new and existing portfolios of [residential security alarm] contracts.” SPT 2 paid approximately \$3.9 million for alarm contracts purchased from March 2001 through April 2003. (*See* Div. Ex. 362) The actual amount SPT 2 invested in alarm contracts was only 83% of the \$4.7 million that should have been invested according to the SPT 2 PPM.

33. On March 1, 2004, FEIN purchased the alarm contracts from SPT 2 for approximately \$4.7 million. (*See* Div. Ex. 356) The SPT 2 bank and accounting records reflect that the funds were used to redeem the SPT 2 investors.

34. SPT 3 offered \$2 million of participation certificates pursuant to a PPM dated September 10, 2001. (*See* Div. Ex. 359) According to the PPM, the net proceeds of the offering (\$1,880,000) were “to acquire both new and existing portfolios of [residential security alarm] contracts.” SPT 3 paid approximately \$1.1 million for alarm contracts purchased from October 2001 through May 2003. (*See* Div. Ex. 362) Thus, the actual amount invested was only approximately 59% of the approximately \$1.9 million that should have been invested in alarm contracts according to the PPM.

35. On October 1, 2004, FEIN purchased the alarm contracts from SPT 3 for approximately \$1.98 million. (*See* Div. Ex. 358) The SPT 3 bank and accounting records reflect that those funds were used to redeem the SPT 3 investors.

36. Combining the purchase of SPT 2 and SPT 3 contracts; FEIN had paid a total of approximately \$6.7 million for alarm contracts that SPT 2 and SPT 3 originally paid approximately \$5 million for. (*See* Div. Ex. 362) FEIN's investment in the contracts had been amortized down to a book value of approximately \$3.6 million as of December 31, 2007. (*See* Ex. 14) As of December 2, 2007, MS&Co. estimated that these alarm contracts had a combined "net realizable value" of \$935,555 and provided \$387,610 of annual cash flow. (*See* Div. Ex. 363 and 408) The annual income from the contracts is approximately 6% of FEIN's investment and is not sufficient to cover the cost of capital.

37. SPT 4 offered \$2 million of participation certificates pursuant to a PPM dated November 21, 2001. (*See* Div. Ex. 361) According to the PPM, the net proceeds of the offering (\$1,880,000) were to be used "to acquire both new and existing portfolios of [residential security alarm] contracts." SPT 4 paid approximately \$943,000 for alarm contracts purchased from November 2001 through May 2003. (*See* Div. Ex. 362) PX 529 The actual amount SPT 4 invested in alarm contracts was only around 50% of the more than \$1.8 million that should have been used for this purpose according to the PPM.

38. According to FEIN and SPT 4 bank records, FEIN purchased the alarm contracts from SPT 4 for approximately \$1.95 million on December 1, 2004. The SPT IV bank and accounting records reflect that those funds were used to redeem the SPT 4 investors.

39. On December 31, 2004, TAIN purchased the alarm contracts from FEIN for approximately \$1.95 million. (See Div. Ex. 360.) FEIN used the funds from TAIN to pay FEIN investor redemptions and FEIN investor interest. The investment in the SPT 4 contracts was initially recorded on TAIN's balance sheet at \$1,953,541 and was amortized down to a book value of approximately \$1.2 million as of December 31, 2007. (See Ex. 14) As of December 2, 2007, MS&Co. estimated that these alarm contracts had a "net realizable value" of \$632,276 and provided \$45,375 of annual cash flow. (See Div. Ex. 363 and 604) The annual income from the contracts is approximately 2% of TAIN's investment and not sufficient to cover the cost of capital.

40. The Four Funds purchases of SPT alarm contracts were negotiated by and between Smith for the Four Funds, as the "buyer," and McGinn for the pre-2003 alarm trusts, as the "seller." The Purchase Agreements were signed by Smith on behalf of the Four Funds and McGinn on behalf of the SPTs. (See Div. Ex. 354, 356, and 358) The purchase prices paid in all cases was equal to the balance needed to redeem the investors in each particular SPT Trust (with the exception of the FIIN purchase of SPT 1 which was subsidized with funds from C4). Smith asked his accounting staff to create the purchase agreements for the Four Fund's 2004 purchases of SPT 2, SPT 3 and SPT 4 in April 2009. (See Div. Ex. 364)

41. Jennifer Spinner, formerly an accountant at MS&Co. prepared a schedule on September 18, 2007 related to the Four Funds support to the Pre-2003 MS Alarm Trusts. Spinner estimated that the Four Funds initially paid a total premium of approximately \$5.5 million for the alarm contracts purchased from the SPT Trusts. (See Div. Ex. 474)

42. The Four Funds investor funds also were used to support other Pre-2003 MS Alarm Trusts, such as Acquisition Trust, Pacific Trust, RTC Trust and SAI Trust as described below.

43. Acquisition Trust matured on July 1, 2004 and was rolled into another MS & Co affiliated entity, Pacific Trust 02 (“Pacific”). (See Div. Ex. 465) According to FEIN’s Quicken records and the bank statements, FEIN loaned Pacific \$281,000 on June 2, 2004. The funds were transferred to Acquisition Trust on June 2, 2004 and used to redeem investors. According to the Four Funds Quicken records and Pacific bank records, beginning in October 2007, the Four Funds began loaning money to Pacific Trust so that Pacific Trust could redeem an investor. The Four Funds Quicken records and Pacific’s bank records reflect that Pacific received \$10,000 from TAIN on October 1, 2007; \$10,000 from FEIN on November 1, 2007; \$10,000 from FIIN, on December 1, 2007; \$8,000 on January 3, 2008, \$10,000 on February 12, 2008, \$10,000 on March 3, 2008, and \$10,000 on April 1, 2008 from FEIN; all of which was used to redeem an investor. (See Div. Ex. 531)

44. In an e-mail dated April 22, 2009, Dave Rees explained to Brian Cooper that Smith asked him to “pull the following items together concerning his due diligence items for his Income Note Fund files”. “Pacific Trust – FEIN lent \$ to Pacific to buy out Acquisition Trust (Acquisition Trust had a loan to SAI). We need a Letter of Credit b/w FEIN and Pacific dated the first day the loan was made.” Payments were made on the original loan. Additional amts. were lent to Pacific to take out Yukiko Schreiber. The letter of credit should carry an interest rate of 12%. Print out a payment history of Pacific Trust to FEIN. Additionally, TAIN may have lent funds to Pacific for Yukiko Schreiber

redemption. They too will need a letter of credit dating back to date of first funding.”  
(*See Div. Ex. 364 and 367*)

45. According to the investor database, RTC Trust raised over \$7 million during 2002. According to the RTC Trust PPM dated May 22, 2002, the RTC Trust certificates were entitled to interest at the rate of 11% per annum and matured in December 2007. (*See Div. Ex. 471*)

46. According to the PPM, the RTC Trust was to use the net proceeds of the offering to purchase a portfolio of alarm contracts from Integrated Alarm Services, Inc. (“IAS”) The common stock of IAS was owned by M&S Partners. M&S Partners was owned equally by McGinn and Smith. The Trustee of the RTC Trust was McGinn Smith Capital Holdings Corp. The PPM states that “Payments on the Certificates will be made out of the Scheduled Amount of the Monitoring Revenue Payments from the Portfolio of Contracts received by the Trust Fund each month.”

47. The RTC Trust alarm contracts were not generating income sufficient to meet investor interest payments, therefore beginning in 2004, FEIN and then FAIN loaned funds to RTC Trust to cover the obligation. By December 2007, over \$750,000 of Four Fund investor funds were used to pay RTC Trust interest. (*See Ex. 14*) The balance of FAIN’s and FEIN’s investment in RTC Trust was ultimately written off as of December 31, 2009.

48. Piaker’s FEIN workpapers include schedules that reflect the accumulation of the amount FEIN paid to RTC Trust. The 2006 workpaper includes a handwritten note that states: “Per Dave Rees – represents fundings of RTC Trust monthly cash flow shortages. To be repaid with Trust receipts – after Trust debt is paid off – OR – will be

purchased by another entity. Not accruing any interest income on above loan as at 12/31/05.” (See Div. Ex. 466)

49. According to FAIN bank records and Quicken records, SAI Trust 01 received funds from FAIN amounting to \$1,010,000 in February 2006 which was used to redeem an investor. The investor exercised his \$1 million put option to McGinn Smith Capital Holdings (the guarantor) in February 2006. FAIN investor funds were wired to cover the put option and FAIN was left holding a \$1 million “investment” in SAI Trust. SAI Trust stopped making interest and principal payments to investors in February 2008. (See Div. Ex. 472 and 473) The balance of FAIN’s investment in SAI Trust was ultimately written off December 31, 2009.

50. Moreover, although SAI Trust stopped making interest and principal payments to investors in February 2008, the bank records reflect that one particular SAI investor continued to receive his monthly SAI interest payment of approximately \$5,000 from MSTF through July 2009.

#### **FOUR FUNDS INVESTMENTS IN AFFILIATES**

51. Some of the conflicts of interest among the Four Funds as issuers of the debt offerings, placement agent, servicing agent and trustee were disclosed in the Four Funds’ PPMs. However, the PPMs failed to disclose that the Funds would invest in affiliates of McGinn and Smith. In November of 2007, Smith recognized that “one of the more troubling aspects of the [Four Funds] investments has been my willingness to make substantial investments in affiliated entities, both because they were available and in some cases, such as Coventry, new investments were needed to support past investments. Thus, in the case of Coventry, alsoT, EXBV the pattern was often the same; invest more



money to support the original investment. In all cases this has proved to be a poor decision and has not only aggravated our cash flow problems, but puts us in some legal jeopardy as well.” (See Div. Ex. 305 and 530.)

52. By December 31, 2007, investments in affiliates accounted for over half of the investments made by the Four Funds. (See Ex. 10-14 (Schedule of Annual Investment Holdings)). According to the Four Funds’ accounting records, many of the affiliated investments provided no cash flow to the Four Funds, however, the investment plus accrued interest remained on the Four Funds balance sheet at cost.

53. An example of a failed affiliated entity investment is FIIN, TAIN and FAIN’s approximately \$8.8 million investment in alseT IP Management (“alseT”), a startup company in which Smith had an indirect equity interest. AlseT had no income of its own. In order to meet its quarterly interest payments to FIIN, TAIN and FAIN, alseT borrowed additional money from the Four Funds. (See Ex. 23). As of December 2, 2007, MS&Co. considered its investment in alseT to be worthless. (See Div. Ex. 408 and 522)

54. Another example of a failed affiliated entity investment is FEIN’s investment in C4. C4 was an MS&Co. entity controlled and used by Smith and McGinn to cover cash short falls in the Pre-2003 MS Alarm Trusts. (See Div. Ex. 353)

55. Mr. Chang held a \$500,000 investment in C4 which was due to mature in January 2004. Mr. Chang requested that at maturity, the proceeds of his redemption be invested in FEIN in his wife’s name, Kee Mann Chang. (See Div. Ex. 367 and 468) C4 did not have funds to redeem Mr. Chang and therefore, no money flowed from C4 to FEIN when Mr. Chang redeemed in January 2004. Rather, FEIN reflected Kee Mann Chang, as an investor in FEIN with a \$500,000 liability due to her, and reflected an asset,

a note receivable of \$500,000 due from C4. (See Div. Ex. 467) Smith signed a promissory note for \$500,000 on behalf of C4. (See Div. Ex. 469) The promissory note pays interest at 12% per annum and provides that the \$500,000 principal be paid on July 24, 2004. This note appears to have been created subsequent to April 2009 according to Smith's handwritten notes. (See Div. Ex. 367)

56. According to the Quicken files, C4 made one \$25,000 payment to FEIN on July 16, 2004. C4 has been in default on the note since July 24, 2004; however, the ending investment balance of \$475,000 plus accrued interest remained on FEIN's books through December 31, 2009. By the end of 2007, the Four Funds had a cumulative total investment in C4 of \$720,231 (including accrued interest) which was written off in full as of December 31, 2009.

57. Similarly, in June 2004, FEIN loaned affiliate JV Associates \$95,000 at the rate of 12% per year. The funds were used to pay four delinquent mortgage payments for August 2002 through November 2002. (See Div. Ex. 476) Smith and McGinn are limited partners of JV Associates, each owning approximately 20% interest. (See Div. Ex. 477) Interest and principal on the JV Associates loan was payable in full to FEIN on December 24, 2004. The promissory note was signed by McGinn on behalf of JV Associates. No interest or principal payments were ever made to FEIN, and the balance remained on FEIN's books through December 31, 2009, when it was written off.

#### **OTHER UNAUTHORIZED USES OF FOUR FUNDS PROCEEDS**

58. The Four Funds used money from each other and the Trusts in order to pay investor redemptions and interest. For example, as described above at ¶¶ 39, FEIN's January and February 2005 interest payments, and a \$2 million investor redemption, were

paid in part using nearly \$2 million of TAIN investor Funds. According to bank and accounting records, in February 2007, TAIN “loaned” FEIN \$450,000 to make an investor redemption and to pay interest due to investors. In another example, FEIN investors were paid interest using a total of \$184,500 of funds raised in the Fortress Trust offering.

#### **FOUR FUNDS RAN A CASH DEFICIT**

59. By the end of 2007, the Four Funds owed investors a total of approximately \$84 million according to the Funds financial statements. (*See* Ex. 14) MS&Co. estimated that at that time, the investments held by the Four Funds were worth only approximately \$37 million. (*See* Div. Ex. 408 and 363 )

60. According to information in the Four Funds’ tax returns, by December 31, 2007, the Four Funds had generated a cumulative cash basis loss amounting to approximately \$6.4 million. (*See* Ex. 15) Based on these reported results, the Funds had not generated enough cash flow to pay the investor interest and fees they had been paying.

61. According to financial statements and a fee analysis prepared by Brian Cooper in late 2009, the Four Funds paid approximately \$7.7 million in underwriting, management and administrative fees to MS&Co. during the period 2003 through 2009. (*See* Div. Ex. 584.) As set out in “Underwriting and Management Fees Paid to MS & Co. From Four Funds Through 2007,” *see* Exhibit 16, the tax returns reflect that the Four Funds paid MS&Co. fees of approximately \$1.5 million in 2004; approximately \$2.6 million in 2005; approximately \$2.5 million in 2006 and substantially less, approximately \$380,000 in 2007. In addition to paying MS&Co. fees, the Four Funds had “invested”

over approximately \$820,000 in McGinn, Smith & Co. Preferred Stock by the end of 2007.

62. Just before November 25, 2007, when Smith wrote the letter discussing the Four Funds inability to pay investor redemptions, interest payments and broker commissions with the income they were generating, (*See Div. Ex. 363*) Smith used Four Fund assets to redeem approximately \$2.7 million preferred investors. In a series of transactions, Smith effectively used Pine Street Capital, one of the only assets the Four Funds owned that had any real value, to redeem his preferred customers out of the Four Funds in September and October 2007. (*See Div. Ex. 525 and 478.*) Smith describes in his letter of November 25, 2007 that MS&Co. was impacted by the fact that the Four Funds were running a cash deficit and were no longer able to pay fees during 2007. Smith expressed concerns for the ability to pay the first maturity of the Four Funds upcoming the following year, but his more immediate concern was the inability to pay the approximately \$700,000 due to the brokers on December 15, 2007 for the Four Funds annual commission payment. (*See Div. Ex. 363.*) The shortfall that MS&Co. was experiencing from the lack of fees coming in from the Four Funds was made up by unauthorized payments made to MS&Co. from the Trusts. The support provided by the Trusts is discussed in more detail below.

