UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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

ORAL ARGUMENT REQUESTED

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,

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

Intervenor
---X

RESPONSE OF STAN AND EVA RABINOVICH IN OPPOSITION TO 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

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Stanley and Eva Rabinovich (collectively, "Claimants" or the "Rabinovichs"), by and through their attorney, respectfully submit this Response in Opposition to 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, filed October 10, 2019 ("Receiver's Motion")[1] (*see* Docket No. 1075).

PRELIMINARY STATEMENT

According to SEC records, the most frequent type of link amongst victims of Ponzi schemes is that they are friends and family of the Ponzi scheme orchestrators. *See* Deason, Rajgopal, Waymire, and White, *Who Gets Swindled in Ponzi Schemes?*, (2015), SSRN Electronic Journal, available at SSRN: https://ssrn.com/abstract=2586490 or http://dx.doi.org/10.2139/ssrn.2586490 (attached to the Declaration of James Henry Glavin IV, filed herewith, ("Glavin Declaration") at Ex. A, at pp. 3 and 11). Approximately 11% of all victims of Ponzi schemes involve family and friends as victims. *Id*. Yet, the Receiver argues that the Rabinovichs' claims should be disallowed because they had a son who worked at McGinn, Smith & Co., Inc. ("MS & Co"). *See* R. Decl. at ¶ 29 and Rec. Memo at p. 8 Considering the statistics on Ponzi scheme orchestrators targeting family and friends, it is no wonder that Timothy McGinn targeted Stanley Rabinovich because he had a relative who worked at MS & Co. The evidence shows that McGinn, did in fact, approach the Rabinovichs' son "with a sense of urgency" about offering bridge loan transactions to his father, Stanley Rabinovich. The Receiver's argument that the Rabinovichs' claims should be disallowed does not hold water for a

[1] The Receiver's Motion is cited to herein as "R. Motion." The Declaration of William J. Brown in Support of the Receiver's Motion (Docket No. 1075-10) is cited to herein as "R. Decl." The Memorandum of Law in Support of the Receiver's Motion (Docket No. 1075-11) is cited to herein as "R. Memo."

number of reasons, but the fact that they had a relative working at MS & Co only makes them more likely to be victims of a Ponzi scheme, not less. Indeed, it is undisputed that the Rabinovichs have claims against MS & Co in an aggregate amount of $3,393,540.33.

The Receiver provides no factual or legal basis to disallow Eva Rabinovich's claims, only conclusory arguments. Without citing to any authority or any fact, the Receiver argues that Eva's claims should be disallowed on account of alleged "inequitable conduct" by her husband. It is no wonder that the Receiver cites no authority for such proposition because the law does not allow the conduct of one spouse to be imputed to another absent a very specific showing that is not present here. The Receiver also makes an argument that Stanley Rabinovich "actively participated in McGinn and Smith's fraudulent scheme" and engaged in "inequitable conduct." Yet, the evidence that the Receiver cites to in his Declaration shows the absence of any fraudulent or inequitable misconduct by Stanley Rabinovich.

STANDARD OF REVIEW

The Receiver has acknowledged that "Under the Plan [of Distribution], the burden is on the Receiver to serve the holders of claims that are disputed with a formal claim objection that sets forth the basis for the objection and persuade the Court at a hearing that the claim should be disallowed or reduced, as applicable." *See* Receiver Omnibus Reply to Objections to Motion for Order (i) Approving Plan of Distribution of Estate Assets and (ii) Authorizing Interim Distributions (Docket No. 883) at 10.

Rule 56 of the Federal Rules of Civil Procedure gives the District Court summary jurisdiction over all the receivership proceedings, and in granting relief, the Court may use summary proceedings. *See SEC v Elliott*, 953 F2d 1560, 1566 (11th Cir 1992). While the term "summary" connotes an abbreviated procedure, the Court must, in substance, adequately safeguard claimants' interests. *Id.* at 1567. Summary proceedings are inappropriate when parties

would be deprived of a full and fair opportunity to present their claims and defenses. *Id*. For summary proceedings to be appropriate, the proceedings must not prejudice claimants, and claimants must be afforded as good an opportunity to present their claims and defenses as in a plenary proceeding. *Id.*

ARGUMENT

I. EVA RABINOVICH IS ENTITLED SUMMARY JUDGEMENT IN HER FAVOR BECAUSE THE RECEIVER HAS FAILED TO SUPPORT HIS MOTION AGAINST HER WITH ANY FACTS

A. THE ALLEGED CONDUCT OF HER SPOUSE CANNOT BE IMPUTED TO EVA

Eva Rabinovich has a claim for $934,953.59 in her own name and $454,664.29 jointly with her husband, for a total of $1,389,617.88. *See* R. Decl. at Ex. A. Eva had no knowledge of misconduct at MS & Co. *See* Declaration of Eva Rabinovich, filed herewith, at ¶ 5. In its Motion and Memorandum, the Receiver seeks to disallow Eva's claims, yet the Receiver provides no factual or legal basis to disallow her claims. *See* R. Motion at Ex. A and R. Memo at pp. 15-16. The Receiver's Declaration likewise asserts no relevant facts about her or her claims. *See generally* R. Decl. Indeed, the Receiver's Declaration has only a heading titled "Stanley Rabinovich Claims," and there is no section about Eva. *See* R. Decl. at p. 9.

The Receiver's Memorandum, without citing to any authority or any fact, argues that Eva's claims should be disallowed on account of alleged "inequitable conduct" by her husband. *See* R. Memo at p. 15. It is no wonder that the Receiver cites no authority for such proposition because the law does not allow the conduct of one spouse to be imputed to another absent a *very specific* showing. In fact, case law holds the opposite, *i.e.*, that "[t]he marital relationship alone is not enough to impute one spouse's fraud to the other." *See Tower Credit, Inc. v Gauthier (In re Gauthier)*, 349 F App'x 943, 945-946 (5th Cir 2009).

The theory of imputing one spouse's conduct on another is controversial and subject to conflicting case law. *See*, *e.g.*, *S&T Bank v Howard (In re Howard)*, 2009 Bankr LEXIS 3743, at *13-14 (Bankr SDNY Nov. 25, 2009, No. 09-22557 (RDD)) ("It's also clear that if a so-called 'imputation' theory may be used to impute Mr. Howard's alleged frauds to Mrs. Howard (a concept that is subject to conflicting case law) -- but to the extent that the imputation theory would apply in this Circuit -- the complaint does not state a cause of action based on imputing Mr. Howard's alleged fraud to Mrs. Howard. As far as the validity of the "imputation" theory in the first place is concerned, see the conflicting authorities cited in paragraph 523.08[3] of 4 Collier on Bankruptcy (15th ed. 2009) at 523-52-3"); *see also Haig v Shart (In re Shart)*, 505 BR 13, 16-17 (Bankr CD Cal 2014) (questioning the propriety of the imputation of fraud theory and stating that "[i]In light of the Supreme Court's recent rulings in *Grogan*, *Geiger*, and especially *Bullock*, I am certain that given the opportunity today, the Supreme Court would not impute fraud to preclude dischargeability to an otherwise innocent partner who had no culpability other than being a partner").[2]

To the extent courts even recognize the imputation theory, they have only done so where spouses were "involved in a business or scheme." *See Tower Credit*, 349 F App'x at 945-946 (holding that "Where we have imputed fraud from one spouse to another, we have relied on agency theory, and done so only where the spouses were 'involved in a business or scheme'").

[2] Courts look to bankruptcy law as an aid to address issues that arise in receiverships. *See*, *e.g.*, *SEC v Total Wealth Mgt.*, 2018 US Dist LEXIS 120132, at *16 (SD Cal July 17, 2018, No. 15-cv-226-BAS-RNB)); citing *SEC v. Wells Fargo Bank*, 848 F.3d 1339, 1345 (11th Cir. 2017) (stating that bankruptcy law is analogous and instructive to the receivership context); *Marion v. TDI Inc.*, 591 F.3d 137, 148 (3d Cir. 2010) (analyzing bankruptcy law in a receivership context); *Fidelity Bank, Nat'l Ass'n v. M.M. Grp., Inc.*, 77 F.3d 880, 882 (6th Cir. 1996); *Unisys Fin. Corp. v. Resolution Tr. Corp.*, 979 F.2d 609, 611 (7th Cir. 1992).