### **TRUST OFFERINGS**

63. Beginning in late 2006, the Respondents began raising money through the sale of Trust certificates. According to the PPMs, the trusts issued one or more tranches of notes and promoted interest rates ranging from 7.75% to 13% per annum. Maturity dates ranged from approximately 15 months to 5 years from the date of the offering.

Exhibit 3 shows that through 2009, a total of approximately \$34 million dollars of investor funds were raised through the Trust offerings.

64. According to the PPMs, the offering proceeds were supposed to be used to invest in specific streams of receivables, usually related to long term contracts for burglar alarm service, “triple play” (broadband, cable and telephone) service or luxury cruise cabin bookings. According to the PPMs, the funds raised from investors would first be deposited into the Trust’s escrow account and after deducting the disclosed fees and other deal costs, the “net proceeds” would be advanced to a Conduit Entity, which would or had already entered into an agreement with a third party for the underlying investment. Although the phrase Conduit Entity does not appear in the PPMs, it is an accurate description of the way investor funds from multiple offerings were routed to a single account, which facilitated the improper and fraudulent transfers described herein. The “Conduit Entity” was typically McGinn Smith Funding LLC (“MSF Conduit”) or TDM Cable Funding LLC (“TDM Conduit”).

65. Exhibit 17 is a list of the Conduit Entities used by the various offerings. As indicated, TDM Cable Trust 06; TDM Verifier Trust 07; TDM Luxury Cruise Trust 07; TDMM Cable Senior Trust 09; and TDMM Cable Jr. Trust 09 all used the Conduit Entity TDM Cable Funding, LLC. All four of the Firstline Trusts; TDM Verifier Trust 08 and TDM Verifier Trust 09 used the Conduit Entity McGinn Smith Funding LLC. Fortress Trust 08 used the Conduit Entity NEI Capital, LLC; TDMM Benchmark Trust 09 used the Conduit Entity TDMM Cable Funding, LLC and the Integrated Excellence Trusts used the MSTF Conduit Entity.

**PROCEEDS FROM THE TRUST OFFERINGS WERE MISUSED**

66. Practically speaking, the Conduit Entities facilitated the flow of investor funds raised in the Trust Offerings to and amongst various other entities controlled by McGinn and Smith. Once the investor funds were deposited to the escrow account and transferred to the Conduit Entity, they were used to enrich McGinn, Smith or Rogers personally, to support MS&Co. or to support other MS&Co. entities as liquidity needs dictated. For each Trust offering, less than the amount represented in the PPM was actually invested in the specific streams of receivables. As shown at Exhibit 5, the maximum aggregate offering amount of all Trusts was approximately \$44 million and \$34 million in total was raised. A total of \$3.7 million was offered by Cruise Charter Ventures Trust 08 and Cruise Charter Ventures, LLC which did not reach their minimum offering amounts, and therefore these funds were returned to investors.

67. TDM Cable Trust 06 (second raise); TDM Verifier Trust 07R; TDM Verifier Trust 08R; TDM Verifier Trust 11 had a maximum aggregate offering of \$7 million for the specific purpose of redeeming out earlier Trust investors. Approximately \$1.6 million was raised for this purpose.

68. TDM Cable Trust 06; TDM Verifier Trust 07; Firstline Trust 07; Firstline Senior Trust 07; TDM Luxury Cruise Trust 07; Firstline Senior Trust 07 Series B; Firstline Trust 07 Series B; TDM Verifier Trust 08; Integrated Excellence Sr. Trust 08; Integrated Excellence Jr. Trust 08; Fortress Trust 08; TDM Verifier Trust 09; TDMM Cable Jr. Trust 09; TDMM Cable Sr. Trust 09; TDMM Benchmark Trust 09 had a maximum aggregate offering of approximately \$33 million, and approximately \$32.5 million was raised to invest in specific streams of receivables related to long term

contracts for burglar alarm service, “triple play” (broadband, cable and telephone) service or luxury cruise cabin bookings (*See* Ex. 5). The PPMs for these Trusts stated that approximately \$28.6 million or (on average) approximately 85% of the \$32.5 million raised from investors was to be invested in these specific streams of receivables. (*See* Ex. 5)

69. However, the bank records for the relevant entities reflect that approximately \$18.7 million (only around 58% of the \$32.5 million raised) was used to invest in the specific streams of receivables disclosed in the PPMs. (*See* Ex. 18) As described below, the remainder of the investor funds were funneled to MS&Co.; to Smith, McGinn and Rogers; or to other entities controlled by McGinn and Smith; and used to make interest and principal payments to investors.

70. The Trust PPM’s disclosed combined maximum underwriting fees and other fees payable to MS & Co of up to \$3.2 million (*See* Ex. 5). However, from October 2006 through December 2009, MS&Co. received in excess of approximately \$6.4 million in connection with the Trust offerings (*See* Ex. 6).

71. Smith, McGinn and Rogers were paid approximately \$4.7 million from Trust escrow and Conduit Entity accounts. These payments were made in connection with the Trust offerings and none of them were authorized by the PPM.

72. Some of the funds transfers to Smith, McGinn and Rogers were initially recorded as fees in MS&Co.’s accounting records, but were later recategorized as loans. The loan documentation was created years later, at the time of the 2009 FINRA investigation.

73. On November 8, 2011, Ronald Simons, CPA, who prepared individual income tax returns for Smith and other Smith, McGinn and MS&Co. related entities, plead guilty to causing a false 2006 U.S. Individual Income Tax Return for David and Lynn Smith to be filed. The 2006 return did not report \$407,000 in fees distributed to Smith from TDM Cable Funding, LLC during 2006. As a result, total income was understated. Ronald Simons admitted to knowing that the amounts paid to Smith were initially booked by the MS&Co. controller as origination fees, but were later reclassified as a “loan” causing Simons not to include it on the Smith’s 2006 tax return. (*See Div. Ex. 447 and 448*)

74. On November 29, 2011, Matthew Rogers plead guilty to filing a false U.S. Individual Income Tax Return for the calendar years 2006 through 2009 which excluded fees of \$385,000 that Rogers received in connection with transactions related to TDM Cable Trust 06 during 2006; \$278,000 in fees Rogers received from transactions related to the TDM Verifier Trust 07, TDM Luxury Cruise Trust 07 and TDM Verifier Trust 08 offerings during 2007; \$285,000 in fees Rogers received in transactions related to the Fortress Trust 08 offering during 2008; and \$25,000 in fees Rogers received from transactions related to the TDMM Cable Jr. Trust 09 offering. (*See Div. Ex. 449 and 450*)

75. On February 6, 2013, following a four-week trial, a jury in the Northern District of New York found McGinn and Smith guilty of multiple counts of mail and wire fraud, securities fraud, and filing false tax returns. On August 7, 2013, McGinn was sentenced to 15 years in prison and Smith was sentenced to 10 years in prison. (*See Div. Ex. 453, 454 and 455*) As with the Four Fund offerings, the investments made by the



Trusts did not generate sufficient returns to cover interest and principal payments owed to investors. As a result, in numerous instances McGinn and Smith used investor funds from one offering to cover interest and principal payments in the same or a different offering. For example, TDM Cable Trust 06, TDM Verifier Trust 07, TDM Verifier Trust 08, TDM Verifier Trust 09, TDMM Cable Jr. and Sr. Trusts, Firstline Trust 07, Firstline Sr. Trust 07, Firstline Trust 07 Series B, Firstline Sr. Trust 07 Series B, Integrated Excellence Jr. Trust 08 and Integrated Excellence Sr. Trust 08 offerings all used investor funds raised by other Trust offerings to cover principal and interest payments to investors. In some instances, clearly in violation of the use of proceeds prescribed by the PPMs, investor funds were transferred directly from the escrow account to that Trust's or another Trust's operating account and used to pay investor interest.

(See Ex. 19)

**TDM Cable Trust 06 ("TDM")**

76. The first Trust offering, TDM raised \$3,575,000 pursuant to a PPM dated November 13, 2006. According to the PPM, the Trust offered two maturities: a two year maturity which paid an annual interest rate of 7.75% (maturing on November 15, 2008) and a four year maturity which paid an annual interest rate of 9.25% (maturing on November 15, 2010).

77. According to the TDM PPM, the net proceeds from the Offering (\$3,443,500) would be used to purchase the Preferred Return cash flow stream arising out of the sale of cable TV, broadband internet, and fiber optic telephone services to the Homeowners Association of Cutler Cay and Keys Cove as well as certain preferred payments received in connection with the purchase of an ADT Note.

78. According to the TDM PPM, the difference between the amount raised and the net proceeds to be invested (\$106,500) was the 3% underwriting fees that were payable to McGinn Smith & Co. In reality, the bank and accounting records reflect that only approximately \$1,804,000 (approximately 50% of the amount raised) was paid to purchase the assets described in the PPM. The remaining investor funds were used for unauthorized purposes including funding payments totaling approximately \$407,000 to McGinn; \$407,000 to Smith; \$385,000 to Rogers; \$392,800 to MS&Co. and \$15,000 to pay interest to the TDM investors. (*See Ex. 7*)

79. Further, the cash flow generated by the underlying assets was not sufficient to meet the debt service of TDM. The Trust borrowed funds from other related entities to make monthly interest payments. For example, according to bank records, the February 2007 interest payments were made to TDM investors using funds from FIIN. In March 2008, TDM investor payments were made using funds from TAIN and FEIN. In July 2008, TDM investor payments were made using funds from MSTF.

80. In November 2008, when over \$1.3 million of notes matured, TDM offered investors the chance to roll their two year notes and earn 10% (up from the current 7.5%) despite the fact that they had been unable to meet the lower debt service. From November 2008 through January 2009, TDM raised an additional approximately \$320,000 to help redeem investors that did not roll over their investments. On February 2, 2009, \$14,500 of investor funds were transferred from the TDM escrow account (Mercantile acct. no. 9573) to the Conduit Entity - TDM Cable Funding, LLC (M&T acct. no. 4500), which prior to the transfer had less than \$100 in its account. On the same day, the funds were used to pay interest to investors.

81. The TDM Cable Funding, LLC account (M&T acct. no. 4500) shows that several Trusts transferred funds in order to cover TDM's investor interest. For example, on May 4, 2009, \$17,000 was received from TDMM Cable Sr. Trust 09 and used to pay TDM investor interest. In June 2009, \$15,000 was received from MSTF and used to pay TDM investor interest. In August, 2009 \$2,000 from Firstline Senior Trust 07 and \$33,000 from TDMM Cable Funding, LLC were used to pay TDM investor interest.

**Firstline Trusts**

82. According to bank records, from May 2007 through January 2008, MS&Co. raised a total of approximately \$3.7 million from investors who purchased unregistered securities from Firstline Junior Trust 07 and Firstline Senior Trust 07 (the "Firstline Trusts"). The investors were to be paid monthly payments from the revenue stream produced by financing secured by alarm contracts.

83. In connection with the above transaction, on May 10, 2007, McGinn and Smith were paid \$620,000 from the McGinn, Smith Funding, LLC account. None of these payments were disclosed in the PPMs. (*See Ex. 7*)

84. From October 29, 2007 through June 16, 2008, MS&Co. raised a total of approximately \$3.2 million from investors who purchased unregistered securities from Firstline Junior Trust 07 Series B and Firstline Senior Trust 07 Series B (the "Firstline Series B Trusts"). The investors were to be paid monthly payments from the financing secured by alarm contracts.

85. In connection with the October offering, McGinn and Smith paid themselves \$315,000 from the McGinn, Smith Funding LLC account. None of these payments were disclosed in the PPMs.

86. The bank records show that Trusts received scheduled monthly payments from September 2007 through December 2007.

87. From approximately January 2008 through approximately September 2009, Firstline made no payments on the loans and there was no cash flow to pay the Firstline Trust and Firstline Series B Trust investors.

88. The Firstline Trusts and Firstline Series B Trusts used approximately \$2 million of funds from TDM Cable Trust 06; TDM Verifier Trust 07; Integrated Excellence Jr. Trust 08; TDM Luxury Cruise Trust 07; TDM Verifier Trust 07R and TDM Cable Funding, LLC to pay its interest to investors.

89. From the time that Firstline filed for bankruptcy through approximately February 2009, Smith and the brokers, including some of the respondents, continued to sell Firstline Trust and Firstline Series B Trust certificates. (*See Ex. 20*) The investor proceeds received from April 22, 2008 through June 17, 2008 were used to redeem Respondent Rabinovich's relative's \$600,000 holding in Firstline Trust 07 Series B. (*See Div. Ex524*) and (*See Ex. 21*).

**Integrated Excellence Jr. ("INEX Jr.") and Sr. ("INEX Sr.") Trusts**

90. From June through September 2008, INEX Jr. and INEX Sr. raised a total of \$1,170,000. Of that amount only approximately \$700,000 (60% of the amount raised) was invested in a loan made by MSTF to Integrated Excellence Funding, LLC and secured by alarm contracts. (*See Ex. 22*) The PPMs disclosed that approximately 95% of the proceeds raised would be invested. According to bank records, the remainder of the funds were utilized to pay Firstline Sr. Trust investors (\$97,000 on August 29, 2008); to pay TDM Luxury Cruise Trust investors (\$45,000 on August 29, 2008); to make

unauthorized payments to Smith (\$35,000 on July 1, 2008) and McGinn (\$50,000 on July 1 and July 15, 2008), and to pay MS&Co. (a total of \$253,000). The only fees authorized to be paid by the PPM were underwriting fees payable to MS&Co. that would have totaled \$57,000 based on the actual amounts raised.

91. The underlying investments did not generate enough income to pay the investors in the Integrated Excellence Trusts. Therefore, funds from other McGinn Smith controlled entities loaned money to the Trusts to meet the obligations. For example, the bank records reflect that Integrated Excellence Trusts borrowed \$4,000 from TDM Luxury Cruise Trust 07 on March 2, 2009; \$4,500 from MSTF on April 1, 2009; \$4,800 from TDMM Cable Sr. Trust 09 on May 5, 2009; \$5,000 from MSTF on June 4, 2009; and \$5,000 from TDMM Cable Sr. Trust 09 on July 2, 2009 all used to make investor interest payments.

#### **Fortress Trust 08**

92. MS&Co. received over approximately \$730,000 from the Fortress Trust 08 offering, even though the PPM stated that MS&Co. would receive \$183,600 as underwriting fees from the approximately \$3 million raised from investors. Although the PPM represents that 94% of the amounts raised would be invested, the bank records reflect that only 36% of the amounts raised were actually invested. Aside from supporting MS&Co., the bank records reflect that McGinn, Smith and Rogers personally received approximately \$855,000 in connection with the Fortress Trust 08 offering. (*See* Ex. 7) The payments to MS&Co. McGinn, Smith and Rogers flowed through NEI Capital, LLC, a Conduit Entity account. The bank records reflect that the remainder of

the investor funds raised were funneled through a series of other McGinn and Smith controlled entities, and utilized to pay interest to FEIN and Firstline Trust investors.

**TDMM Cable Senior and Junior Trusts**

93. In January 2009, MS&Co. raised \$554,000 for the TDMM Cable Senior Trust 09 offering, and bank records reflect that these funds were deposited in an escrow account. Shortly thereafter, \$475,000 was transferred to TDMM Cable Funding, LLC (one of the Conduit Entity accounts and then \$413,000 was subsequently transferred from the Conduit Entity account to MS&Co., where it was used to cover payroll. In total, of the approximately \$2.8 million combined raise for the TDMM Cable Senior and Junior 09 Trust offerings, only approximately \$1.1 million was invested in accordance with the PPM. The PPM disclosed that a total of approximately \$2.3 million would be invested.

94. Of the remaining investor funds, approximately \$850,000 was transferred to MS&Co. to cover payroll and operating expenses. According to the PPM, MS&Co. was entitled to approximately \$182,000 in underwriting fees and \$400,000 for acquisitions, negotiations, legal and due diligence fees. The remaining approximately \$1 million was paid out directly from the escrow accounts or funneled through other McGinn and Smith controlled entities and the majority was used to pay investor redemptions and interest and to make payments to McGinn, Rogers and Smith personally.

95. According to the bank records, on June 16, 2009, investor funds of \$150,000 were deposited to the TDMM Cable Sr. Trust 09 account. On June 19, 2009, \$143,588.64 was paid to Respondent Rabinovich's father as a partial redemption of his holding in the same Trust. From July 2, 2009 through July 8, 2009 TDMM Cable Trust 09 investor funds of \$150,000 were transferred or deposited into the operating account of

TDMM Cable Trust 09. On July 8, 2009, \$93,212.18 was paid to Respondent Rabinovich's father as a partial redemption of his holding in the same Trust.

**TDMM Benchmark Trust 09**

96. Bank records reflect that from August 25, 2009 through August 27, 2009, the first few days of the offering, TDMM Benchmark Trust 09 raised over \$550,000 which was deposited to the TDMM Benchmark Trust 09 escrow account at M&T (0322). On August 27, 2009, \$536,000 of the investor funds were transferred from the escrow account to TDMM Cable Funding, LLC (the commingling entity) at Mercantile Bank (acct no. 9077) when the account had a \$525 balance in it. On August 28, 2009 a total of \$100,000 was paid to the personal accounts of McGinn (\$50,000) and Smith (\$50,000); \$275,000 was paid to MS&Co. \$33,000 was paid to TDM Cable Trust 06 \$33,000 to TDM Cable Trust 06 to cover investor interest payments and \$74,000 was paid to TDM Verifier Trust 07 (\$74,000) to cover investor interest payments. None of these payments were authorized by the TDMM Benchmark Trust 09 PPM.

97. An analysis of the bank records reflect that from the total approximately \$2.5 million raised in the TDMM Benchmark Trust 09 offering, \$294,000 was funneled through Conduit Entity TDMM Cable Funding, LLC (Mercantile Bank acct no. 9077) to the operating accounts of TDMM Benchmark Trust, TDM Cable Trust 06, TDM Verifier 07 and TDMM Cable Senior Trust offerings as shown in the table below. The funds were then used to pay interest to those Trusts' investors:

<b>Date</b>	<b>Trust</b>	<b>Acct No.</b>	<b>Bank</b>	<b>Amount</b>
8/28/2009	TDM Cable Trust 06	9839964500	M&T	\$33,000
8/28/2009	TDM Verifier 07	9839964765	M&T	\$74,000

9/1/2009	TDMM Cable Sr Trust	9845816710	M&T	\$5,000
11/13/2009	TDM Cable Trust 06	9839964500	M&T	\$17,000
11/19/2009	TDM Cable Trust 06	9839964500	M&T	\$34,500
11/19/2009	TDMM Cable Sr Trust	9845816710	M&T	\$55,000
11/13/2009	TDMM Benchmark Trust 09	9845817056	M&T	\$48,000
12/30/2009	TDMM Benchmark Trust 09	9845817056	M&T	\$27,500
Total				\$294,000

### **MSTF**

98. From May 2, 2008 through November 2008, MSTF raised approximately \$6.9 million from investors. According to the PPM, MS&Co. was to be paid a 2% underwriting fee, or \$140,000. The MSTF PPM stated that the net proceeds of the raise were to be used by MSTF to (a) provide capital to close financial transactions originated by MS&Co.; (b) invest in other public and private securities; and (c) purchase \$1.5 million of the broker-dealer's 2008 Series Cumulative Stock."

99. According to bank records, from May 2, 2008 through May 13, 2008, MSTF raised a total of \$2,575,000 from investors. The investor funds were deposited to MSTF's account at Mercantile Bank (acct 3083). On May 14, 2008, MSTF transferred \$300,000 of the investor funds to open an account for Cruise Charter Ventures, LLC at Mercantile Bank (acct 0435). From that account, on the same day, \$175,000 of the investor funds were paid to MS&Co., \$50,000 was paid to Smith's personal account and \$25,000 was paid to McGinn's personal account. Within the first fifteen days of the offering, MS&Co. was paid \$160,000 more than was authorized in the MSTF PPM and Smith and McGinn were paid \$75,000 more than was authorized in the PPM.



100. On May 15, 2008, investor funds of \$25,000 were deposited to MSTF's Mercantile account ending in 3083. On the same day, \$22,500 of funds were used to pay investor interest to preferred Four Funds customers. The Four Funds' investor payments had been cut or suspended earlier in 2008. In a letter written by Smith to an attorney Jay Kaplowitz, Smith expressed serious concern over the fact that MSTF had made "advances from MSTF to customers of McGinn Smith of whom we had decided to support because of their high level of importance to the firm and to whom we were attempting to bridge the gap of their shortfall in income due to the non-performance of their investment in the funds." Smith identified these payments as "the major risk". He goes on to explain that "there is no supportable or plausible reason why monies from MSTF were used to pay clients of the firm." Smith attached a list of such preferential investor payments from MSTF that, in his calculation, amounted to a total of \$596,281.

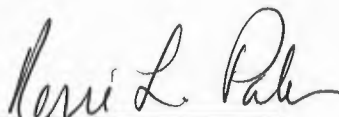
101. According to the bank records, the total amount raised, borrowed by and paid to the MSTF Mercantile account ending in 3083 during the entire period May 2, 2008 through November 2008 was approximately \$8,000,000. The amount was used as follows: (i) \$1,000,000 was used to purchase the Preferred Stock of MS&Co.; (ii) net amount of \$1,867,000 was funneled through a related entity, Cruise Charter Ventures, LLC and used in part to make payments to MS&Co., McGinn and Smith listed at Ex.'s 6 and 7; (iii) net amount of \$1,000,000 was paid to various related entities including over \$545,000 which was paid to Firstline Trusts and \$54,000; paid to TDM Cable Trust 06; \$89,000 paid to TDM Verifier Trust 08 and \$44,000 paid to TDM Verifier Trust 07 to enable those trusts to pay interest to their investors, (iv) over \$1,000,000 was provided to Zetek Corporation; (v) \$175,000 was used to pay Mr. Cranberry, LLC (a related entity

that made distributions to McGinn and Smith); (vi) approximately \$520,000 was used to pay interest to preferred Four Fund investors; (vii) approximately \$150,000 was used to pay legal fees; (viii) approximately \$290,000 was paid directly to MS&Co.; (ix) \$50,000 was paid to IA5 Associates; (x) \$200,000 was paid directly to McGinn; (xi) \$130,000 was loaned to CMS Financial (a related entity); and (xii) other various payments were made including approximately \$12,000 which was paid to McGinn's son, Matthew McGinn.

102. Aside from the investor funds raised for MSTF and deposited to the Mercantile account, a significant number of related party transactions were run through the MSTF accounts specifically to funnel money to and from the Four Funds, Trusts, various affiliates to cover interest payments, McGinn, Smith and Rogers, and MS&Co. to cover payroll. In a separate MSTF account from where investor funds flowed, money from the Four Funds were transferred in and back out to cover shortfalls in other affiliated entities. On November 14, 2008; November 26, 2008 and April 14, 2009 a total of \$525,000 from the Four Funds flowed through an MSTF account to MS&Co. to cover payroll and commissions.

I declare under penalty of perjury that the foregoing is true and correct.

Dated: New York, New York  
January 10, 2014

  
Kerri L. Palen

Date	Description	Investor		Amount	Cumulative Amount From Investors	Cumulative Amount Paid to Stan Rabinovich	Broker of Sale
4/23/2008	Sale To	Boris & Berta Kogan	FIRSTLN11B	\$ 150,000	\$ 150,000		Phil Rabinovich
4/23/2008	Sale To	Kate Thursby	FIRSTLN11B	\$ 50,000	\$ 200,000		MAYER/LEO-82 MAYER/LEO-82
4/23/2008	Sale To	Jeremiah Colihan	FIRSTLN11B	\$ 25,000	\$ 225,000		MAYER/LEO-82 MAYER/LEO-82
4/23/2008	Sale To	Rivi Peer-tirosh	FIRSTLN11B	\$ 25,000	\$ 250,000		MAYER/LEO-82 MAYER/LEO-82
4/28/2008	Sale To	Anthony Bailey	FIRSTLN11B	\$ 15,000	\$ 265,000		Franz Scutt
4/28/2008	Sale To	Anthony Bailey	FIRSTLN11B	\$ 10,000	\$ 275,000		Franz Scutt
4/28/2008	Sale To	James Johnson	FIRSTLN11B	\$ 10,000	\$ 285,000		GEOF SMITH
4/29/2008	Sale To	Piero & Hsiu Tozzi	FIRSTLN11B	\$ 10,000	\$ 295,000		COLIN MCARTHY
5/1/2008	Sale To	Avram Cahn	FIRSTLN11B	\$ 25,000	\$ 320,000		COLIN MCARTHY
5/1/2008	Sale To	Paula Green	FIRSTLN11B	\$ 15,000	\$ 335,000		Franz Scutt
5/1/2008	Sale To	Paul & Arlee Maier	FIRSTLN11B	\$ 25,000	\$ 360,000		COLIN MCARTHY
5/1/2008	Redemption	Stan Rabinovich	Check 1015	\$ (360,000)	\$ -	\$ (360,000)	
5/5/2008	Sale To	Andrew Greenberg	FIRSTLN11B	\$ 20,000	\$ 20,000		GEOF SMITH
5/15/2008	Sale To	Albert Ellis	FIRSTLN11B	\$ 30,000	\$ 50,000		Frank Chiappone
5/15/2008	Sale To	Robert F & Suzanne L Babcock	FIRSTLN11B	\$ 50,000	\$ 100,000		Frank Chiappone
5/23/2008	Redemption	Stan Rabinovich	Check 1018	\$ (100,000)	\$ -	\$ (100,000)	
5/28/2008	Sale To	Timothy Radice	FIRSTLN11B	\$ 25,000	\$ 25,000		GEOF SMITH
5/29/2008	Redemption	Stan Rabinovich	Check 1019	\$ (25,000)	\$ -	\$ (25,000)	
5/29/2008	Sale To	Kenneth Courey	FIRSTLN11B	\$ 10,000	\$ 10,000		Bill Lex
5/30/2008	Redemption	Stan Rabinovich	Check 1020	\$ (10,000)	\$ -	\$ (10,000)	
6/9/2008	Sale To	Andrew M & Moira L O'shea	FIRSTLN11B	\$ 30,000	\$ 30,000		COLIN MCARTHY
6/10/2008	Redemption	Stan Rabinovich	Check 1024	\$ (30,000)	\$ -	\$ (30,000)	
6/10/2008	Sale To	Robert & Judith Pugliese	FIRSTLN11B	\$ 55,000	\$ 55,000		Richard Feldmann
6/11/2008	Redemption	Stan Rabinovich	Check 1025	\$ (55,000)	\$ -	\$ (55,000)	
6/13/2008	Sale To	Dawn Bortman	FIRSTLN11B	\$ 10,000	\$ 10,000		Henry Lucander
6/16/2008	Sale To	Joseph Timmons	FIRSTLN11B	\$ 10,000	\$ 20,000		STEVE FURNO
6/16/2008	Redemption	Stan Rabinovich	Check 1026	\$ (10,000)	\$ 10,000	\$ (10,000)	
6/17/2008	Redemption	Stan Rabinovich	Check 1027	\$ (10,000)	\$ -	\$ (10,000)	
						\$ (600,000)	
<i>Source: Bank records and investor database</i>							

# *Exhibit 2*

Page 2088	Page 2090
<p>1 P. Rabinovich - Direct 2 Q. Let's start at the back, which is page 3 505. Four lines from the top we see Stan 4 Rabinovich, TDMM CAP 09, 9 percent, 250,000. 5 Right? 6 A. Correct. 7 Q. That was a bridge loan. Right? 8 A. Correct. 9 Q. That was repaid. Correct? 10 A. Yes. 11 Q. Let's go to page 4. A little higher 12 than the middle of the page -- Mr. Chan, you can 13 highlight it. Stan Rabinovich, Firstline, 11B, 14 October 29, 2007, 600,000. Do you see that one? 15 A. Yes. 16 Q. That is another bridge loan. Right? 17 A. Yes. 18 Q. That is repaid; right? 19 A. Yes. 20 Q. Let's go to page 3: The bottom half, 21 again we see Stan Rabinovich, Firstline 11, 22 May 29, 2007, 200,000? 23 A. Correct. 24 Q. That is not a bridge loan? 25 A. No. That was a permanent investment.</p>	<p>1 P. Rabinovich - Direct 2 JUDGE MURRAY: I think the record will 3 show what it shows. Yours is down there. I saw 4 it; right? 5 THE WITNESS: Yes. My immediate 6 family or the other members of the family you 7 mentioned this morning? There are additional 8 investments of family. 9 Q. So you are referring to your in-laws. 10 Correct? 11 A. My in-laws, yes. 12 Q. Let's stick with your dad. Your dad's 13 last investment is July 2007. Right? 14 A. It appears that way, yes. 15 Q. Then if we flip to your in-laws, the 16 last one I see -- please correct me if I am 17 wrong, is page 4, Fortress, September 29, 2008. 18 Do you see that? It is \$100,000? 19 MR. MUNNO: Would you give me a moment 20 to get there, please? What page are we on? 21 MS. MARLIER: Page 4, near the bottom. 22 THE WITNESS: No. On page 5 -- 23 MR. MUNNO: Can I find page 4 first 24 and then get to page 5? Where are we on page 4? 25 Q. You said you found one on page 5?</p>
<p>Page 2089</p> <p>1 P. Rabinovich - Direct 2 Q. The last investment your family made 3 in the private placement we are looking at for 4 purposes of this hearing is May 29, 2007. 5 Right? 6 A. Well, made an investment in 7 July 200 -- 8 Q. Sorry. The very last line. Page. 9 Sorry. Stan Rabinovich, TDML, July 24, 2007. 10 You see that? 11 A. Yes. 12 Q. I will ask my question again now with 13 the correct date. The last investment anyone 14 from your family made in the private placements 15 we are looking at for purposes of this hearing 16 is July 2007. Right? 17 A. No. I made an investment in 18 September 2009. 19 Q. With respect to your family, is what I 20 said correct? The last investment was 21 July 2007? 22 MR. MUNNO: Mr. Rabinovich is not a 23 member of his own family? 24 MS. MARLIER: Mr. Rabinovich is 25 himself.</p>	<p>Page 2091</p> <p>1 P. Rabinovich - Direct 2 A. Yes. TDM Verifier 09, 12/31/08 for 3 25,000. 4 Q. That is his last investment. Right? 5 A. I believe so, yes. 6 Q. Let's go back to the 600,000 7 Firstline, 11B bridge loan your father provided 8 on October 29, 2007, and that is on page 4 of 9 the sales chart if you need to look at it. 10 You testified that this was a bridge 11 loan. What did you mean when you said it was a 12 bridge loan? 13 A. Well, you need a little context. 14 Mr. McGinn came to me at the end of October with 15 a sense of urgency to close this particular 16 transaction. There was a \$600,000 shortfall 17 that he needed to make up in order to secure the 18 asset on behalf of our clients. Knowing that I 19 was potentially in a position to provide him 20 that capital, he requested -- he requested the 21 investment. 22 I went back, I spoke to my father, 23 with the conditions that Mr. McGinn laid out, 24 which would be a 60 to 90-day sort of interim 25 financing that he had requested that I provide.</p>