Thus, for the Court to apply the imputation theory, the Receiver is required to show, at the very least, that the Rabinovichs were involved together in a business or scheme.

The marital relationship does not alone give rise to a business relationship, legal partnership or agency. *See Tower Credit*, 349 F App'x at 945-946 (*citing* Lawrence Ponoroff, *Vicarious Thrills: The Case for Application of Agency Rules in Bankruptcy Dischargeability Litigation,* 70 TUL. L. REV. 2515, 2552 (1996) that "as a matter of substantive nonbankruptcy law, it is axiomatic that the marital relationship does not alone give rise to either a legal partnership or an agency"); *Tsurukawa v Nikon Precision, Inc. (In re Tsurukawa)*, 258 BR 192, 198 (BAP 9th Cir 2001) (holding "[c]ertainly, spouses can be partners in a business enterprise where agency principles apply. However, the marital status alone does not create an agency relationship"); *In re Allison*, 960 F2d 481, 485 (5th Cir 1992) ("The agency theory has been applied to impute the fraudulent acts of one spouse to the other in cases in which the other spouse was involved in a business or scheme"); S*&T Bank v Howard (In re Howard)*, 2009 Bankr LEXIS 3743, at *13-14 (Bankr SDNY Nov. 25, 2009, No. 09-22557 (RDD)) ("The courts that have recognized the imputation of one spouse's fraud or wrongdoing to the other have generally concluded that it must be shown that the debtor-spouse was a partner, a business partner or the business partner, of the spouse who committed the fraud"); *Gannett v Carp (In re Carp)*, 340 F3d 15, 26 (1st Cir 2003) (finding that a marriage of 30 years and past joint real estate ventures did not establish an agency relationship between a husband and wife, holding that "[t]he sins of the husband are not automatically visited upon the wife" ... "the fact that the Carps may have done business together in the past is insufficient"); *Stevens v Antonious (In re Antonious)*, 358 BR 172, 184 (Bankr ED Pa 2006) ("decisions that have attributed the wrongdoing of a party to a debtor-spouse have done so based upon agency theory. The existence

of a marital relationship alone does not establish an agency relationship"); *Scheidelman v Henderson (In re Henderson)*, 423 BR 598, 615 (Bankr NDNY 2010); ("Absent a very specific showing, the actions or intent of a co-debtor spouse will not be imputed to the debtor or 'innocent' debtor spouse").

In addition, some courts have held that even if it is proven that a business relationship or partnership existed between the spouses, it must be proven that the otherwise innocent spouse knew or should have known of her partner's fraud. *See Treadwell v Glenstone Lodge, Inc. (In re Treadwell)*, 637 F3d 855, 860 (8th Cir 2011) ("If the creditor proves a partnership between two of its debtors, non-dischargeability may be imputed from one partner to the other. Under our precedent, imputation only is proper if the otherwise innocent debtor knew or should have known of his partner's fraud").

As the Receiver's Declaration presents no facts adverse to Eva Rabinovich's claims, the Receiver's Declaration should be disregarded and the Court should enter a judgment allowing Eva Rabinovich's claims. *See* Fed. R. Civ. P. 56(c)(1); *see also Celotex Corp. v Catrett*, 477 US 317, 323 (1986) ("a party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact); *BellSouth Telecom. v W.R. Grace & Co.*, 77 F3d 603, 615 (2d Cir 1996) ("conclusory statements are insufficient to raise a triable issue of material fact, and hence were properly disregarded") citing 10A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 2738, at 486 & 489 (1983) and Fed. R. Civ. P. 56.

Accordingly, Eva's claim for $934,953.59 in her own name and her claim for

$454,664.29 held jointly with her husband, for a total of $1,389,617.88, should be allowed.[3]

B. FRAUD MUST BE STATED WITH PARTICULARITY

FRCP 9(b) requires that "a party must state with particularity the circumstances constituting fraud or mistake." The Second Circuit has "construed Rule 9(b) strictly" in order to protect individuals "from harm to their reputation resulting from ungrounded actions, and to give defendants notice of the precise conduct in issue." *Billard v. Rockwell Int'l Corp.*, 683 F.2d 51, 57 (2d Cir. 1982). Here, the Receiver has failed to allege any particularity regarding any grounds for why Eva Rabinovich's claims should be disallowed. Conclusory allegations of fraud should be dismissed under Rule 9(b). See *Rosner v Bank of China*, 2008 US Dist LEXIS 105984, at *10 (SDNY Dec. 18, 2008, No. 06 CV 13562).

C. AN OFFSET OR RISING TIDE METHODOLOGY IS NOT APPROPRIATE FOR EVA RABINOVICH'S CLAIMS

As the Receiver has presented no evidence showing that Eva Rabinovich acted improperly or inequitably, her claims should be allowed in their entirety and should not be offset. Even if this Court were to conclude that Stanley Rabinovich's claims should be disallowed, that will have no effect on Eva's claims. The $850,000 repayment of the bridge loans to Stanley Rabinovich was made to Stanley and not to Eva Rabinovich. *See* Receiver Decl. at ¶ 32. Eva never made any bridge loans. Thus, there is absolutely no basis for the Court to offset Eva's claims on account of her husband's transactions.

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[3] The opening of a joint account creates a rebuttable presumption that each named tenant is possessed of the whole of the account. Thus, all of Eva's claims (the $934,953.59 in her own name and $454,664.29 in the joint account) should be allowed regardless of what the Court decides regarding her husband's claims. Under no circumstances, however, should Eva's claim in the joint account be completely disallowed. See, e.g., *Velocity Invs., LLC v. Kawski*, 21 Misc. 3d 276, 283-284 (City Court of New York 2008) ("As a matter of law, the opening of a joint account is prima facie evidence of an intention to create a joint tenancy and, pursuant to *Moskowitz* and its progeny, prima facie evidence that the judgment debtor's interest is limited to 50% of the amount on deposit in the account").

II. THE RECEIVER HAS FAILED TO SUPPORT HIS MOTION AGAINST STANLEY RABINOVICH WITH ANY RELEVANT FACTS ABOUT HIM

A. THERE IS NO EVIDENCE THAT STANLEY RABINOVICH ACTED IMPROPERLY OR INEQUITABLY

Actual, not constructive, knowledge is required to show that someone was an active participant in, or an aider and abettor of, fraud. *See Rosner v Bank of China*, 2008 US Dist LEXIS 105984, at *10-11 (SDNY Dec. 18, 2008, No. 06 CV 13562); *citing Renner v. Chase Manhattan Bank, N.A.*, 85 Fed. Appx. 782, 784 (2d Cir. 2004) ("As to the knowledge requirement, New York courts require that the alleged abettor have *actual* knowledge of the primary wrong."(emphasis in original)); *Mazzaro de Abreu v. Bank of Am. Corp.*, 525 F. Supp. 2d 381, 388 (S.D.N.Y. 2007). The Second Circuit has applied the heightened pleading requirements of Rule 9(b) to claims for aiding and abetting fraud. *See Rosner*, 2008 US Dist LEXIS 105984, at *10-11; *citing Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 292 (2d Cir. 2006); *Filler v. Hanvit Bank*, 156 Fed. Appx. 413, 417 (2d Cir. 2005) ("[T]he particularity requirements of Rule 9 (b) apply to claims of aiding and abetting fraud no less than to direct fraud claims.").