Page 2092	Page 2094
<p>1 P. Rabinovich - Direct 2 We were comfortable making the investment based 3 on the merits of the Firstline transaction. And 4 with the understanding that McGinn Smith -- 5 Mr. McGinn would then line up permanent 6 financing within that period of time and repay 7 that loan. 8 Q. The loan took longer than 60 to 9 90 days to pay off. Correct? 10 A. It took longer, yes. 11 Q. Do you remember how long it took? 12 A. In full it took about -- I want to say 13 about eight months. 14 Q. Did you ask any questions of 15 Mr. McGinn as to why he felt an urgency for the 16 capital immediately and couldn't just wait for 17 the McGinn Smith sales force to, you know, 18 basically reach the offering amount that he 19 needed? 20 A. Yeah. He gave me the reason that he 21 needed to complete this transaction by the end 22 of October. 23 Q. Did you have any understanding of why 24 it had to be complete by end of October? 25 A. I believe it was in a PPM that he</p>	<p>1 P. Rabinovich - Direct 2 entire email chain was forwarded to 3 Mr. Rabinovich on Monday, October 29, 2007, at 4 1:32 p.m., which we can see at the bottom of the 5 first page. 6 JUDGE MURRAY: Maybe if you go to a 7 question it would help his review of the 8 document. What were you going to ask him about? 9 MS. MARLIER: I was just giving him 10 time to read it and he was going to let me know 11 when he was set. 12 A. All right. 13 Q. Do you recognize this email chain, 14 Mr. Rabinovich? 15 A. Yes. 16 Q. Do you have any doubt that you 17 received the email chain and responded to 18 Mr. McGinn regarding the email chain? 19 A. I did respond. I received it and 20 responded to him. 21 MS. MARLIER: Division moves 22 Exhibit 549 in evidence. 23 MR. MUNNO: No objection. 24 JUDGE MURRAY: Received. 25 (So received in evidence)</p>
Page 2093	Page 2095
<p>1 P. Rabinovich - Direct 2 needed to secure the full financing by the end 3 of the month. 4 Q. Did you get any information as to why 5 the timing was so important other than the PPM? 6 A. Just from Mr. McGinn. 7 MS. MARLIER: Can I have Division 8 Exhibit 549, please? 9 Q. Mr. Rabinovich, I am going to bring 10 you a paper copy because this is a many page 11 exhibit. 12 MR. MUNNO: What is the date of this 13 document, please? 14 MS. MARLIER: October 29, 2007. 15 May I approach, your Honor? 16 JUDGE MURRAY: Yes. 17 Q. Take all the time you need to read it 18 and let me know when you are finished. 19 (Pause.) 20 MR. MUNNO: I just want to note for 21 the record that this is a long email chain. A 22 number of emails are included within the chain 23 that were not sent to or copied to 24 Mr. Rabinovich. 25 MS. MARLIER: For the record, the</p>	<p>1 P. Rabinovich - Direct 2 as Division Exhibit 549.) 3 Q. Does this email pertain to the 600,000 4 your father loaned to Firstline 11B? 5 A. Yes. 6 Q. When you received Mr. McGinn's email 7 of October 29, 2007 at 1:32 p.m., which is the 8 bottom of the first page, did you read the 9 emails that were attached to it, or did you read 10 the chain he was forwarding, to be more precise? 11 A. I don't recall at the time reading the 12 full chain. I did read it later when it was 13 brought to my attention. 14 Q. Let's look at the chain. 15 MS. MARLIER: Mr. Chan, could you 16 please go to the fourth page of the document. 17 One more. One more than four. The fifth page? 18 Q. At the bottom there of the fifth page 19 we see Mr. McGinn is emailing with someone, 20 mcoocca@stewartshops.com. Do you see that? 21 A. Yes. 22 Q. Then I think if we look at the email 23 just above that it looks like that person's name 24 is Michael Cocca? 25 A. Yes.</p>

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1 P. Rabinovich - Direct  
2 MR. MUNNO: Just to be clear, that  
3 email is August 14, 2007.  
4 Q. If you go to the second page, please,  
5 at the bottom --  
6 MR. MUNNO: You mean literally the  
7 second page or second page from the end?  
8 MS. MARLIER: Page 2.  
9 MR. MUNNO: Page 2 of your exhibit?  
10 MS. MARLIER: Yes. Correct.  
11 Mr. Chan, you will need to make this  
12 scroll for people on the screen because it goes  
13 on to the third page.  
14 Q. At the bottom of the page Mr. McGinn  
15 writes "Please journal 599,000 from Firstline  
16 Trust 07 Series B. We will be receiving an  
17 incoming wire into this account today in the  
18 amount of 600,000 to McGinn Smith Funding LLC.  
19 Also please journal 240,000 from TDM Luxury  
20 Cruise to McGinn Smith Funding LLC. Thereafter,  
21 please wire \$782,812.50 to the Adirondack Trust  
22 Company for credit to Stewart Shops Corp. as  
23 more fully described below. Thank you."  
24 Do you see that?  
25 A. Yes.

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1 P. Rabinovich - Direct  
2 Q. Was sending money raised from  
3 Firstline to Stewart Shops a disclosed use of  
4 Firstline funds in the Firstline PPM?  
5 A. Sorry. Can you repeat the question?  
6 Q. Sure. Was sending money raised as  
7 part of Firstline, sending that money to Stewart  
8 Shops, was that a disclosed use of Firstline  
9 proceeds as per the PPM?  
10 A. No.  
11 Q. Same question for TDM Luxury Cruise.  
12 Was sending money to Stewart Shops a disclosed  
13 use of money raised from the TDML investors?  
14 A. No.  
15 Q. When do you believe you read this  
16 email in its entirety?  
17 A. I was given this chain of emails by  
18 Ms. Coombe at the U.S. Attorney's office.  
19 Q. Do you know approximately when this  
20 was?  
21 A. It would have been around October,  
22 November of 2011.  
23 Q. So at the time you received this  
24 email, just to be clear, in 2007, did you not  
25 read it even though you did respond to

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1 P. Rabinovich - Direct  
2 Mr. McGinn?  
3 A. Yes. That's correct, I did not read  
4 this.  
5 Q. At some point in 2008 did you put in a  
6 redemption request on behalf of your dad to get  
7 the \$600,000 repaid?  
8 A. Yes.  
9 Q. At the time your father was redeemed  
10 on the \$600,000 Firstline note the sales force  
11 was still selling Firstline. Right?  
12 A. I believe they sold the second half of  
13 it, yes.  
14 Q. Did you know that new customer funds  
15 coming in would be the source of funding that  
16 would repay your dad's \$600,000 loan?  
17 A. Well, originally, my understanding was  
18 that Mr. McGinn was going to line up the  
19 financing. I believe he lined up a portion of  
20 it but the remaining portion went out to the  
21 sales force; yes.  
22 Q. Okay.  
23 A. Per Mr. McGinn's request.  
24 Q. So, in other words, the \$600,000 had  
25 to be sold to other investors first for your dad

Page 2099

1 P. Rabinovich - Direct  
2 to get repaid. Right?  
3 MR. MUNNO: That is not the witness's  
4 testimony. He just testified that Mr. McGinn  
5 paid a portion and Mr. McGinn put the balance  
6 out to the sales force.  
7 Q. Is that your testimony?  
8 A. Not necessarily, but that is  
9 apparently how it --  
10 Q. Well, is that your testimony or  
11 Mr. Munno's testimony? What do you remember --  
12 JUDGE MURRAY: Wait a second. Can you  
13 just answer her question? What was your  
14 original question?  
15 Q. So, in other words, the \$600,000 had  
16 to be sold to other investors first for your  
17 father to get redeemed?  
18 MR. MUNNO: I object to that because  
19 it is contrary to the witness's testimony. Can  
20 we have the witness's prior testimony read back?  
21 JUDGE MURRAY: Read back.  
22 (Record read.)  
23 JUDGE MURRAY: What is the question?  
24 MS. MARLIER: Now let's go to --  
25 should I --

Page 2100	Page 2102
<p>1 P. Rabinovich - Direct 2 JUDGE MURRAY: Do you have another 3 question? 4 MS. MARLIER: I am going to go to his 5 grand jury testimony now. October 6, 2011, 6 please, page 37. 7 MR. MUNNO: A moment, please, so I can 8 get there. 9 MS. MARLIER: Line 10. 10 MR. MUNNO: What page is it on? 11 MS. MARLIER: 37. 12 MR. MUNNO: Line? 13 MS. MARLIER: 10. 14 Page 37, line 10. "Question: What 15 did you have to do to get paid back? 16 "Answer: I believe that Mr. McGinn 17 had to resell the note. So, in other words, 18 they kept that allocation open so they continued 19 to sell it and when they sold it I would get 20 repaid." 21 I would also like to go to the 22 November 3, 2011 grand jury transcript. 23 JUDGE MURRAY: Excuse me, counsel. 24 What exactly are we talking about here? What 25 note is this now?</p>	<p>1 P. Rabinovich - Direct 2 Division Exhibit 2, page 154. 3 Mr. Rabinovich, this is a chart of 4 money raised from other investors, tracked 5 through bank records, which was then used to 6 repay your father on the \$600,000 note. Do you 7 see on the top April 23, 2008 there is a sale to 8 Boris and Berda Kogen, Firstline is 11B, 9 \$150,000. 10 A. Yes. 11 Q. You made that sale; right? 12 A. I did. 13 Q. When you sold the \$150,000 Firstline 14 certificate to Boris and Berda Kogen, did you 15 tell them their money would not be used 16 according to the terms of the PPM? 17 MR. MUNNO: Objection. That 18 presupposes that Mr. Rabinovich had any 19 knowledge that it wouldn't be used. I object to 20 the question. 21 JUDGE MURRAY: I will overrule the 22 objection. 23 Do you understand the question? 24 THE WITNESS: I don't understand the 25 question.</p>
Page 2101	Page 2103
<p>1 P. Rabinovich - Direct 2 MS. MARLIER: This is the \$600,000 3 Firstline 11B note that was held by 4 Mr. Rabinovich's father. 5 JUDGE MURRAY: You agree with that? 6 Are you comfortable with that? 7 THE WITNESS: I am comfortable with 8 the question. 9 JUDGE MURRAY: Okay. 10 Q. Let's go to November 3, 2011, grand 11 jury. Page 12, line 1. Here we are still 12 talking about the \$600,000 note held by Mr. Stan 13 Rabinovich in Firstline. 14 Line 1. "Question: When you said the 15 portion he couldn't fill you mean the \$600,000 16 that you provided your father's money for? 17 "Answer: Correct. 18 "Question: So, in other words, that 19 \$600,000 had to be sold to other investors. 20 Correct? 21 "Answer: Correct." 22 Were you asked those questions and did 23 you give those answers? 24 A. Yes, I did. 25 Q. Let's go to the Palen declaration,</p>	<p>1 P. Rabinovich - Direct 2 Q. When you sold the \$150,000 Firstline 3 certificate to Boris and Berda Kogen in 4 April 2008, did you tell them that that money 5 would be used to redeem your father? 6 A. Well, that money was used to invest in 7 the Firstline certificates. 8 Q. So you didn't tell them that that 9 money was going to -- 10 A. I may have. They are friends of the 11 family, so the Kogens were always interested to 12 know what my father was investing in. We may 13 have had that conversation but I don't think 14 that you are characterizing it properly. I 15 don't think it went towards repaying a loan. I 16 think they -- they made an investment in 17 Firstline. 18 Q. So when you said -- 19 A. They purchased Firstline, they 20 received a Firstline certificate note, they got 21 paid interest on the Firstline investment 22 according to the schedule. 23 Q. When you said you may have had that 24 conversation with them, what did you tell them? 25 A. I presented the opportunity, I</p>



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1 P. Rabinovich - Direct  
2 presented the investment to them and I explained  
3 to them the situation regarding this investment.  
4 JUDGE MURRAY: When you say that, did  
5 you mention to them that it was likely that  
6 these funds would be going to paying your  
7 father's bridge loan?  
8 THE WITNESS: I don't recall  
9 specifically but we may have had that  
10 conversation.  
11 Q. Now, if we look below, we see a sale  
12 same day to Kate Thursbee, \$50,000. That is  
13 from Mr. Mayer and Mr. Leo's joint broker code..  
14 Do you see that?  
15 A. I see that, yes.  
16 Q. Sorry. I didn't hear you.  
17 Did you have any conversations with  
18 Mr. Mayer regarding the \$600,000 bridge loan  
19 that your father made to Firstline?  
20 A. We had discussed it. He was aware of  
21 it.  
22 Q. He was aware of it?  
23 A. Yeah.  
24 Q. Did he know as of this time that your  
25 father still hadn't been repaid?

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1 P. Rabinovich - Direct  
2 A. I can't answer that.  
3 Q. Did you ever tell Mr. Mayer during  
4 this time period that your father still hadn't  
5 been repaid?  
6 A. We may have had a conversation about  
7 it but I can't recall specific dates of when we  
8 would have had that conversation.  
9 Q. Did you and Mr. Mayer ever discuss  
10 that the source of repayment for your father's  
11 loan would be new monies raised from Firstline  
12 customers?  
13 A. I don't recall.  
14 Q. Now, did your father receive interest  
15 on his \$600,000 bridge loan to Firstline?  
16 A. He did.  
17 Q. Do you recall the amount of that  
18 interest?  
19 A. I don't. It would have been the  
20 amount stated on the PPM, so if it was the  
21 11 percent note he would have received  
22 11 percent for the duration of his investment.  
23 Q. What was your understanding? What was  
24 the source of funds that paid the interest on  
25 your father's loan?

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1 P. Rabinovich - Direct  
2 A. Cash flow from -- from Firstline  
3 certificates.  
4 Q. Is that what McGinn told you?  
5 A. That's what -- that's how the PPM was  
6 written. Sure.  
7 Q. During this time period, the spring of  
8 2008, did you contact Mr. Guzzetti to make sure  
9 that your father was redeemed?  
10 A. I think I may have reminded him to --  
11 to either have a conversation with Mr. McGinn or  
12 to just -- just to give him a heads-up that it  
13 should probably be put in the inventory and made  
14 available for resale.  
15 MS. MARLIER: Division 547, please.  
16 Q. Mr. Rabinovich, would you, please,  
17 review the email? For the record, you are not a  
18 sender or recipient.  
19 MR. MUNNO: The exhibit number,  
20 please?  
21 MS. MARLIER: 547.  
22 A. I see it.  
23 Q. At the bottom Mr. Guzzetti writes to  
24 Mr. Rees and Mr. Cooper, "When can Phil R.  
25 expect his money from his Firstline sales?"

Page 2107

1 P. Rabinovich - Direct  
2 Then Mr. Cooper responds stating, "We  
3 received another 65K today so I will be sending  
4 350 to Phil's account."  
5 Does this pertain to redeeming your  
6 father?  
7 A. It appears like it is.  
8 MS. MARLIER: We would move 547 into  
9 evidence.  
10 MR. MUNNO: Objection. This witness  
11 is not a recipient of this. It should come in  
12 through Mr. Cooper or Mr. Guzzetti. I object.  
13 JUDGE MURRAY: I will overrule the  
14 objection. It is received in evidence.  
15 (So received in evidence  
16 as Division Exhibit 547.)  
17 Q. So hold that \$65,000 figure in your  
18 head. Let's turn back to Division Exhibit 2,  
19 page 154. If we look at May 1st, which is the  
20 day before Cooper emails Guzzetti, we see a sale  
21 to Avram Kahn, 25,000; Paula Green, 15,000; and  
22 Paul and Arlene Myer, 25,000.  
23 Would you agree that adds up to  
24 65,000?  
25 A. Yes.

6 (Pages 2104 to 2107)

Page 2108

1 P. Rabinovich - Direct  
2 Q. According to this, the same day a  
3 check is cut to your dad for 360,000. Do you  
4 see that?  
5 A. Yes.  
6 MS. MARLIER: Can I have Division  
7 Exhibit 28, please, and can you enlarge the top,  
8 please?  
9 Q. Mr. Rabinovich, do you recognize this  
10 document?  
11 A. Yes.  
12 Q. This is the Firstline Trust 07 Series  
13 B PPM. Correct?  
14 A. Correct.  
15 Q. At the top do you see it is a 60 --  
16 the term is 60 months at 11 percent?  
17 A. Yes.  
18 MS. MARLIER: May I have Division  
19 Exhibit 487, please? I am going to bring up a  
20 paper copy because this is a lengthy one.  
21 May I approach, your Honor?  
22 JUDGE MURRAY: Yes.  
23 Q. Are you familiar -- take the time you  
24 need to look at it, please. My question is  
25 whether you are familiar with this email chain.

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1 P. Rabinovich - Direct  
2 (Pause.)  
3 Q. Do you have any doubt that you sent  
4 and received these emails?  
5 A. No.  
6 MS. MARLIER: Your Honor, we would  
7 move Division Exhibit 487 into evidence.  
8 MR. MUNNO: No objection.  
9 JUDGE MURRAY: Received.  
10 (So received in evidence  
11 as Division Exhibit 487.)  
12 Q. Let's go to the fourth page. I  
13 apologize there is no page numbers on this.  
14 Mr. Chan? Thank you.  
15 Q. On March 18, 2008, 10:38 a.m., you  
16 write to Mr. Ross Strickland. I am just read  
17 the last two sentences. "The recent history of  
18 these notes is that we have not had any defaults  
19 or late payments of interest or principal. They  
20 have all been retired on time according to each  
21 respective amortization schedule."  
22 Do you see that?  
23 A. Yes.  
24 Q. At this point, March 2008 Firstline  
25 11B had been out for five months. Right?

Page 2110

1 P. Rabinovich - Direct  
2 A. Yes.  
3 Q. We saw it was a 60-month term.  
4 Correct?  
5 A. Right.  
6 Q. So the 11B certificates at this point  
7 are more than four years away from maturing.  
8 Right?  
9 A. Correct.  
10 Q. So what did you mean when you said  
11 they have all been retired on time?  
12 A. The notes I was referring to was the  
13 notes that he previously referenced.  
14 Mr. Strickland was an investor all the way back  
15 to the original alarm notes. You see here in  
16 these communications that he repeats multiple  
17 times that he's had great success with those  
18 investments.  
19 So I just reiterate here that the  
20 history of these notes, not specifically the  
21 Firstline notes but these notes in the  
22 aggregate, the alarm notes have all had a  
23 history of no defaults, no late payments of  
24 interest and principal. That is the reference  
25 here.

Page 2111

1 P. Rabinovich - Direct  
2 Q. Are there other references to old  
3 alarm notes in this email?  
4 A. Let's see. The first email that he  
5 writes, "Do you have any recent reports on  
6 these? Have there been any defaults? I know I  
7 realized that kicker. That was part of my  
8 previous investment but I didn't lose any money  
9 either."  
10 He is referring to the SPT. There was  
11 a kicker at the back end but the SPT trusts were  
12 all retired at par.  
13 Then again he makes another reference  
14 on his March 18, 3:14 p.m. email. "In any case,  
15 I have a good experience with these and remain  
16 interested."  
17 Q. So without --  
18 A. And there is another email --  
19 Q. Sorry. Go ahead.  
20 A. March 18th, 5:01 p.m. "Thanks Phil.  
21 There are both no classes generally available to  
22 the public. Do the notes amortize or are they  
23 interest only? It seems the previous to me that  
24 the previous ones I did were taken out and  
25 repaid with sales or contracts. Are these the

Page 2112

1 P. Rabinovich - Direct  
2 same? Keep me on your list."  
3 So three examples here of success that  
4 he had had with previous notes.  
5 Q. When you say the "recent history of  
6 these notes" in your email, what is "these  
7 notes?"  
8 A. Alarm notes.  
9 Q. You are generally speaking of alarm  
10 notes going back?  
11 A. With Ross Strickland because those are  
12 the only types of investments he participated  
13 in.  
14 Q. Would you agree you are relying on  
15 those alarm notes here to sell Firstline?  
16 A. I am just giving an example here of  
17 the type of investments that he has invested in  
18 in the past.  
19 Q. In an email where you are recommending  
20 Firstline, correct, offering Firstline?  
21 MR. MUNNO: Objection.  
22 Mischaracterizes his email.  
23 JUDGE MURRAY: Well, that is up for  
24 him to say. That is a question.  
25 A. I don't think I am saying that. I

Page 2113

1 P. Rabinovich - Direct  
2 think I am explaining what the notes are.  
3 JUDGE MURRAY: Which notes now?  
4 THE WITNESS: Now the Firstline  
5 security notes.  
6 MS. MARLIER: Division Exhibit 488,  
7 please?  
8 Q. This is a two-page email. Would you  
9 put the second page up first so Mr. Rabinovich  
10 and others can read from the first email?  
11 (Pause.)  
12 A. I see that.  
13 MS. MARLIER: And would you go to the  
14 first page, Mr. Chan?  
15 Q. Read these emails and let me know if  
16 you are familiar with this document.  
17 (Pause.)  
18 A. Okay.  
19 Q. Are these emails that you sent and  
20 received?  
21 A. Yes.  
22 MS. MARLIER: We move Division 488  
23 into evidence, your Honor.  
24 MR. MUNNO: I think it has already  
25 been admitted, hasn't it? No objection.

Page 2114

1 P. Rabinovich - Direct  
2 JUDGE MURRAY: Received.  
3 (So received in evidence  
4 as Division Exhibit 488.)  
5 Q. Looking at the second page you write  
6 to Mr. Strickland, "Initially we sold out both  
7 deals. Senior 1,435,000, and junior 2,115,000.  
8 But as happens from time to time, we make some  
9 available in the secondary market out of our  
10 inventory."  
11 Do you see that?  
12 A. Yes.  
13 Q. So here you are saying that the 11B,  
14 which is the junior, has been sold out. Right?  
15 A. At that time I believe so.  
16 Q. At the time of this email, March 2008?  
17 A. Yes.  
18 Q. But there are still notes available in  
19 the secondary market. Right?  
20 A. Correct.  
21 Q. And that includes your father's note,  
22 right, for 600,000?  
23 A. Correct.  
24 MS. MARLIER: Division Exhibit 548,  
25 please.

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1 P. Rabinovich - Direct  
2 Q. Mr. Rabinovich, take the time you need  
3 to read this but my question is whether you  
4 received this email?  
5 A. I have read it.  
6 Q. And you received this email?  
7 A. I did.  
8 MS. MARLIER: We move 548 into  
9 evidence.  
10 MR. MUNNO: No objection.  
11 JUDGE MURRAY: Received.  
12 (So received in evidence  
13 as Division Exhibit 548.)  
14 Q. We saw your father also loaned  
15 \$250,000 to TDMM Cable 09. Correct?  
16 A. Correct.  
17 Q. Please refer to the sales chart if you  
18 need to but I believe that was January 30, 2009?  
19 A. Yes.  
20 Q. Was this loan because McGinn needed  
21 money to get the TDMM Cable 09 deal done?  
22 A. That was my understanding.  
23 Q. So the money was invested pending  
24 completion of the deal?  
25 A. Correct.

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1 P. Rabinovich - Direct  
2 Q. At this point had the money raised  
3 from TDMM Cable 09 investors, had it met the  
4 minimum offering required by the PPM?  
5 A. I don't recall.  
6 Q. Was Mr. McGinn desperate for the  
7 money?  
8 A. There was a sense of urgency again,  
9 same way that we saw with the Firstline  
10 transaction.  
11 Q. Did you feel pressured by Mr. McGinn  
12 to make these bridge loans?  
13 A. I wouldn't call it pressure. I wanted  
14 to help Mr. McGinn, I wanted to help the firm, I  
15 wanted us to secure the asset on behalf of our  
16 clients. I felt it was a good asset and we had  
17 the opportunity to do it.  
18 Q. And did you feel confident that the  
19 McGinn Smith sales force would be able to sell  
20 enough of the TDMM cable notes to hit the  
21 required offering amount?  
22 A. I felt confident that they could.  
23 Q. Okay. And did you receive interest  
24 on -- not you. Did your father receive interest  
25 on the \$250,000 lent to TDMM Cable?

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1 P. Rabinovich - Direct  
2 A. Yes, I believe he did.  
3 Q. Was it your understanding your father  
4 would be redeemed on the \$250,000 once the  
5 McGinn Smith sales force raised the balance of  
6 the money?  
7 A. Yes.  
8 MS. MARLIER: May I have Division  
9 Exhibit 70, please?  
10 Q. This is a two-page email. Let us know  
11 if you need the second page as well. Let us --  
12 MR. MUNNO: I would like the witness  
13 to see the second page, please.  
14 MS. MARLIER: Why don't you start with  
15 the second page, Mr. Chan, since that is how it  
16 will go chronologically.  
17 A. Okay.  
18 Q. Can you go to the first page, please?  
19 A. I have read it.  
20 Q. Did you send and receive these emails?  
21 A. Yes.  
22 MS. MARLIER: We would move Division  
23 70 into evidence, your Honor.  
24 MR. MUNNO: No objection.  
25 JUDGE MURRAY: Received.

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1 P. Rabinovich - Direct  
2 (So received in evidence  
3 as Division Exhibit 70.)  
4 Q. Looking at this email at the bottom,  
5 your email to Mr. Guzzetti May 26, 2009,  
6 10:54 a.m. The third sentence states "If you  
7 talk to Tim, please get a sense from him on the  
8 timing of my 250,000 refunding on the senior.  
9 He had told me end of the month, which means  
10 sometime this year. Maybe this accelerates the  
11 timing." Do you see that?  
12 A. Yes.  
13 Q. When you say, "Maybe this accelerates  
14 the timing," you are referring to the fact that  
15 the sales force had sold out the junior tranche.  
16 Correct?  
17 A. No. I think I am referring to the  
18 fact that I want Mr. McGinn to be aware of it.  
19 So, him being aware of it may accelerate the  
20 timing.  
21 JUDGE MURRAY: Aware of what?  
22 THE WITNESS: Aware that -- that the  
23 250,000 that I lent should be put out to the  
24 sales force.  
25 Q. You are responding to an email from

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1 P. Rabinovich - Direct  
2 Mr. Guzzetti. The second page of the email,  
3 where he says the subject is "TDM Cable junior,  
4 11 percent done." Do you see that?  
5 A. Yes.  
6 Q. Then you write back "While Brian  
7 filled me in, I am shocked and impressed."  
8 Do you see that?  
9 A. Yes.  
10 Q. Let's go back to the first page.  
11 Mr. Guzzetti writes, May 26, 2008 at --  
12 MR. MUNNO: 2009 I think.  
13 MS. MARLIER: Thank you. Counsel.  
14 Q. 2009, 8:58. The time is screwed up.  
15 Maybe one of you is on GMT. It says 8:58. He  
16 writes, "Talked to Tim about your 250,000 this  
17 a.m. This is the senior, right? Wants me to  
18 put it out. We'll probably do it tomorrow. I  
19 just want to think about what I can say. I hate  
20 today. Someone is selling."  
21 Do you see that?  
22 A. I think he meant to say I hate to say  
23 someone is selling.  
24 Q. When he says "wants me to put it out,"  
25 that refers to putting it out to the McGinn

Page 2120

1 P. Rabinovich - Direct  
2 Smith sales force. Correct?  
3 A. Correct.  
4 Q. You write back, "Yes, it's the senior.  
5 I understand the dilemma. Of course, I am not  
6 technically a seller since my investment was  
7 never intended to be part of the overall  
8 allocation but just a bridge to get this deal  
9 done. Just let me know what he says. Thanks."  
10 Did you write that?  
11 A. I did.  
12 MS. MARLIER: May we have Division  
13 Exhibit 71, please. Can you start with the  
14 second page?  
15 Q. Mr. Rabinovich, if you would let me  
16 know if you are familiar with this email chain,  
17 that would be great.  
18 A. I am familiar with it.  
19 MS. MARLIER: We move Division  
20 Exhibit 71 into evidence, your Honor.  
21 MR. MUNNO: May I just have a moment,  
22 please?  
23 (Pause.)  
24 MR. MUNNO: No objection.  
25 JUDGE MURRAY: Received.