Without any evidence, the Receiver makes an argument that Stanley Rabinovich "actively participated in McGinn and Smith's fraudulent scheme" and engaged in "inequitable conduct." *See* R. Memo at p. 15. The Declaration of Kerri L. Palen, dated January 10, 2014 ("Palen Declaration"), which is attached to the Receiver's Declaration, shows, if anything, the absence of any fraudulent or inequitable misconduct by Stanley Rabinovich. In fact, Palen's thirty-four page Declaration has no mention of any conduct by Stanley Rabinovich. The only other piece of factual information that the Receiver relies upon are excerpts from the transcript of the public hearing held before the Administrative Law Judge in the Administrative Proceeding (File No. 3-11514) commenced by the SEC as to certain MS & Co. brokers ("Broker Trial Transcript"). *See* R. Decl. at Ex. 2. The excerpts from the Broker Trial Transcript also contain

no information regarding Stanley Rabinovich's conduct. Rather, the Broker Trial Transcript shows that, unsurprisingly, MS & Co. improperly handled the treatment and documentation of Stanley Rabinovich's bridge loans:

> Q. Did you know with respect to Firstline, did you know that Mr. Rabinovich's father had made a $600,000 bridge loan to Firstline 11B?
>
> A. I do recall Mr. Rabinovich's father making a bridge loan for Firstline. I don't recall exactly which Firstline it was.
>
> Q. Do you recall the $600,000 figure?
>
> A. I do recall approximately that number, yes.
>
> Q. And you knew at the time of that bridge loan that McGinn Smith ticketed the $600,000 from Stan Rabinovich's regular investment, right?
>
> A. What I do recall is calling up to either Patty or Dave Smith or Tim -- I don't recall specifically -- I do recall some communication going up saying "How do you want this transaction to be done in the ticket system," and they coming back with the information saying "Just do it the way you would a regular one."
>
> Q. A regular investment?
>
> A. That's what I recall.

See R. Decl. at Ex. 2 at 3409:7 - 3410:5.

As is apparent from the Receiver's exhibits, Stanley Rabinovich did not engage in conduct that the Receiver is alleging. There is nothing illegal or improper about making bridge loans, especially whereas here, the lender believes them to be for legitimate purposes. *See* Affidavit of Stanley Rabinovich, filed herewith, at ¶ 7. Thus, there is no basis for disallowing Stanley Rabinovich's claims based upon his conduct. When disallowing claims based upon someone's conduct, courts recognize that only those persons who "took the business over the

edge" or "primary operators" who profited from the fraudulent scheme by putting "a great deal of effort into promoting and marketing" defendants' products or was "responsible for recruiting the investors who ultimately suffered" should have their claims disallowed. *See SEC v Bivona*, 2017 US Dist LEXIS 148575, at *42-44 (ND Cal Sep. 13, 2017, No. 16-cv-01386-EMC); *see also SEC v Pension Fund of Am. L.C.*, 377 F App'x 957, 963 (11th Cir 2010) (disallowing the claims for wages and commissions of a former Pension Fund Sales Agent and/or Regional Director who was responsible for "recruiting the investors who ultimately suffered losses due to the Pension Fund's fraud"); *SEC v. Basic Energy & Affiliated Res.*, 273 F.3d 657, 660 (6th Cir. 2001) (affirming distribution plan that prohibited defendants from recovering and reduced recovery of employees based on level of involvement in fraudulent scheme).

This Court has also previously recognized that a District Court's discretion to exclude claimants involved in the underlying fraudulent scheme can extend to a "sales agent who was among those 'responsible for recruiting the investors who ultimately suffered losses'" and received "commissions . . . derived from the funds of investors who were victimized," individuals whose "activities extended to marketing and solicitation on [the scheme]'s behalf," and "individuals who, among other things, induced clients and violated state laws." *See SEC v McGinn, Smith & Co.*, 2019 US Dist LEXIS 35678, at *6-7 (NDNY Mar. 6, 2019, No. 1:10-cv-457 (GLS/CFH)) citing Sec. & Exch. Comm'n v. Byers, 637 F. Supp. 2d 166, 184 (S.D.N.Y. 2009); *Sec. & Exch. Comm'n v. Pension Fund of Am. L.C.*, 377 F. App'x 957, 963 (11th Cir. 2010); *Sec. & Exch. Comm'n v. Merrill Scott & Assocs.*, Civil No. 2:02 CV 39, 2006 U.S. Dist. LEXIS 93248, 2006 WL 3813320, at *12 (D. Utah Dec. 26, 2006); *Sec. & Exch. Comm'n v. Enterprise Tr. Co.*, No. 8 C 1260, 2008 U.S. Dist. LEXIS 79731, 2008 WL 4534154, at *3, *7 (N.D. Ill. Oct. 7, 2008); *Sec. & Exch. Comm'n v. Bivona*, Case No. 16-cv-1386, 2017 U.S. Dist.

LEXIS 148575, 2017 WL 4022485, at *13 (N.D. Cal. Sept. 13, 2017).

Stanley Rabinovich was not, and the Receiver has presented no evidence that he was, someone who "took the business over the edge," was a "primary operator" who profited from the fraudulent scheme by putting "a great deal of effort into promoting and marketing" defendants' products or was "responsible for recruiting the investors who ultimately suffered." *See* Affidavit of Stanley Rabinovich at ¶ 6. Accordingly, Stanley Rabinovich's claims should be allowed in their entirety.

B. THE RISING TIDE OFFSET IS NOT APPROPRIATE FOR STANLEY RABINOVICH'S CLAIMS

The Receiver moves the Court to offset Stanley Rabinovich's claims by applying the Rising Tide Methodology. The Rising Tide Methodology is being used to offset Preferred Investor distributions. *See* Receiver Memo at p. 18. There is no legitimate reason to offset Stanley Rabinovich's claims because he made loans without any knowledge of MS & Co.'s fraud. *See* Section II (A) infra. In addition, and as detailed below: (1) he was not a preferred investor; and (2) his bridge loans should be outside the scope of the Receiver's Plan of Distribution.

1. Stanley Rabinovich Was Not A Preferred Investor

The Receiver asks the Court to apply the Rising Tide Methodology to offset Stanley Rabinovich's claims because such methodology is also being applied to "Preferred Investor" claims. *See* Receiver Memo at 16 and 18. The evidence demonstrates, however, that Stanley Rabinovich was not a "Preferred Investor." As stated by the United States Attorney's Office during the criminal trial securing the convictions of Timothy McGinn and David Smith:

> Ladies and gentlemen, I want to talk for a moment about the preferred investor payments … Mr. McGinn had a select group of his best customers that he did not want to stop receiving their payments. So he started paying them out of MSTF. You heard

> from Mr. Cooper how he got a list of those investors from Ms. Sicluna. You heard what he called them. Timothy McGinn supplemental preferred investors. They continued to get their payments. The rest of the investors in the Four Funds did not, not Tom Brown, that state worker, not Ron DeLeonardis, Mr. McGinn's high school friend who owned the fish fry place, not Mr. Rabinovich's father.

see pp. 3343:12 – 3344:5 of the Transcript of the Trial Proceedings held on January 31, 2013, before the Honorable David N. Hurd, attached to the Glavin Declaration at Ex. B; *see also* pp. 1459:15 -1460:4 of the Transcript of the Trial Proceedings held on January 15, 2013, before the Honorable David N. Hurd, attached to the Glavin Declaration at Ex. C.

Accordingly, Stanley Rabinovich's claims should not be offset because he was not a "Preferred Investor."

2. The Bridge Loans Are Outside the Scope of The Plan Of Distribution

The Receiver, despite evidence to the contrary, paints Stanley Rabinovich's loans as regular investments. *See* Rec. Decl. at ¶ 30. Evidence adduced in the criminal proceeding against McGinn and Smith, as well as the SEC proceedings, shows that bridge loans transactions were somewhat regularly done at MS & Co. *See*, *e.g*., pp. 2158:7 – 19 of the Broker Trial Transcript attached to the Glavin Declaration at Ex. D (MS & Co. "historically had investors that would bridge their transactions" so the asset could be acquired); pp. 2050:16 – 2051:6 of the Transcript of the Trial Proceedings held on January 22, 2013, before the Honorable David N. Hurd attached to the Glavin Declaration at Ex. E. The PPMs for the Four Funds offerings stated broadly that the offering proceeds would be used "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 …" *See* Palen Decl. at ¶ 22.

Further, the evidence also shows that Stanley Rabinovich's bridge loans, were in fact,

bona fide loans and not, as implied by the Receiver, like other regular investments. *See*, *e.g.*, pp. 2139:19 – 2140:4 of the Transcript of the Trial Proceedings held on January 23, 2013, before the Honorable David N. Hurd, attached to the Glavin Declaration at Ex. F; Stanley Rabinovich Declaration at ¶¶ 5 and 7. As described in the Broker Trial:

> Q. … Can you describe for the Court what a bridge loan is? Is that like one of these trusts or the Four Funds?
>
> A. A bridge loan is like mezzanine funding where you are giving the money and then from the proceeds you get the money back from the proceeds.
>
> Q. In connection with Mr. Rabinovich's bridge loan, what was the purpose of that bridge loan, if you recall?
>
> A. To close the deal.
>
> Q. Let's be a little more specific.
>
> A. There is a minimum that has to be reached, and close the deal.
>
> Q. Am I correct that that a bridge loan is bridging the time from the start of an offering to when that offering closes?
>
> A. Yes.
>
> Q. And then the investor who made the bridge loan he is not part of the offering he gets his money back, right?
>
> A. Right.
>
> Q. And he only gets his money back when conditions are met that that deal is funded?
>
> A. Yes.
>
> Q. Is that what they are talking about in those e-mails about how much money they have to pay Mr. Rabinovich back?
>
> A. In the Rabinovich e-mails, yes.
>
> Q. That wasn't anything about a redemption in a trust or redemption in the Four Funds, was it?

A. No.

See pp. 3214:6 – 3215:16 of the Broker Trial Transcript attached to the Glavin Declaration at Ex. D.

If at the time of the transaction, the parties involved intended repayment, then it is a loan. *See Bergersen v C.I.R.*, 109 F3d 56, 59 (1st Cir 1997) (when determining whether a transaction is a loan, "[t]he conventional test is to ask whether, at the time of the withdrawal in question, the parties actually intended repayment). Here the evidence shows that the parties intended repayment. *See*, *e.g.*, Stanley Rabinovich Declaration at ¶ 7; *see also* pp. 3214:6 – 3215:16 of the Broker Trial Transcript attached to the Glavin Declaration at Ex. D.

The reason the Receiver challenges the characterization of bridge loans is because there is no basis to exclude Stanley Rabinovich's claims if in fact, he made bona fide bridge loans. The Receiver's Plan of Distribution, approved by this Court, "seeks to pool the assets of various MS Entities and distribute the pooled assets to *investors* on a pro rata basis" and the Plan "proposes to treat all *investors* equally." *See* Plan of Distribution at p. 11 (emphasis added). Under the Plan, "the amount of an *investor's* claim has been determined pursuant to the Claims Procedure Order and was generally determined by the "net investment" method, i.e., the *investor* claim amount is equal to the amount of the initial investment(s) less any *distributions received* prior to the appointment of the Receiver." *See id*. at p. 12 (emphasis added). It is clear that the Plan of Distribution is for investors, and does not relate to those who made bridge loans because bridge loans are not investments. Further, investor claims are equal to the amount of the initial investment less any distributions. Since the repayment of a bridge loan is not a distribution, the bridge loans made by Stanley Rabinovich are outside the scope of the Plan. Stanley Rabinovich has claims totaling $ 2,003,922.45 in his own name, and $454,664.29 jointly with his wife, apart

from the bridge loans he made (he has made no claim for any amounts related to his bridge loans). *See* R. Decl. at Ex. A.

The opinion in *SEC v Bivona*, 2017 US Dist LEXIS 148575 (ND Cal Sep. 13, 2017, No. 16-cv-01386-EMC) is instructive. In that matter, Ann Bivona objected to the SEC and the Receiver's motion to exclude her based upon her $1.4 million loan she gave to the defendants. *Id*. at *39. The court began by analyzing whether a bona fide loan existed, and then proceeded to analyze whether exclusion or differential treatment was warranted. *Id*. Based upon the record, the Court assumed the loan was bona fide, and held that if Ms. Bivona's claim was to be excluded, the SEC needed to present evidence to challenge the loan's bona fides at an evidentiary hearing. *Id*. at *41. A hearing was necessary because the court needed to "examine whether Ms. Bivona's claim should be treated differently or discounted – should her claim be treated as repayment of a loan or as an investment subject to the distribution plan ordered by the Court?" Id. at *45. The Court concluded that "[w]hat equity requires will likely depend on the level of Ms. Bivona's awareness [of misconduct]." *Id*. at *47.

The fundamental principle governing a distribution plan is that it should be "equitable and fair, with similarly-situated investors treated alike." *See SEC v. Credit Bancorp, Ltd.*, 99 Civ. 11395 (RWS), 2000 U.S. Dist. LEXIS 17171, at *93 (S.D.N.Y. Nov. 29, 2000) (citing *SEC v. Elliott*, 953 F.2d 1560, 1569 (11th Cir. 1992); *United States v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996); *United States v. Vanguard Inv. Co.*, 6 F.3d 222, 226-27 (4th Cir. 1993)). Here, there is no basis to exclude Stanley Rabinovich's claims on his investments or treat his claims differently from other investors because the facts show that the bridge loans he made were bona fide bridge loans.

III. THE RABINOVICHS' CLAIMS SHOULD NOT BE DISSALLOWED OR OFFSET WITHOUT AN EVIDENTIARY HEARING AND DISCOVERY

If the Court finds that the Receiver has met its burden in providing evidence that the Rabinovich claims should be disallowed or reduced, then the Rabinovichs should be permitted to conduct discovery and afforded an evidentiary hearing. *See*, *e.g.*, *SEC v Wencke*, 783 F2d 829, 836-838 (9th Cir 1986) (appellant's due process challenge to the summary disgorgement proceedings failed because he was "given the opportunity to introduce evidence and to call and cross-examine witnesses in the hearings before the magistrate and district court" and was "permitted extensive discovery, including the taking of depositions"); *SEC v Elliott*, 953 F2d 1560, 1567 (11th Cir 1992).

IV. NEW EVIDENCE AND ARGUMENTS IN A REPLY SHOULD BE DISREGARDED

As stated *supra*, the Receiver has failed to submit any evidence showing "fraudulent" or "inequitable" conduct by Stanley or Eva Rabinovich. Any attempt by the Receiver (or the Securities and Exchange Commission) to introduce new facts or arguments against Stanley or Eva Rabinovich in reply papers should be disregarded. *See*, *e.g.*, *Knipe v Skinner*, 999 F2d 708, 711 (2d Cir 1993) ("Arguments may not be made for the first time in a reply brief"); *NLRB v. Star Color Plate Service, Div. of Einhorn Enterprises, Inc.*, 843 F.2d 1507, 1510 n.3 (2d Cir. 1988) (rejecting a party's "attempts to raise for the first time in its reply brief" a new issue); *United States v Letscher*, 83 F Supp 2d 367, 377 (SDNY 1999) ("arguments raised in reply papers are not properly a basis for granting relief").

V. CONCLUSION

For the foregoing reasons, the Rabinovichs respectfully request that the Court allow their claims and deny the Receiver's Motion with respect to their claims.

ORAL ARGUMENT REQUESTED

Dated: November 18, 2019

Respectfully submitted,

/s/ James Henry Glavin IV
James Henry Glavin IV Bar Number: 518250
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Waterford, NY 12188
Tel: (518) 237-5505
Fax: (518) 237-1990
Email: hglavin@glavinandglavin.com

Attorney for Claimants

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

--X

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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,

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

Intervenor

--X

AFFIDAVIT OF STANLEY RABINOVICH IN SUPPORT OF THE RESPONSE OF STAN AND EVA RABINOVICH IN OPPOSITION TO 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

State of New York)
)
County of New York)

Stanley Rabinovich, being duly sworn, deposes and says:

1. I have read the foregoing affidavit and the contents thereof are true to the best of my knowledge, information, and belief.

2. I am submitting this affidavit in support of the Response in Opposition to 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.

3. By way of background, I am an engineer, with a master's degree in electrical engineering. I have worked in the medical technology field for the last 40 years. I have helped to innovate breakthrough medical device technologies, which have extended the lives of millions of patients dealing with cardiovascular diseases. In addition to the development of stent technologies, I co-founded the company that pioneered development of the first heart valve that could be placed without open heart surgery, a procedure called TAVR, which has become the standard of care for treating heart valve disease. My company was acquired by a major medical device corporation in 2004.