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1 P. Rabinovich - Direct  
2 (So received in evidence  
3 as Division Exhibit 71.)  
4 Q. As of this point your father's  
5 \$250,000 loan had not yet been redeemed.  
6 Correct?  
7 A. Correct.  
8 Q. So you write in the first email on the  
9 second page, "Andy, what is the status of my  
10 redemption of 250K?" Do you see that?  
11 A. Yes.  
12 Q. Mr. Guzzetti writes back "Checked with  
13 Patty." Does that refer to Ms. Sicluna?  
14 A. Yes.  
15 Q. "150,000 came in yesterday. We are  
16 waiting on Bill Lex for 100,000. Should be in  
17 by July 1st. If you want 1,950,000 call Patty  
18 and we will put a sell ticket in for 150,000,  
19 then put another in for 100,000 when it comes  
20 in."  
21 Do you see that?  
22 A. Yes.  
23 Q. This is new customer money coming into  
24 the TDMM Cable investment. Right?  
25 A. Correct.

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1 P. Rabinovich - Direct  
2 Q. You write back "Am I still earning  
3 interest on the 150,000 or is the new buyer?"  
4 Correct?  
5 A. Correct.  
6 Q. Now, your father was redeemed on this  
7 loan in two parts in June and July 2009.  
8 Correct?  
9 A. I am not sure when exactly he was  
10 redeemed.  
11 Q. But he was redeemed; right?  
12 A. He was redeemed, yes.  
13 Q. We can assume from this email it is  
14 sometime after this email. Correct?  
15 A. Yes.  
16 Q. During this time period were you  
17 selling TDMM Cable to any of your customers?  
18 A. I am not sure if it was during this  
19 time period but I certainly did sell TDMM Cable  
20 Trust.  
21 Q. Let's shift to Benchmark. With  
22 respect to Benchmark, you only sold TDMM  
23 Benchmark 09 to a few customers. Right?  
24 A. Looks like seven or eight to be exact.  
25 Q. Was Benchmark first offered on

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1 P. Rabinovich - Direct  
2 August 25, 2009?  
3 JUDGE MURRAY: Counsel, I don't know  
4 why we are testing his memory on things.  
5 Q. I will represent to you Benchmark  
6 offered on August 25, 2009.  
7 MR. MUNNO: I object to "first  
8 offered." I don't know what that means. Does  
9 that suggest none of the sales force prior to  
10 August 25th may have talked to a prospective  
11 client who may have been interested before  
12 August 25th?  
13 Q. I will rephrase. I will represent to  
14 you August 25, 2009 I believe is the date on the  
15 PPM.  
16 MR. MUNNO: That is irrelevant but  
17 okay.  
18 Q. As of August 2009, you knew you were  
19 not staying at McGinn Smith; right?  
20 A. Well, we weren't sure at that point.  
21 Q. You weren't sure of what McGinn  
22 Smith's future would be at that point; right?  
23 A. We weren't sure if McGinn Smith was  
24 going to continue to support our office. We  
25 weren't sure. We didn't know what McGinn

<p style="text-align: right;">Page 3409</p> <p>1 Direct/Mayer 2 with it. 3 I wouldn't correlate it to the 4 general accounting of other projects and things 5 that I would argue were more important to Dave and 6 Tim. 7 Q. Did you know with respect to 8 Firstline, did you know that Mr. Rabinovich's 9 father had made a \$600,000 bridge loan to 10 Firstline 11B? 11 A. I do recall Mr. Rabinovich's father 12 making a bridge loan for Firstline. I don't 13 recall exactly which Firstline it was. 14 Q. Do you recall the \$600,000 figure? 15 A. I do recall approximately that 16 number, yes. 17 Q. And you knew at the time of that 18 bridge loan that McGinn Smith ticketed the 19 \$600,000 from Stan Rabinovich's regular 20 investment, right? 21 A. What I do recall is calling up to 22 either Patty or Dave Smith or Tim -- I don't 23 recall specifically -- I do recall some 24 communication going up saying "How do you want 25 this transaction to be done in the ticket system,"</p>	<p style="text-align: right;">Page 3411</p> <p>1 Direct/Mayer 2 them," and then he has a separate objection to 3 Exhibits 105 and 142. "We object for the 4 additional reason that Mr. Lex never sold 5 Benchmark, and with respect to 248, we object 6 for the additional reason that it is dated 7 well after Mr. Lex's last sale." 8 JUDGE MURRAY: My understanding 9 is you are going to give this list of exhibits 10 to the court reporter? 11 MR. STOELTING: Yes, but there 12 is a couple of categories. The first category 13 is the broker check. These were stipulated to 14 before the case started. The broker check 15 reports from the FINRA website, which are 16 Exhibits 479 through 486. We realize that 17 those had not actually been received into 18 evidence per the transcript so we wanted to 19 make sure those were in. 20 JUDGE MURRAY: Are respondents 21 aware of these exhibits? Can you tell me 22 whether you have any objection or have you 23 cleared it with them? 24 MR. STOELTING: I cleared it 25 with them.</p>
<p style="text-align: right;">Page 3410</p> <p>1 Direct/Mayer 2 and they coming back with the information saying 3 "Just do it the way you would a regular one." 4 Q. A regular investment? 5 A. That's what I recall. 6 JUDGE MURRAY: Off the record. 7 (Discussion off the record.) 8 JUDGE MURRAY: Back on the 9 record. 10 MR. TOLCOTT: Your Honor, 11 Michael Tolcott for respondent Lex. My train 12 was about 15 minutes late this morning, and if 13 this is regarding admission of the Division's 14 exhibits, we communicated yesterday by e-mail 15 Lex's position and certain objections we had. 16 I wanted to be sure those were on the record. 17 I don't know if any were 18 admitted before we got here. 19 JUDGE MURRAY: No. 20 MR. STOELTING: Mr. Guzzetti's 21 counsel sent me an e-mail agreeing to all of 22 them, and then Mr. Lex's counsel sent an 23 e-mail objecting to some of them, and the 24 e-mail says "On the grounds that they do not 25 pertain to Mr. Lex and he is not a party to</p>	<p style="text-align: right;">Page 3412</p> <p>1 Direct/Mayer 2 JUDGE MURRAY: There is no 3 objection? 4 MR. MUNNO: There is actually 5 an objection to this extent for Rabinovich, 6 Mayer and Rogers: To the extent that the 7 Division is offering exhibits as regards a 8 specific respondent and that respondent 9 doesn't have an objection to it, that's fine, 10 but if it is being offered as against all 11 respondents who may not have received the 12 e-mail, we would object to that being received 13 in evidence as regards Rabinovich, Mayer and 14 Rogers. 15 To the extent that these 16 exhibits don't involve our clients, it should 17 not be in evidence as against our clients. 18 JUDGE MURRAY: I won't know 19 until I go through all of this what I think is 20 relevant to the allegations against your 21 clients and against the other clients. 22 I am overruling that 23 objection. 24 MR. TOLCOTT: I have the same 25 objection, your Honor.</p>

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

-----X  
SECURITIES AND EXCHANGE COMMISSION :

*Plaintiff,* :

vs. :

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

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

**MEMORANDUM OF LAW IN SUPPORT OF  
NINTH CLAIMS MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR  
AN ORDER (A) DISALLOWING CERTAIN DISPUTED CLAIMS, (B)  
RECLASSIFYING CERTAIN DISPUTED CLAIMS, (C) APPLYING  
PREFERENTIAL PAYMENT OFFSET TO CERTAIN DISPUTED CLAIMS,  
AND (D) EXPUNGING PAPER CLAIMS**

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Errors of Fact in the Initial Decision, Administrative Proceedings Release  
No. 2528 (Apr. 9, 2015), 111 SEC Docket 5 .....10

William J. Brown, as Receiver (“Receiver”) of McGinn, Smith & Co., Inc. (“MS & Co.”), respectfully submits this Memorandum of Law in support of his Ninth Claims Motion (“Motion”) for an Order (a) disallowing certain Disputed Claims, (b) reclassifying certain Disputed Claims, (c) applying a Preferential Payment Offset to certain Disputed Claims, and (d) expunging paper claims.

### **PRELIMINARY STATEMENT**

During the course of this Receivership, the Receiver has filed eight motions objecting to certain investor claims on various grounds, with the ultimate goal of maximizing amounts available for distribution to investors defrauded by MS & Co. The Receiver has also made a First Distribution of ten percent (10%) on a rolling basis to investors with allowed claims. The Receiver now seeks to complete the First Distribution and commence a second distribution to investors with allowed claims and to proceed to conclude the receivership estate.

Accordingly, the Receiver has reviewed those claims classified as “Disputed” in the Receiver’s books and records which remain unresolved by the claims objection motions previously filed by the Receiver (collectively, the “Disputed Claims”). The Disputed Claims include (a) claims which should be disallowed on account of the claimants’ fraudulent or inequitable misconduct, (b) claims which should be reclassified, (c) claims held by recipients of preferential payments, and (d) paper claims for which there is no basis for payment in the Receiver’s books and records.

The Receiver intends that this Motion will resolve the remaining Disputed Claims and will conclude the claims objection process in this Receivership, allowing the

Receiver, when the Motion is decided, to make a second distribution to investors with allowed claims and to begin to conclude this Receivership.

### **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” or “David 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.<sup>1</sup>

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

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<sup>1</sup> “Brown Dec’l. ¶ \_\_” refers to the Declaration of William J. Brown dated October 9, 2019 filed in support of the Motion.

entered judgments in favor of the SEC in 2015 (Docket Nos. 835, 836, 837). The MDO was affirmed on appeal in June 2016.

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.

**A. 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. ¶9. A confidential password providing access to the Receiver’s Claims Website at [www.mcginnsmithreceiver.com](http://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. *Id.*

The Claims Procedure Order established June 19, 2012 ("Bar Date") as the deadline for creditors and investors to file claims (if required) against the MS Entities. Claims Procedure Order at 2. Any investor who was required to file a paper claim and who failed to do so on or before the Bar Date is barred, estopped, and enjoined from asserting such claim. *Id.*

In accordance with the Claims Procedure Order, nearly six hundred creditors and investors timely filed paper claims prior to the Bar Date. Brown Dec'1. ¶11. 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'1. ¶12.

**B. 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 sets forth the following priority of claims: (1) administrative expenses; (2) secured creditors; and (3) investors. Further, 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 July 25, 2019, \$6,578,150.28 has been distributed to investors with allowed claims as a First Distribution. Brown Dec’1. ¶15. 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).

**C. 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 (Docket No. 1043) (“Broker Claims Order”).

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.

On May 22, 2019, the Receiver filed a Motion (Docket No. 1056) (“Seventh Claims Motion”) to seek to apply a preferential payment offset to the distributions to be made to certain preferred investors that received certain fund redemptions.

The Sixth and Seventh Claims Motions remain *sub judice*.

On September 12, 2019, the Receiver filed a Motion (Docket No. 1067) (“Eighth Claims Motion”) to seek to disallow certain claims asserted by the Smith family, or, in the alternative, offset their outstanding judgment obligations by any distributions owed in connection with such claims. The return date of the Eighth Claims Motion is October 31, 2019.

**D. Remaining Disputed Claims**

The remaining Disputed Claims may be described as follows: (1) claims that should be disallowed due to the claimants’ inequitable and/or fraudulent conduct; (2) claims improperly classified as investor claims and requiring reclassification and/or

disallowance; (3) claims asserted by recipients of preferential payments that should be offset by such preferential payments; and (4) paper claims for which there is no basis for payment in the Receiver's books and records.

**E. Claims to be Disallowed due to Inequitable or Fraudulent Conduct**

**1. Remar-Lex Claims**

Among the claims disallowed by the Broker Claims Order were those asserted by William F. Lex ("Lex"). Lex was a registered representative at MS & Co. who sold \$45,536,000 of MS & Co. private placements between September 2003 and July 2009. Third Claims Motion at 6. The Court disallowed Lex's claims, as described in the Third Claims Motion, based on Lex's violations of the Securities Act. Broker Claims Order at 8.

Following the entry of the Broker Claims Order, the Receiver discovered that Lex holds two additional disputed claims that were not included in the Third Claims Motion ("Remar-Lex Claims"). Brown Dec'1. ¶28. The Remar-Lex Claims are held jointly by Lex and Kimellen Remar ("Remar") and are described in greater detail on Exhibit A to the Motion. Presumably in accordance with the instructions set forth in the Claims Procedure Order, Remar and Lex filed a paper claim for each Remar-Lex Claim ("Remar-Lex Paper Claims"), which paper claims are exactly duplicative of the Remar-Lex Claims and are described on Exhibit A to the Motion. *Id.*

**2. Stanley Rabinovich Claims**

In the Broker Claims Order, the Court also disallowed the claims of Philip S. Rabinovich ("Philip Rabinovich"), who was a senior vice president, registered representative, and an investment advisor with MS & Co. As with Lex, the Court disallowed Philip Rabinovich's claims based on his violations of the Securities Act. Broker Claims Order at 8.

As described in more detail below, in 2007 and 2009, Phillip Rabinovich arranged for his father, Stanley Rabinovich (“Stanley Rabinovich”), to provide so-called “bridge loans” to allow McGinn and Smith to close private placement offerings. By providing bridge loans, Stanley Rabinovich allowed certain offerings to close, at which time escrow could be broken and McGinn and Smith could access investor funds. Brown Dec’1 ¶30; *see also* Palen Dec’1. ¶¶66, 99 (describing how, after investor funds left the escrow account, they were used to enrich McGinn and Smith personally, or to support MS & Co. or other MS & Co. entities).<sup>2</sup> In October 2007, McGinn approached Philip Rabinovich about a “bridge loan” necessary to secure an asset for the First Line 07 Series B private placement. *See* Broker Trial Tr. 2091:14-18.<sup>3</sup> Philip Rabinovich arranged for Stanley Rabinovich to make a \$600,000 loan to satisfy the shortfall, which McGinn promised to repay two to three months later. *Id.* 2091:22-25. Although this transaction was characterized as a “loan” by McGinn and Philip Rabinovich, there was no loan documentation and Stanley Rabinovich executed a subscription agreement as if he were an investor and received the same interest payments as other investors in Firstline 07 Series B. *Id.* 3409:17-3410:5.

When new investors purchased Firstline 07 Series B notes, the incoming funds were improperly funneled directly to Stanley Rabinovich to pay off his loan. In total, between April 23, 2008 and June 16, 2008, MS & Co. brokers made twenty sales of Firstline

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<sup>2</sup> “Palen Dec’1” refers to the Declaration of Kerri L. Palen, dated January 10, 2014, submitted in support of the SEC’s allegations in the Broker Proceeding, which is attached, together with the relevant exhibits, to the Brown Dec’1 as Exhibit 1.

<sup>3</sup> “Broker Trial Tr.” refers to the transcript of the public hearing held before the Chief Administrative Law Judge (“ALJ”) in the Administrative Proceeding commenced by the SEC on September 23, 2013 as to certain MS & Co. brokers (including Philip Rabinovich) (“Broker Proceeding”), an excerpt of which is attached to the Brown Dec’1 as Exhibit 2.