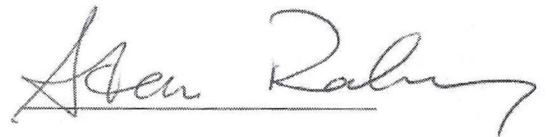
4. I have never received any formal education or certifications in accounting, finance, marketing, or any similar fields.

5. McGinn, Smith & Co., Inc. ("McGinn, Smith"), was a broker dealer with which I invested some funds and made two bridge loans. During the entire time I had

been investing with and loaned money to McGinn, Smith, I had no knowledge of any facts that suggested they may have acted fraudulently or unlawfully.

6. Contrary to the Receiver's allegations, I did not "actively participate" in McGinn, Smith's fraudulent scheme. *See* Receiver's Memorandum of Law at p. 15. I have never had any affiliation with McGinn, Smith. In addition, at no time did I promote or market McGinn, Smith products. I have never recruited or induced other investors to do business with McGinn, Smith. Nor have I ever received any commissions from McGinn, Smith.

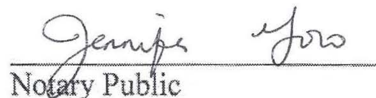
7. Regarding specifically my bridge loans to McGinn, Smith, and unlike my other investments with McGinn, Smith, it was always my understanding that the loans were temporary and would be repaid. I also trusted that McGinn, Smith would properly document the loans. I believed that the loans would be paid back lawfully and properly, and I was aware of no information that would have led me to believe otherwise.



Stanley Rabinovich

Sworn to before me

November 15, 2019



Notary Public

JENNIFER GORO
NOTARY PUBLIC-STATE OF NEW YORK
No. 01GO6205718
Qualified in Queens County
My Commission Expires 05-11-2021

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

---X
SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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,

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

Intervenor
---X

AFFIDAVIT OF EVA RABINOVICH IN SUPPORT OF THE RESPONSE OF STAN AND EVA RABINOVICH IN OPPOSITION TO 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

State of New York)
)
County of New York)

Eva Rabinovich, being duly sworn, deposes and says:

1. I have read the foregoing affidavit and the contents thereof are true to the best of my knowledge, information, and belief.

2. I am submitting this affidavit in support of the Response in Opposition to 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.

3. By way of background, I have been a real estate agent in New Jersey for over 30 years, focused on the Bergen County residential housing market. I have a separate career from my husband, Stanley Rabinovich, and I have never been one of his business partners or associates.

4. I have never received any formal education or certifications in accounting, finance, marketing, or any similar fields.

5. McGinn, Smith & Co., Inc. ("McGinn, Smith") was a broker dealer with which I invested some funds. During the entire time I had been investing with McGinn, Smith, I had no knowledge of any facts that suggested they may have acted fraudulently or unlawfully.

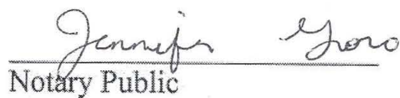
6. I did not "actively participate" in McGinn, Smith's fraudulent scheme. *See* Receiver's Memorandum of Law at p. 15. I have never had any affiliation with McGinn, Smith. In addition, at no time did I promote or market McGinn, Smith products. I have

never recruited or induced other investors to do business with McGinn, Smith. Nor have I ever received any commissions from McGinn, Smith.

Eva Rabinovich

Sworn to before me

November 15, 2019



Notary Public

JENNIFER GORO
NOTARY PUBLIC-STATE OF NEW YORK
No. 01GO6205718
Qualified in Queens County
My Commission Expires 05-11-2021

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

---X

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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,

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

Intervenor

---X

DECLARATION OF JAMES HENRY GLAVIN IV IN SUPPORT OF THE RESPONSE OF STAN AND EVA RABINOVICH IN OPPOSITION TO 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

I, James Henry Glavin IV, declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information, and belief:

1. I am a member of the bar of this Court and counsel for claimants, Stanley and Eva Rabinovich in this action.

2. I submit this declaration to place before the Court copies of certain documents relevant to the motion at bar.

3. Attached as Exhibit A is a copy of an excerpt from Deason, Rajgopal, Waymire, and White, *Who Gets Swindled in Ponzi Schemes?*, (2015).

4. Attached as Exhibit B is a copy of an excerpt from the Transcript of the Trial Proceedings held on January 31, 2013, before the Honorable David N. Hurd regarding Stanley Rabinovich not being a preferred investor.

5. Attached as Exhibit C is a copy of an excerpt from the Transcript of the Trial Proceedings held on January 15, 2013, before the Honorable David N. Hurd also regarding Stanley Rabinovich not being a preferred investor.

6. Attached as Exhibit D is a copy of excerpts from the transcript of the public hearing held before the Administrative Law Judge in the Administrative Proceeding (File No. 3-11514) commenced by the SEC as to certain MS & Co. brokers regarding MS & Co historically having investors that would bridge their transactions and details regarding Stanley Rabinovich's bridge loans.

7. Attached as Exhibit E is a copy of an excerpt from the Transcript of the Trial Proceedings held on January 22, 2013, before the Honorable David N. Hurd regarding bridge financing.

8. Attached as Exhibit F is a copy of an excerpt from the Transcript of the Trial Proceedings held on January 23, 2013, before the Honorable David N. Hurd regarding Stanley Rabinovich's bridge loan.

9. In addition, Claimants Stanley and Eva Rabinovich have not yet been afforded discovery in this matter. Thus, Stanley and Eva Rabinovich have not been able to completely present all relevant facts in support of their opposition to the Receiver's motion.

s/ James Henry Glavin IV__

James Henry Glavin IV

EXHIBIT A

Who Gets Swindled in Ponzi Schemes?

by

Stephen Deason

Shivaram Rajgopal*

Gregory Waymire

and

Roger White

Goizueta Business School
Emory University
1300 Clifton Road NE, Atlanta, GA 30030

May 12, 2015
Comments welcome

*Corresponding author. Email: shivaram.rajgopal@emory.edu.

For helpful comments, we thank workshop participants at Chapman University, Tulane University, and the University of California at Irvine. We appreciate research assistance by Matsunao Masuda, Kelly Meric, Anton Ouzounov, Esha Chandra, Chenlin Ding, Xinyi Liu, Ting Luo, Patrick Ryan, Kyung Hwan Shin, Yang Song, Xi Wang, Ge Wu, Hua Xu, and Monica Yang. We also gratefully acknowledge expert legal assistance from Emory University Law Librarian Thomas Sneed, J.D. We acknowledge financial assistance from our respective schools. All errors are ours alone.

ABSTRACT

Extant knowledge of Ponzi schemes in the accounting and finance literature is mainly anecdotal. The consequence of this is that it is difficult to know what, if anything, can be done to deter these frauds. We seek to fill part of our knowledge gap about Ponzi schemes by providing large-scale evidence based on a sample of 376 Ponzi schemes prosecuted by the SEC between 1988 and 2012. Our evidence indicates that the majority of SEC-prosecuted schemes involve sums that are much lower than those in the highly visible frauds perpetrated by Bernard Madoff and Allen Stanford. The mean duration of Ponzi schemes in our sample is about four years and these schemes have a mean (median) average per-investor investment of around $431,700 ($87,800). Ponzi schemes are more likely to occur in U.S. states where the citizenry is inherently more trusting and where they have fewer alternate opportunities for local investment. The *ex post* success of a Ponzi scheme (as measured by duration, total amount invested, or the percentage cut to perpetrators) tends to be greater when an affinity link is present, the elderly are targeted, and whether the perpetrator provides financial incentives to third-parties to recruit victims into the scheme.

JEL codes: D14, D19, G18
Keywords: Ponzi scheme, trust, descriptive, victims, SEC

INTRODUCTION

"The crucial puzzle of those early days – the one that would shape public reaction for months – was this: Who were Madoff's victims? Aside from some worthy charitable and cultural institutions, were they just a few movie stars, plutocrats, and hedge funds, each mourning a $100 million loss? Or had tens of thousands of ordinary middle-class families also lost hundreds of thousands of dollars in retirement savings?"
Diana Henriques, *The Wizard of Lies* (2012, 215)

"When we think of the anguish of the sufferers, we take part with them more earnestly against their oppressors; we enter with more eagerness into all their schemes of vengeance, and feel ourselves every moment wreaking, in imagination, upon such violators of the laws of society, that punishment which our sympathetick indignation tells us is due to their crimes."
Adam Smith, *The Theory of Moral Sentiments* (1759, Vol. I, Pt. II, Section I)

Bernard Madoff was arrested on December 11, 2008 after confessing to his family that his investment business was an "enormous lie… 'a giant Ponzi scheme'" (Henriques 2012, 8). The judge imposed a sentence of 150 years in prison in part because he was moved by a letter that described "how Madoff conned an 86-year-old widow by putting his arm around her 'and in a kindly manner told her not to worry, that the money is safe with me'" ("Bye, Bye Bernie: Ponzi King Madoff sentenced to 150 years," *New York Daily News*, June 29, 2009). Madoff's harsh sentence suggests that a thief's punishment depends on whether his theft evokes what Adam Smith (1759) referred to as moral sentiments – embezzling a widow's last penny is fundamentally different than stealing from a wealthy man to feed a starving child.

More broadly, there is likely considerable social value in economic institutions that effectively penalize and deter frauds like Madoff's Ponzi scheme. However, building effective mechanisms to deter Ponzi schemes requires that we understand how Ponzi schemers identify their victims, secure their trust, and convince them to invest large amounts in the fraud. Unfortunately, our knowledge of Ponzi schemes is based largely on anecdotes provided by a few sensational cases like Madoff or the 1920 scheme for which the crime is named (Henriques

2012; Zuckoff 2006). Our contribution is to provide evidence on the "who" and "how" of Ponzi schemes using a broader sample of such frauds.

A pure Ponzi scheme is an investment fund where the fund originator never makes a legitimate investment in assets that produce income.[1] Thus, "dividends" are paid to existing investors out of the capital contributions of new investors. The survival of a Ponzi scheme depends on the schemer's ability to attract new investors who make sufficiently large contributions to sustain high payouts to existing investors. These payouts then can serve as a vehicle to market the fraudulent scheme as a desirable investment. The main constraint faced by a would-be Ponzi schemer is that a legal authority like the SEC must remain unaware of the scheme while investors are deceived as to the schemer's true intentions.

A Ponzi schemer is a criminal entrepreneur who seeks to gain the trust of his victims through deception. The trust of victims is based on a false belief that income is being earned as a result of investment in legitimate assets that actually exist. This false belief is typically sustained through a combination of large and/or stable returns to investors and information manipulation by the schemer. We expect that a Ponzi scheme's *ex post* success (as measured by its size, duration, and amounts taken by the schemer) will be positively associated with whether the perpetrator and his victim share an affinity link through religion or ethnicity, or whether the victim is a person like a senior citizen who might more prone to believing a schemer's "tall tales." Successful Ponzi schemers will build social connections with their victims using marketing techniques that can entice victims while also concealing the scheme from legal authorities.

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[1] Ponzi schemes have long existed; such frauds were referred to as "Rob Peter to Pay Paul" schemes before Charles Ponzi's fraud (Zuckoff 2006).

Our sample includes 376 SEC-prosecuted Ponzi schemes during the period 1988-2012. These cases represent material frauds –The mean total funds invested in our sample Ponzi schemes is $208 million, the average Ponzi scheme in our sample lasts about 4.25 years, and the average Ponzi perpetrator takes about 29% of the funds raised as personal compensation. Our analysis also suggests the following about Ponzi schemes:

1. *Size*. Most Ponzi schemes are small in relation to widely known schemes such as those of Bernard Madoff and Allen Stanford, both of which totaled in the billions. In contrast, the median size of schemes in our sample is $14.7 million total invested and the first quartile was just over $5 million. The median number of investors in our sample schemes is 150, and investors in our sample Ponzi schemes are investing $431,200 ($87,800) at the mean (median). On all measures of size, the distribution is heavily right-skewed, which suggests that a small number of very large cases affect the distribution.

2. *Perpetrators and victims*. Males acting as solo operators perpetrate most of the Ponzi schemes in our sample. The most frequent type of victim mentioned by the SEC is the elderly. The most frequent type of affinity link cited by the SEC is family and friends with a common religion coming in a close second.

3. *Marketing*. Surprisingly, many Ponzi schemes are marketed in visible ways – e.g., through a website or mass media like newspapers. Ponzi schemers also frequently provide incentive payments (e.g., commissions) to third parties to obtain victims. The returns promised by Ponzi schemers to their victims are sizable. It is typical for these promises to be communicated as a range. The mean (median) of the minimum annual return promised was 111% (12%), and the mean (median) of the maximum annual return promised was 437% (24.5%).

4. *Victim trust*. Patterns in the location, duration, size, and amounts stolen in Ponzi schemes suggest that building false trust is a major focus of a Ponzi schemer. Ponzi schemes are significantly more frequent in U. S. states where citizens are known to place greater trust in strangers. Perhaps for the same reason, Ponzi schemes where an affinity link is present or the SEC cites the elderly as prominent in the victim class tend to last longer. Perhaps because social distance makes it harder to build trust, schemes marketed using mass media also have significantly shorter duration. The use of commissioned recruiters and referral rewards to identify victims is the most important variable in explaining the amount of funds raised in a Ponzi scheme.

5. *Alternate investment opportunities.* Both institutional and individual investors prefer to invest locally. We find that more Ponzi schemes emerge in states with fewer conventional, local investment opportunities. When few local companies are publically traded, and when local governments have little debt (few local government bonds available), investors examine alternate investment strategies, which likely leads to more Ponzi schemes.

Zucker (1986) argues that trust is one of three types: (a) *institutional-based* trust that stems from the functioning of formal and informal institutions, (b) *process-based* trust based on an individual's reputation derived from information about past inter-personal exchanges, and (c) *characteristics-based* trust based on an affinity relation such as a common religion or ethnicity (see also Stolowy *et al*. 2011). Ponzi schemes will more likely occur in unregulated, informal settings that involve greater one-on-one interaction between the fraudster and his victim. Thus, characteristics-based trust (e.g., ethnicity or religion) and process-based trust (e.g., fraudulent attempts to build credibility and reputation) will be more important than institutional-based trust in enabling a Ponzi scheme.

We expect that Ponzi schemers will try to exploit less-skeptical individuals who are more likely to trust the perpetrator. These individuals would likely include those with a social tie to the perpetrator – e.g., the perpetrator of an "affinity fraud" exploits the notion that "you can trust me because I am like you" (Fairfax 2001). Affinity groups are more vulnerable to Ponzi schemes because their members are in close and frequent contact with each other; news travels faster within the group, members share values and tastes, and they trust each other (Frankel 2009). Prominent sociologists suggest that social ties encourage false comfort by a victim wherein *ex ante* information asymmetries and *ex post* opportunism are perceived to be lower than they actually are (Granovetter 1983, 1985; Krackhardt 1992; Baker and Faulkner, 2004).[7]

To evaluate the reliance of the fraudster on social ties, we read the description of the victims in SEC court flings and press releases and coded them as follows: (1) immediate social

[7] Social ties have also been shown to have a "dark side" (Vaughan, 1999, 276), and the sociology literature provides numerous examples where reliance on social ties enables fraud. Granovetter (1985) notes that "the trust engendered by personal relations presents, by its very existence, enhanced opportunity for malfeasance" (p. 491), and this enhanced opportunity is supported empirically. For instance, Titus *et al*. (1995a, 1995b) find that attempts at fraud have a significantly greater likelihood of successful initiation when the victim knows or knows of the fraudster.

circle (e.g. family, friends, neighbors); (2) professional affinity (e.g. physicians, schoolteachers, police, firemen); (3) religious ties (e.g. Protestant, Catholic, Mormon, Hindu, Jewish); and (4) ethnic affinity (e.g. Greek, Jew, Italian). Given the prevalence of fraud involving the elderly (Titus *et al*. 1995a, b), we also coded whether the scheme targeted the elderly.