07 Series B notes to pay back Stanley Rabinovich's \$600,000 loan in its entirety. *Id.* 2101: 14-24; *see also* Palen Dec'1. ¶ 89, Ex. 21. At the time, the Firstline 07 Series B notes were more than four years away from maturing. *Id.* 2109: 24-2110: 4.

McGinn approached Philip Rabinovich for another bridge loan in January 2009 to close the TDMM Cable 09 private placement. Broker Trial Tr. 2115: 14-22. Stanley Rabinovich "loaned" \$250,000 to TDMM Cable 09, which, again, was treated like an investment, although characterized as a loan. *Id.* 2116:23 - 2117:2. As with the Firstline 07 Series B transaction, McGinn agreed to put \$250,000 worth of TDMM Cable 09 notes out for secondary market sales in order to improperly repay Stanley Rabinovich's loan. *Id.* 2117: 3-7.<sup>4</sup> Stanley Rabinovich's loan to TDMM Cable 09 was improperly repaid in full from the secondary sales. *Id.* 2122: 6-12. Both improper and illegal repayments of more than \$850,000 to Stanley Rabinovich deceived legitimate investors that the minimum funding for those investments had been achieved and allowed Stanley Rabinovich to be repaid when legitimate investors were not repaid. Brown Dec'1. ¶32.

Stanley Rabinovich and his wife, Eva Rabinovich, collectively assert fourteen disputed claims against the Receivership in an aggregate amount of \$3,393,540.33 (collectively, the "Rabinovich Claims"), as described in greater detail on Exhibit A to the Motion. Brown Dec'1. ¶33. Stanley and Eva Rabinovich filed twelve paper claims

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<sup>4</sup> In the Broker Proceeding, the ALJ found in the Initial Decision entered on February 25, 2015 that Stanley Rabinovich made the \$600,000 bridge loan to purchase an asset for the Firstline 07 Series B transaction and the \$250,000 bridge loan to TDMM Cable 09 to close the offering. *Donald J. Anthony, Jr., et al.*, Initial Decision Release No. 745 (Feb. 25, 2015), 110 SEC Docket 19, modified by Order on Motions to Correct Manifest Errors of Fact in the Initial Decision, Administrative Proceedings Release No. 2528 (Apr. 9, 2015), 111 SEC Docket 5, at 59. As a result of the Supreme Court of the United States' opinion in *Lucia v. S.E.C.*, 138 S.Ct. 2044 (2018), the Initial Decision was vacated and the Broker Proceeding was remanded for reassignment to a new administrative law judge. The SEC subsequently entered into a settlement with the brokers to avoid a re-trial.

(collectively, the “Rabinovich Paper Claims”), also described on Exhibit A to the Motion, presumably in accordance with the instructions in the Claims Procedure Order. *Id.*

**F. Improperly Classified Claims**

In reviewing the records and records of MS & Co., the Receiver has discovered that certain Disputed Claims were classified incorrectly as investor claims at the time that the Claims Procedure Order was entered. Those claims requiring reclassification are described in greater detail below and are set forth on Exhibit B to the Motion.

**1. ADT Claims**

ADT Security Services, Inc. (“ADT”) filed two paper claims (collectively, the “ADT Claims”), as described on Exhibit B to the Motion, asserting claims against TDM Cable Funding LLC (“TDM”) and Prime Vision Communications LLC (“Prime Vision”) arising out of a certain Assignment Agreement dated October 6, 2006 between ADT and TDM (“Assignment Agreement”). Brown Dec’1. ¶35. Pursuant to the Assignment Agreement, TDM purchased from ADT a certain Balloon Promissory Note for \$3,165,762 made by Prime Vision to ADT (“ADT Note”). *Id.* The Assignment Agreement included an agreement that, if the ADT Note were paid or subsequently sold, the proceeds would be divided and a portion would be paid to ADT Security. The ADT Note has not been paid or sold. Consequently, ADT does not hold or assert any other claims against the Receivership. *Id.*

**2. HSK Claim**

107th Street Associates, LLC (“107th Street”), a Receivership entity, borrowed one million dollars (“Loan”) from HSK Funding, Inc. (“HSK”) pursuant to a certain Promissory Note dated October 9, 2007. Brown Dec’1. ¶36. The Loan was secured by a pledge of stock in an entity called United Security Assurance, Inc. The debt obligation

owing to HSK was mistakenly described as an investor claim and was assigned claim number 5328D (“HSK Claim”), as shown on Exhibit B to the Motion. *Id.* The HSK Claim is a loan secured by collateral and should be reclassified as such and as an unsecured claim for any deficiency. *Id.*

### **G. Preferential Payments**

Certain investors (“Preferred Investors”) received preferential payments in the form of interest payments and redemptions (“Preferential Payments”) made by two MS Entities, McGinn Smith Funding LLC (“MSF”) and TDM. Brown Dec’1. ¶37. MSF and TDM were essentially “conduit entities”: funds raised from investors in various Trust Offerings would first be deposited into an escrow account and net proceeds then advanced to MSF or TDM, which was supposed to then purchase the underlying investment. Palen Dec’1. ¶ 64. MSF and TDM, however, were used by McGinn and Smith to facilitate “improper and fraudulent transfers” between and among McGinn and Smith, personally, and other MS & Co. Entities. *Id.* ¶ 64, 66.

The Preferential Payments were made in late 2009 and early 2010, at the height of the Ponzi scheme and when many other MS & Co. investors ceased receiving any payments on account of their investments. Brown Dec’1. ¶38. Four of the Preferred Investors received preferential interest payments from TDM starting in January 2010, going through to April 2010. Two of the Preferred Investors received preferential interest payments and redemptions from MSF starting in November 2009, through to April 2010. *Id.* The funds used to make these Preferential Payments were not generated through the legitimate investment operations of TDM or MSF but instead were amounts raised from certain Trust Offerings or deposited directly by other investors or MS & Co. Entities.

Consequently, the Preferred Investors received Preferential Payments comprised of funds that they were not entitled to receive, at a time when most other investors in MS & Co. were no longer receiving payments on account of their investments. *Id.*

The Preferential Payments are set forth in greater detail on Exhibit C-1 to the Motion. Presumably in accordance with the instructions in the Claims Procedure Order, three of the Preferred Investors filed paper claims (collectively, the “Preferred Investor Paper Claims”), which are set forth in greater detail on Exhibit C-2 to the Motion. Brown Dec’l. ¶39.

#### **H. Paper Claims**

Generally, most investors holding Disputed Claims followed the Receiver’s instructions in the Claims Procedure Order and submitted paper claims exactly duplicative of their claims marked “Disputed” on the Receiver’s website. Brown Dec’l. ¶40. In addition, other investors who do not hold Disputed Claims also filed paper claims, either in the exact amount of their Receiver-granted claims shown on the Receiver’s Website, or presumably because they disagreed with the amounts of their claims as set forth on the Receiver’s Website or because they assert claims which were not shown on the Receiver’s Website. *Id.* These paper claims may be categorized as Discrepant Claims, Duplicate Claims, No Liability Claims, Non-Receivership Claims, Excluded Claims, and Untimely Claims, each as described in greater detail below.

### **ARGUMENT**

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). This includes the discretion of district courts to classify claims sensibly in order to achieve an equitable result. *See S.E.C. v. Enter. Trust Co.*, 559 F.3d 649, 652 (7th Cir. 2009); *S.E.C. v. Infinity Grp. Co.*, 226 Fed. Appx. 217, 218 (3d Cir. 2007). “It is within a district court’s discretion to approve a distribution plan proposed by a receiver—and to defer to the receiver’s choices for the plan’s details—so long as the plan is ‘fair and reasonable.’” *Sec. & Exch. Comm’n v. Amerindo Inv. Advisors Inc.*, No. 5-CV-5231, 2016 WL 10821985, at \*3 (S.D.N.Y. May 20, 2016) (quoting *Sec. Exch. Comm’n v. Wang*, 944 F.2d 80, 81 (2d Cir. 1991)) (internal citation omitted).

**A. The Remar-Lex Claims and the Rabinovich Claims Should be Disallowed**

District courts have used their broad equitable powers to disallow claims in equity receiverships based on the conduct of the claimants. For example, the courts have permitted equity receivers to exclude claimants from receiving distributions where such claimants were involved in the “development, implementation, and/or marketing” of a fraudulent Ponzi scheme. *See S.E.C. v. Byers*, 637 F.Supp.2d 166, 183 (S.D.N.Y. 2009) (approving distribution plan where employees who actively participated in a Ponzi scheme were excluded from receiving distributions). Courts have also approved distribution plans disallowing claims of investors who recklessly participated in a Ponzi scheme. *See S.E.C. v. Forte*, Civil Nos. 09-63, 09-64, 2012 WL 1719145 at \*3 (E.D.Pa. May 16, 2012). A person acts recklessly if “he or she realizes or, from the facts which he [or she] knows, should



realize that there is a strong probability that harm may result.” *Id.* at \*3. Investors who, by their reckless behavior, further a Ponzi scheme “are not ‘innocent’ and so are not entitled to the same relief as truly innocent investors.” *Id.*

**1. The Remar-Lex Claims Should be Disallowed**

The Remar-Lex Claims should be disallowed for the same reasons that Lex’s Claims were disallowed by this Court. In the Broker Claims Order, the Court “agree[d] with the Receiver that the brokers’ claims should be disallowed because of their conduct; the brokers should not be permitted to share in the recovery with the innocent investors who were harmed by that conduct.” Broker Claims Order at 5. Accordingly, the Court disallowed each of Lex’s claims included in Exhibit A to the Third Claims Motion. *Id.* at 9. The Court also ordered that the rights of the Receiver to object to the claims of all investors or claimants on any other basis was expressly preserved. *Id.* For the same arguments set forth in the Third Claims Motion, the Remar-Lex Claims listed on Exhibit A to the Motion should be disallowed and the Remar-Lex Paper Claims should be disallowed.

**2. The Rabinovich Claims Should be Disallowed or, in the Alternative, Offset by Amounts Received**

The Rabinovich Claims should be disallowed on account of Stanley Rabinovich’s inequitable conduct. Stanley Rabinovich actively participated in McGinn and Smith’s fraudulent scheme by providing bridge loans that allowed McGinn and Smith to secure assets for and close private placement offerings. By assisting McGinn and Smith with closing certain private placement offerings, Stanley Rabinovich enabled McGinn and Smith to break escrow and access investor funds, which funds were then used to enrich McGinn and Smith or to support other MS & Co. Entities. As a result, legitimate investors were deceived into believing that the offerings had raised sufficient funding to close.

Moreover, although Stanley Rabinovich was treated like an investor, and received regular investment payments like an investor, his loans were repaid long before the investments matured. Further, he was repaid directly from funds subsequently invested by new investors, which new investments were solicited by MS & Co. brokers specifically to repay the bridge loans. The subsequent investors who took Stanley Rabinovich's place now stand to recover a small percentage of their original investment. Stanley Rabinovich assisted McGinn and Smith with the implementation of the Ponzi scheme and was repaid directly from the scheme. Accordingly, based on his participation in the Ponzi scheme, the Rabinovich Claims should be disallowed, and all paper claims filed by Stanley Rabinovich and Eva Rabinovich should be disallowed.

In the alternative, if the Rabinovich Claims are not disallowed, any distributions otherwise owed on account of the Rabinovich Claims should be offset by \$850,000, representing the improper and illegal repayments made to Stanley Rabinovich on account of the bridge loans. Stanley Rabinovich was improperly paid from secondary sales of certain MS & Co. investments, which were sold by MS & Co. brokers specifically to pay back Stanley Rabinovich's bridge loans long before the underlying investments were due to mature. Stanley Rabinovich received full redemptions of the bridge loans while other similarly situated investors were not redeemed. Accordingly, it would be most equitable, if the Rabinovich Claims are not disallowed, to apply the Rising Tide Methodology to offset any distributions owed in connection with the Rabinovich Claims by the improper and illegal redemptions received by Stanley Rabinovich. *See infra* Sect. D.1.

**B. The ADT Claims Should be Reclassified and Disallowed**

The ADT Claim should be reclassified as an unsecured claim, because it is a claim for an unsecured contractual payment obligation owing by TDM and is not an investor claim. Further, the ADT Claim should be disallowed and the paper claims submitted by ADT should be disallowed: the obligation of TDM to make payments to ADT is conditioned on the payment or sale of the ADT Note, neither of which conditions has occurred. Thus, there is no basis upon which ADT may assert a claim for payment against either TDM or Prime Vision.

**C. The HSK Claim Should be Reclassified to a Secured Claim**

The HSK Claim represents a secured debt obligation owing by 107th Street to HSK and is not an investor claim. Accordingly, the HSK Claim should not be treated as an investor claim but instead should be reclassified as a secured claim to the extent of the value of the collateral and an unsecured claim for any deficiency, and treated as such in accordance with the Plan of Distribution.

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

**1. The Rising Tide Method Promotes Equality Among Investors**

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.

As described in the Fourth, Fifth, and Seventh Claims Motions, 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.

**2. A Preferential Payment Offset Should be Applied to Preferred Investor Distributions**

Distributions made to Preferred Investors on account of their Receivership claims (collectively, the "Preferred Investor Claims") should be adjusted to account for the receipt of the Preferential Payments using the Rising Tide methodology ("Preferential Payment Offset").

It would be inequitable to allow the Preferred Investors to retain the Preferential Payments and to receive full distributions on account of their Preferred Investor Claims. Applying the Preferential Payment Offset to distributions owed on account of the Preferred Investor Claims will put all investors in a more equal position. The Preferential Payment 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 Preferential Payment Offset will reduce distributions to the Preferred Investors by amounts paid to them by TDM or MSF, as applicable, as interest and/or redemption payments. These Preferential Payments were paid improperly from funds raised from various offerings or deposited by investors. Indeed, two of the Preferred Investors received payments from entities in which they hold no investments.

As a result of the Preferential Payment Offset, the Preferred Investors instead would have a credit against future distributions in the amount of the Preferential Payment over the amount of the interim first distribution. Of the six Preferred Investors described in the Motion, only two Preferred Investors would not receive a first distribution as a result of applying the Preferential Payment Offset. Further, 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 Preferential Payments, 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 improperly paid to the Preferred Investors by MS & Co. from funds that should have been invested, and not used to make payments of principal and interest. The Preferential Payment Offset promotes equality among all investors by accounting for this unfair treatment.

To apply the Preferential Payment Offset, the Receiver has used the books and records of MS & Co. to determine when the Preferential Payments were made, to

whom, and from which MS & Co. entity. Brown Dec'1. ¶41. The Preferential Payment Offset was then applied to the aggregate first distribution which would otherwise be made on account the Preferred Investors' claims in TDM or MSF, as applicable. *Id.* If the Preferred Investor does not hold a corresponding claim in TDM or MSF, the Receiver applied the Preferential Payment Offset to their other claims asserted against MS & Co. *Id.*

The Preferred Investor Paper Claims should be disallowed because there is no basis in the books and records of MS & Co. to justify a distribution on account of such paper claims. Two Preferred Investor filed paper claims that are exactly duplicative and in the same amount as their Preferred Investor Claims scheduled on the Claims Website. These 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 above. One Preferred Investor filed a paper claim for an amount lower than the claim amount scheduled on the Receiver's Website in an attempt to account for the Preferential Payments received, as described in Exhibit C-2. The Receiver has determined, consistent with the approach taken in the Fourth, Fifth, and Seventh Claims Motions, that it is most equitable to apply the Preferential Payment Offset to the distributions to be made on account of the Preferred Investors' scheduled claims. Accordingly, this Discrepant Paper Claim should be disallowed and the Preferential Payment Offset applied to distributions made on account of the Preferred Investor's full, scheduled claim amount.