Panel A of Table 3 indicates that about 17% of our sample Ponzi schemes involve elderly victims, and 11% involve family or friends as victims. Another 10% involve affinity ties based on religion, and in 7% of the cases the schemer and victim share a common ethnic background. Only about one percent target individuals who were prior clients of a legitimate business endeavor. Overall, 46% of the schemes in our sample involve an affinity link or have elderly victims, and multiple such links are present in about 10% of our sample schemes.

While Ponzi schemers may rely on affinity links to bilk money from their victims, this does not mean that they will eschew other, more formal, marketing methods to entice victims. Ponzi scheme perpetrators often use mass media and websites, which do not involve face-to-face interactions between the schemer and his victims (29% and 26% of all schemes, respectively) – see Panel B of Table 3. While formal methods might help scale up the scheme, such methods are risky since their use allows the scheme to be more readily observed by legal authorities that might shut it down. Direct communication methods such as seminars and public speaking events are used in 18% of the sample cases. Commissioned recruiters are employed in 27% of the cases, client contacts from legitimate firms are used in 11% of the sample cases, and referral rewards are employed in 8% of the cases.

Ponzi scheme perpetrators also frequently make promises of unsustainably high future returns to those who invest in the scheme. An excessively large promised return is seen as a "red flag" in Ponzi cases (Phelps and Rhodes 2012, 4-8). In an archetypical case, Charles Ponzi

EXHIBIT B

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

****

UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

****

Transcript of the Trial Proceedings held on January 31, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

A P P E A R A N C E S

Government: UNITED STATES ATTORNEY'S OFFICE
445 BROADWAY, ROOM 218
ALBANY, NEW YORK 12207
BY: ELIZABETH C. COOMBE, AUSA
RICHARD D. BELLISS, AUSA

Defendant McGinn: E. STEWART JONES LAW FIRM, PLLC
ATTORNEYS AT LAW
28 SECOND STREET
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BY: E. STEWART JONES, JR., ESQUIRE

NANCY L. FREDDOSO, R.P.R.
Official United States Court Reporter
10 Broad Street, Room 316
Utica, New York 13501
(315) 793-8114

1 FINRA that they changed the accounting records or they
2 could change the accounting records, not tell FINRA about
3 it, and try to conceal what had happened. Once again, they
4 made the wrong choice. And that choice shows their intent.
5 They did their best to disguise what they
6 had done. They directed their accountants to hide where
7 the money would come from by making false accounting
8 entries in corporate records. Then they directed that
9 these records be submitted to FINRA without a single word
10 of explanation about how the records had been changed,
11 without any disclosure about how they changed the records.
12 Ladies and gentlemen, I want to talk for a
13 moment about the preferred investor payments. You are
14 familiar with these charts that showed the money from the
15 Four Funds that was supposed to go out to both regular
16 investors and preferred investors, that there was a letter
17 that one of the Four Funds were performing badly. In fact,
18 Mr. Rees did a calculation that showed that they were forty
19 or fifty million dollars under water.
20 And so after those stopped, Mr. McGinn had a
21 select group of his best customers that he did not want to
22 stop receiving their payments. So he started paying them
23 out of MSTF. You heard from Mr. Cooper how he got a list
24 of those investors from Ms. Sicluna. You heard what he
25 called them. Timothy McGinn supplemental preferred

1 investors. They continued to get their payments. The rest
2 of the investors in the Four Funds did not, not Tom Brown,
3 that state worker, not Ron DeLeonardis, Mr. McGinn's high
4 school friend who owned the fish fry place, not
5 Mr. Rabinovich's father.
6 Beginning in May 2008, those preferred
7 investors continued to receive their payments. This was
8 plainly an unauthorized use of MSTF investor money. In
9 fact, Mr. Smith, himself, acknowledged that it was wrong.
10 You heard Mr. Shea testify that Mr. Smith reacted strongly.
11 I believe he used some strong language. Mr. Shea testified
12 about that. He knew it wasn't right. He said he knew that
13 Tim was paying these people, but he had no idea that it was
14 out of this entity.
15 Mr. McGinn also admitted that it was wrong
16 because they sent a letter to Gersten and Savage.
17 Mr. Smith kept a copy of this letter at his house, and you
18 will be able to see the handwritten letter in the exhibits.
19 This is the typewritten copy. You see it is from both
20 Mr. Smith and Mr. McGinn.
21 In it, they write: Advances from MSTF to
22 customers of McGinn, Smith of whom we had decided to
23 support because of their high level of importance to the
24 firm and to whom we were attempting to bridge the gap of
25 their shortfalling income due to the non-performance of

EXHIBIT C

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

****

UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

****

Transcript of the Trial Proceedings held on January 15, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

A P P E A R A N C E S

Government: UNITED STATES ATTORNEY'S OFFICE
445 BROADWAY, ROOM 218
ALBANY, NEW YORK 12207
BY: ELIZABETH C. COOMBE, AUSA
RICHARD D. BELLISS, AUSA

Defendant McGinn: E. STEWART JONES LAW FIRM, PLLC
ATTORNEYS AT LAW
28 SECOND STREET
TROY, NEW YORK 12180
BY: E. STEWART JONES, JR., ESQUIRE

NANCY L. FREDDOSO, R.P.R.
Official United States Court Reporter
10 Broad Street, Room 316
Utica, New York 13501
(315) 793-8114

1 A. Correct.
2 Q. Based upon the language in the two letters that
3 we have just been looking at from Mr. Smith, would you have
4 expected all of the Four Fund investors who owned the
5 Junior notes, those notes that paid 10.25 percent, to have
6 their quarterly interest payments suspended?
7 A. Yes.
8 Q. I show you Exhibit GB-1B. Mr. Rabinovich, does
9 this diagram for you depict the Four Funds with the icon
10 paying 10.25 percent to the Junior noteholders. And then
11 there is two icons showing a group called regular investors
12 and another one called preferred investors. Are you
13 tracking on that?
14 A. Yes, sir.
15 Q. If you go to the next slide, the letter icon
16 represents the letters that Mr. Smith sent eventually
17 suspending interest payments to the Junior noteholders such
18 as your father; is that right?
19 A. Yes.
20 Q. And the next slide shows an icon called MSTF.
21 Are you aware of what MSTF was?
22 A. McGinn, Smith Transaction Funding.
23 Q. An unrelated investment to the Four Funds?
24 A. Yes.
25 Q. And it is showing that MSTF was used to make

1 interest payments in the amount of 10.25 percent to a group
2 called preferred investors. Was your father part of a
3 group that's identified as the preferred investors?
4 A. No.
5 Q. If you were selling investments in the Four
6 Funds after Mr. Smith's two letters went to investors,
7 would information about MSTF being used to pay a select
8 group of investors have been of concern to you in
9 presenting the investment to other investors?
10 A. Yes.
11 Q. Is that something you would have wanted to have
12 known to have passed to your clients?
13 A. Yes.
14 Q. If the Four Funds began to default on their
15 interest payments to the Senior or Senior subordinated
16 investors, would this have had any effect on the brokers'
17 ability to sell other McGinn, Smith products?
18 A. Probably, yes.
19 Q. What do you think the effect would have been?
20 A. Well, you probably wouldn't have had as much
21 interest internally.
22 Q. Do you recall -- let me ask you this. Do you
23 see Mr. McGinn and Mr. Smith in the courtroom today?
24 A. I do.
25 MR. JONES: Stipulated.

EXHIBIT D

BEFORE THE SECURITIES AND EXCHANGE COMMISSION

In the Matter of:
DONALD ANTHONY, JR., FRANK H. CHIAPPONE,
RICHARD D. FELDMANN, WILLIAM F. LEX,
THOMAS E. LIVINGSTON, BRIAN T. MAYER,
PHILIP S. RABINOVICH and RYAN C. ROGERS,

File No. 3-15514

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26 Federal Plaza

Courtroom 208

New York, New York

Monday,

January 27, 2014

BEFORE: HONORABLE BRENDA MURRAY

The above-entitled matter came on for hearing at 9:30 a.m.

1 P. Rabinovich - Cross

2 Firstline and the bridge loan investment that

3 your father made to help, you thought, obtain

4 the assets for a particular Firstline trust. Do

5 you recall those questions?

6 A. Yes.

7 Q. Prior to that point in time when that

8 $600,000 bridge loan investment was made, had

9 your father already invested in a Firstline

10 vehicle?

11 A. He did.

12 Q. How much did he invest?

13 A. He invested $200,000 in original

14 junior note.

15 Q. Was there anything wrong, in your

16 mind, about a bridge loan financing investment

17 being made for 600,000?

18 A. No. McGinn Smith had historically had

19 investors that would bridge their transactions.

20 MR. MUNNO: Your Honor, I am going to

21 refer reluctantly and with a continuing

22 objection to the grand jury testimony of

23 Mr. Rabinovich, but because there was some

24 testimony in each of the two days that he

25 testified about regarding this particular bridge

1 Cross/Guzzetti
2 we would like to reserve our right to some of
3 the questions that come up -- reserve our
4 right to recall Mr. Guzzetti.
5 JUDGE MURRAY: Fine.
6 Q. Mr. Guzzetti, with respect to --
7 you talked yesterday and today about a bridge
8 loan. Can you describe for the Court what a
9 bridge loan is? Is that like one of these trusts
10 or the Four Funds?
11 A. A bridge loan is like mezzanine
12 funding where you are giving the money and then --
13 from the proceeds you get the money back from the
14 proceeds.
15 Q. In connection with Mr. Rabinovich's
16 bridge loan, what was the purpose of that bridge
17 loan, if you recall?
18 A. To close the deal.
19 Q. Let's be a little more specific.
20 A. There is a minimum that has to be
21 reached, and close the deal.
22 Q. Am I correct that that a bridge
23 loan is bridging the time from the start of an
24 offering to when that offering closes?
25 A. Yes.

1 Cross/Guzzetti

2 Q. And then the investor who made the

3 bridge loan -- he is not part of the offering --

4 he gets his money back, right?

5 A. Right.

6 Q. And he only gets his money back

7 when conditions are met that that deal is funded?

8 A. Yes.

9 Q. Is that what they are talking about

10 in those e-mails about how much money they have to

11 pay Mr. Rabinovich back?

12 A. In the Rabinovich e-mails, yes.

13 Q. That wasn't anything about a

14 redemption in a trust or redemption in the Four

15 Funds, was it?

16 A. No.

17 Q. Going a little bit in reverse

18 order, I suppose, when did you start to inquire or

19 look into your options about leaving McGinn Smith?

20 A. As I said, I think we started in

21 late 2008.

22 Q. And that would be --

23 MR. ASTARITA: Withdrawn.

24 Q. And then when did you leave?

25 A. Well, it was agreed upon that we

EXHIBIT E

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

****

Transcript of the Trial Proceedings held on January 22, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

A P P E A R A N C E S

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Official United States Court Reporter
10 Broad Street, Room 316
Utica, New York 13501
(315) 793-8114

1 A. This is a private placement memorandum for
2 McGinn, Smith Transaction Funding.
3 Q. If we could look at page six, please, towards
4 the top. What were the maturity and interest rate of this
5 particular investment?
6 A. It was eight percent with an additional
7 contingent percentage depending on performance, and the
8 maturity date was July 1, 2012.
9 Q. If we go back and look at page one, please, at
10 the bottom. The underwriting discount for this investment
11 was two percent; is that right?
12 A. Yes, it is.
13 MR. BELLISS: Go back to page six, please,
14 Ron, at the bottom.
15 BY MR. BELLISS, CONTINUED:
16 Q. If you could take a look at the use of proceeds
17 section. We will also look at page ten, please.
18 Mr. Greenberg, what was your understanding of what investor
19 money was going to be used for in this investment?
20 A. Predominantly for bridge financing so that
21 McGinn, Smith could do more deals. Basically I remember
22 thinking, well, I am already doing the deals that they are
23 selling, so I might as well take the opportunity to
24 participate in paying myself back since they are
25 essentially giving us some contingency, contingent benefit

1 resulting from their performance. So since I was on the
2 other end buying the deals, I thought it would make sense
3 to do this. And my understanding was that the money would
4 be used to provide bridge financing so that they could do
5 more deals and just grow their business, and I could be a
6 partner in that.
7 Q. At the time you made your two investments,
8 Mr. Greenberg, did you think that your money would be used
9 in accordance with the use of proceeds sections that we
10 have just been looking at?
11 A. Yes, I did.
12 Q. I show you Exhibit GB1A. Mr. Greenberg, if
13 could you set aside for the moment the red arrow just
14 tracing the flow with the black arrows, does this diagram
15 accurately reflect your understanding of what McGinn, Smith
16 Transaction Funding would use its investor money on?
17 A. Yes.
18 Q. Did anyone tell you that Mr. McGinn was planning
19 to take two hundred and thirty thousand dollars from
20 McGinn, Smith Transaction Funding above and beyond the fees
21 disclosed in the private placement memorandum?
22 A. No.
23 Q. Is that information that would have been
24 significant to you in making your investment decision?
25 A. Yes.

EXHIBIT F

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

`*************************************************`

UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

`*************************************************`

Transcript of the Trial Proceedings held on January 23, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

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Official United States Court Reporter
10 Broad Street, Room 316
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(315) 793-8114

1 signed this?
2 A. Timothy McGinn.
3 Q. What date?
4 A. January 29, 2008.
5 Q. And if we could go back to look at GF1B again,
6 please. Could you explain to the jury how this chart was
7 created and how it relates to the support documentation?
8 A. The first column is investor name, last name,
9 first name. Then the contract date, which is on the date
10 the certificate is issued, the amount of their purchase,
11 the subscription agreement lists who signed that, which
12 principal, and the date it was signed. And then the type
13 of investment, which series of the Firstline, senior or
14 junior trust.
15 Q. So this chart just summarizes the subscription
16 agreement and ticket information that's found in GF1B
17 support?
18 A. Yes.
19 Q. I am showing you now previously admitted
20 Exhibit GF16. This is an electronic mail message between
21 Mr. Rabinovich and Mr. McGinn. And if we could look at the
22 next page, please. There is also some e-mails to
23 Ms. Birnbach at Mercantile Bank indicating that money
24 should be sent to Adirondack Trust Company for credit to
25 Stewart's Shops Corporation as more fully described below.

1 Now Mr. Rabinovich has reflected in this e-mail
2 his father put up six hundred thousand dollars, he
3 understood that to be for a bridge loan?
4 A. Yes, that's correct.
5 Q. Did you look into what that money was actually
6 used for, the six hundred thousand dollars?
7 A. The six hundred thousand dollars came into the
8 Firstline Trust 07 Series B account, and then it was
9 transferred out to McGinn, Smith Funding, five hundred and
10 ninety-nine thousand dollars. And that went towards a
11 payment of seven hundred and eighty-two thousand, eight
12 hundred and twelve dollars and fifty cents to Stewart's
13 Shops Corporation.
14 Q. It didn't go to Firstline Security Incorporated?
15 A. No, it went in into Firstline Trust 07 Series B
16 and then out to the MS Funding, LLC account.
17 Q. I am showing you now previously admitted
18 Exhibit GF34. This is an electronic mail message dated
19 May 12th of 2008. It is from Jeff Smith to Mr. Guzzetti,
20 Mr. Smith, Mr. McGinn, Mr. Livingston. The subject is
21 weekly report, report for May 5th. It says that Mr. Smith
22 was the vice-president of institutional sales.
23 Could we look at the next page, please? Could
24 we look at the last paragraph? It states:
25 As far as Andrew Nigrelli, who I think is my

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

---X
SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

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 UIA 8/04/04,
LAUREN T. SMITH, and NANCY McGINN,

Defendants,

LYNN A. SMITH and
NANCY McGINN,

Relief Defendants,

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

Intervenor
---X

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the RESPONSE OF STAN AND EVA RABINOVICH IN OPPOSITION TO 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 the Affidavits of Stanley Rabinovich, Eva Rabinovich, and of James Henry Glavin IV (with attached exhibits) in support thereof, was electronically served upon the registered participants to this action.

Dated: November 18, 2019

___s James Henry Glavin IV_____
James Henry Glavin IV