**E. The Paper Claims Should be Disallowed**

The Paper Claims described on Exhibits D-1 - D-3 to the Motion should be disallowed 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 D-1 is comprised of Discrepant Claims, which are paper claims filed by investors for the same investments as their Receiver-granted claims but in different amounts. All Receiver-granted claims are based upon the records of McGinn Smith and represent principal balances. The differences in the amounts of the Receiver-granted claims and the Discrepant Claims filed by investors are likely due to one or more payments previously received by the investor in the form of principal or interest.<sup>5</sup> If the Discrepant Claims are not disallowed, 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 holders of Discrepant Claims as compared to other investors. As such, the Discrepant Claims should be disallowed.

Exhibit D-2 is comprised of Duplicate Claims. Duplicate Claims represent paper claims filed by investors that are exactly duplicative and are in the exact amount of the 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.

Exhibit D-3 is comprised of (a) No Liability Claims, (b) Non-Receivership Claims, (c) Excluded Claims, and (d) Untimely 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. No Liability Claims include filed paper claims for

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<sup>5</sup> In the Plan Distribution Order, the Court approved the Receiver's method of calculating investor claims based upon the principal balance of the investment as reflected in McGinn Smith's books and records, as well as the treatment of certain pre-Receivership interest payments as a reduction in principal. *See* Plan Distribution Order at 15 (Docket No. 904); Plan of Distribution at 6-7 (Docket No. 847).

investments of 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. These entities include, among others, MS Real Estate Capital Partners, LLC, Integrated Alarm Services, Inc., and Coventry CareLink Holding Corp. (“Coventry”) (sometimes also known as CMS Financial Services). Because these entities are not included in the Receivership, the Receiver cannot make distributions on account of these claims with Receivership funds. In the case of Coventry claims, those investors hold direct claims against Coventry and not against the Receivership estate. Accordingly, Non-Receivership Claims should be disallowed.

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.

Finally, Untimely Claims represent paper claims filed after the Bar Date of June 19, 2012. Investors who filed Untimely Claims are barred, estopped, and enjoined from asserting such claim, pursuant to the Claims Procedure Order. The Untimely Claims should be disallowed because the holders of such claims are not entitled to assert such claims against the Receivership.



**F. Summary Proceedings are Appropriate**

The Receiver has sought to provide the claimants asserting Disputed Claims 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 claimant listed on the Exhibits attached to the Motion at least thirty-one days in advance of the scheduled return date of November 21, 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](http://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 claimants. Brown Dec’1. ¶42.

The Receiver requests that the Court enter an order granting the relief requested in this Motion without a hearing with respect to those 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 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 E (a) disallowing certain Disputed Claims, (b) reclassifying certain Disputed Claims, (c) applying a Preferential Payment Offset to certain Disputed Claims, and (d) expunging paper claims, together with such other and further relief as the Court deems just and proper.

Dated: October 9, 2019

PHILLIPS LYTTLE LLP

By /s/ Catherine N. Eisenhut  
William J. Brown (Bar Roll #601330)  
Catherine N. Eisenhut (Bar Roll #520849)  
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and

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Buffalo, New York 14203  
Telephone No.: (716) 847-8400

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

-----X  
SECURITIES AND EXCHANGE COMMISSION

*Plaintiff,*

vs.

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

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

**CERTIFICATE OF SERVICE**

I, Karen M. Ludlow, being at all times over 18 years of age, hereby certify that on October 10, 2019, a true and correct copy of the (i) Notice of Motion and Ninth Claims Motion of William J. Brown, as Receiver, for an Order (A) Disallowing Certain Disputed Claims, (B) Reclassifying Certain Disputed Claims, (C) Applying Preferential Payment Offset to Certain Disputed Claim, and (D) Expunging Paper Claims ("Ninth Claims Motion"), (ii) Declaration of William J. Brown, as Receiver, in Support of Ninth Claims Motion, and (iii) Memorandum of Law in Support of Ninth Claims Motion (collectively, "Ninth 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

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- **Benjamin Zelermyer** bzlaw@optonline.net, seincav@aol.com

And, I hereby certify that on October 10, 2019, I mailed, via first class mail using the United States Postal Service, copies of the Ninth Claims Motion Documents to the individuals listed below and on the investors with the claim numbers listed on the attached Exhibits A, B, C-1, C-2, D-1, D-2 and D-3 which were filed with the Motion herewith.

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Glavin and Glavin  
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Waterford, NY 12188

Dated: October 10, 2019

/s/ Karen M. Ludlow  
Karen M. Ludlow

## Exhibit A - Broker Claims

Claim No.	Last Name	First Name	Description	Amount	Paper Claims
6192	Remar & Lex	Kimellen & William F	FAIN SECURED SENIOR NOTES	\$45,997.68	Filed duplicate paper claim
6193	Remar & Lex	Kimellen & William F	FAIN SECURED SENIOR NOTES	\$18,399.07	Filed duplicate paper claim
6122	EVA	RABINOVICH	TDM CABLE TRUST 06 9.25% 48 MONTHS CONTRACT CERTIFICATES 11/15/10	\$15,000.00	Filed duplicate paper claim
6123	Eva	Rabinovich	FEIN SECURED SENIOR NOTES	\$919,953.59	Filed discrepant paper claim for \$1,000,000
6125	Stan	Rabinovich	Cruise Charter Ventures, LLC	\$100,000.00	Filed duplicate paper claim
6126	STAN	RABINOVICH	FIIN 10.25% SECURED JUNIOR NOTES DUE 12/15/2008	\$200,000.00	Filed duplicate paper claim
6127	STAN	RABINOVICH	FIRSTLINE TRUST 07 11% JUNIOR CONTRACT CERTIFICATES DUE 05/01/12	\$179,542.00	Filed discrepant paper claim for \$200,000
6128	STAN	RABINOVICH	TDM LUXURY CRUISE TRUST 07 CONTRACT CERTIFICATES 10% DUE 9/1/11	\$185,000.00	Filed discrepant paper claim for \$200,000
6129	STAN	RABINOVICH	TDMM CABLE SR TRUST 09 9%	\$5,434.92	
6130	Stan	Rabinovich	FEIN SECURED SENIOR NOTES	\$919,953.59	Filed discrepant paper claim for \$1,000,000
6131	Stan	Rabinovich	McGinn, Smith Firstline Funding, LLC	\$300,000.00	Filed duplicate paper claim
6132	STANLEY	RABINOVICH	FEIN 10.25% SECURED JUNIOR NOTES DUE 01/30/2009	\$75,000.00	Filed duplicate paper claim
6133	STANLEY	RABINOVICH	PACIFIC TRUST	\$18,991.94	Filed discrepant paper claim for \$24,000
6134	STANLEY	RABINOVICH	TDM CABLE TRUST 06 9.25% 48 MONTHS CONTRACT CERTIFICATES 11/15/10	\$20,000.00	Filed duplicate paper claim
6135	Stanley B & Eva	Rabinovich	TAIN SECURED SENIOR NOTES	\$454,664.29	Filed discrepant paper claim for \$500,000
6136	STANLEY B & EVA	RABINOVICH	TDMM BENCHMARK TRUST 09 08%	\$0.00	

## Exhibit B - Reclassification Claims

Claim No.	Last Name	First Name	Description of Claim	Amount	Current Classification	Proposed Reclassification	Explanation
4107D	ADT Security Services, Inc.	Sally Edison-McGuire	No Liability, TDM Cable Funding LLC	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
(Paper Claim)	ADT Security Services, Inc.		TDM Cable Funding LLC	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
(Paper Claim)	ADT Security Services, Inc.		Prime Vision Communications L	\$3,746,151.70	Investor Claim	Unsecured Claim	Claimant asserts a claim for unsecured contractual payment obligation
5328	HSK Funding Inc.		107th Associates LLC	\$1,030,000.00	Investor Claim	Secured Claim to the extent of the value of the collateral and Unsecured Claim for any deficiency	Claimant asserts a claim for secured debt obligation

Exhibit C-1 - Preferential Payment Offset

Claim Nos.	Claim Description	Claim Amount	Proposed First Distribution (10%)	Total Preferential Payments Received	Source of Preferential Payment	Proposed First Distribution After Application of Offset
5444D	TDM Cable Funding LLC	\$50,000	\$5,000.0	\$4,098.98	TDM	\$901.02
5812D	McGinn, Smith Funding LLC	\$125,000	\$12,500.0	\$134,700.00	MSF	(\$122,200.00)
6164	McGinn Smith Funding, LLC	\$50,000	\$5,000.0	\$4,098.96	TDM	\$901.04**
6234D	TDM Cable Funding LLC	\$25,000	\$2,500.0	\$1,983.39	TDM	\$516.61
6492D	TDM Cable Funding LLC	\$50,000	\$5,000.0	\$4,890.65	TDM	\$109.35
6312D	TMM Benchmark Trust 09 12%	\$150,000	\$15,000.0	\$837,588.17	MSF	(\$687,588.17)

\*\*This investor also received preferential payments, as described in greater detail in the Seventh Claims Motion, and the Receiver has sought to apply an offset of \$780,435 to distributions owed in connection with all of this investor's claims



## Exhibit C-2 - Preferred Investor Paper Claims

Claim Nos.	Claim Description	Claim Amount	Paper Claim	Reason for Disallowance
5444D	TDM Cable Funding LLC	\$50,000	\$50,000	Duplicate
6492D	TDM Cable Funding LLC	\$50,000	\$44,823	Discrepant**
6312D	TMMM Benchmark Trust 09	\$150,000	\$150,000	Duplicate

\*\*This Preferred Investor filed a discrepant paper claim reducing the principal amount of the scheduled claim to account for the Preferential Payments received. By the Motion, the Receiver proposes to reduce the distributions to be made to this Preferred Investor, rather than the principal amount of the claim.

**Exhibit D-1 - Discrepant Paper Claims**

Claim No.	Description of Investment	Amount of Allowed Claim	Amount of Paper Claim
6491	TAIN Secured Senior Notes	\$54,559.72	\$60,000.00
6487	Integrated Excellence Sr. Trust 08	\$10,254.75	\$15,000.00

## Exhibit D-2 - Duplicate Paper Claims

Claim No.	Description of Investment	Amount of Claim on Receiver's Website	Amount of Paper Claim
5562 **	FAIN Secured Senior Subordinated Notes	\$25,000.00	\$25,000.00
5608 **	Seton Hall Mortgage Note Holders	\$21,576.97	\$21,576.97
5779	FAIN Secured Senior Subordinated Notes Due 1/30/2009	\$10,000.00	\$10,000.00
5777	FAIN Secured Senior Subordinated Notes	\$10,000.00	\$10,000.00
5780	FAIN Secured Senior Subordinated Notes Due 1/30/2009	\$15,000.00	\$15,000.00
5778	FAIN Secured Senior Subordinated Notes	\$20,000.00	\$20,000.00
6100	FEIN 10.25% Secured Junior Notes Due 01/30/2009	\$25,000.00	\$25,000.00
6099	FEIN Secured Senior Subordinated Notes Due 1/30/2009	\$30,000.00	\$30,000.00
6101	TAIN Secured Junior Notes Due 12/15/2009	\$25,000.00	\$25,000.00
6102	FAIN Secured Senior Subordinated Notes	\$100,000.00	\$100,000.00
6103	TAIN Secured Senior Subordinated Notes 7.75% Due 12/15/2009	\$50,000.00	\$50,000.00
6751	TAIN Secured Senior Notes	\$100,026.14	\$100,026.14
6930	TDM Cable Trust 06 10% Contract Certificates Due 11/15/10	\$10,000.00	\$10,000.00

\*\* This investor has previously received a first distribution. Disallowance of this paper claim will not affect this investor's allowed claims.

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## Exhibit D-3 - Other Paper Claims

Claim No.	Description of Investment	Amount of Paper Claim	Reason for Disallowance
4111	CMS Financial	\$31,000.00	Non-Receivership
	Atlantis Strategic	\$25,000.00	Non-Receivership
	SASB Int A/O 1/2	None given	Non-Receivership
	Integrated Alarm	\$10,100.00	Non-Receivership
	Federated Premier Muni	\$26,969.00	Non-Receivership
	Integrated Alarm	\$19,274.44	Non-Receivership
	Aim Invesco High Yield	\$13,393.00	Non-Receivership
	Evergreen Income Advantage	\$6,584.09	Non-Receivership
	FLB	\$41,000.00	Non-Receivership
	MS Real Estate Capital Partners	\$15,000.00	Non-Receivership
	Unknown	\$33,232.00	No liability
	SAI Trust	\$10,000.00	Excluded Entity
	SAI Trust	\$15,000.00	Excluded Entity
	SAI Trust	\$8,634.00	Excluded Entity
4355 **	CMS Financial	\$100,000.00	Non-Receivership
	CMS Financial	\$40,274.32	Non-Receivership
	Integrated Alarm	\$21,000.00	Non-Receivership
	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 00	\$8,707.70	Excluded Entity
	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 03	\$20,076.06	Excluded Entity
5401	CMS Financial	\$25,000.00	Non-Receivership
	SAI Trust 00	\$16,535.40	Excluded Entity
5527	TDM Verifier Trust 09 10% Contract Certificates		
	Due 12/31/11	\$10,000.00	Untimely Filed
	Christian Values Network, Inc.	\$25,000.00	Non-Receivership
	Faith and Family Values Network, Inc.	\$25,000.00	Non-Receivership
	SAI Trust	\$20,000.00	Excluded Entity
	CMS Financial	\$109,350.00	Non-Receivership
	CMS Financial	\$109,350.00	Non-Receivership
	CMS Financial	\$30,000.00	Non-Receivership

	SAI Trust 00		\$20,000.00	Excluded Entity
	CMS Financial		\$155,000.00	Non-Receiverhsip
6192	FIIN Secured Senior Note		\$22,733.21	No liability
	MS Real Estate Capital Partners		\$30,000.00	Non-Receiverhsip
	CMS Financial		\$30,000.00	Non-Receiverhsip
	CMS Financial		None given	Non-Receiverhsip
	CMS Financial		None given	Non-Receiverhsip
6453	SAI Trust 00		\$16,660.12	Excluded Entity
	SAI Trust		\$8,707.76	Excluded Entity
	SAI Trust 00		\$10,000.00	Excluded Entity
	CMS Financial		\$38,100.00	Non-Receiverhsip
	First Independent Income Notes LLC		\$25,000.00	No liability

\*\* This investor has previously received a first distribution. Disallowance of this paper claim will not affect this investor's allowed claims.