UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	
v.	**10 Civ. 457(GLS/DRH)**
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, DAVID L. SMITH, LYNN A. SMITH, DAVID M. WOJESKI, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, GEOFFREY R. SMITH, LAUREN T. SMITH, and NANCY MCGINN,	
Defendants,	
LYNN A. SMITH, and NANCY MCGINN,	
Relief Defendants, and	
DAVID M. WOJESKI, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04,	
Intervenor.	

PLAINTIFF'S REPLY MEMORANDUM IN RESPONSE TO OPPOSITION OF DEFENDANTS LYNN SMITH, THE TRUSTEE, AND GEOFFREY AND LAUREN SMITH AND IN FURTHER SUPPORT OF ITS MOTION FOR AN ORDER TO SHOW CAUSE AND EMERGENCY RELIEF

INTRODUCTION

In sworn statements and testimony before this Court, Lynn Smith repeatedly and without qualification stated that she and David Smith created the David L. and Lynn A. Smith Irrevocable Trust (the "Trust") and transferred the Charter One bank stock to the Trust for the benefit of their two children and for no other reason. The Court relied upon her testimony in concluding that: "the Trust benefits did not flow to David Smith and he did not exercise control over them such that he treated the corpus as his own." (July 7 Order, at 40-41).

We now know that Ms. Smith's sworn statements and testimony before this Court regarding the Trust were materially false and misleading. Confronted with the newly discovered annuity agreement, neither Lynn Smith nor the Trustee now dispute the fact that the Smiths sold 100,000 shares of Charter One stock to the Trust pursuant to a binding annuity agreement; that the annuity agreement obligates the Trust to make annual payments of $489,932 to David and Lynn Smith beginning in September 2015 and continuing until their death; that if the Smiths reach their twenty year joint life expectancy, the Trust will be obligated to pay out at least $9,798,640 to the Smiths; and that the right to these payments are assets of David and Lynn Smith (*see, e.g.,* Featherstonhaugh Affidavit, ¶ 5, conceding that the annuity payments should have been included on Lynn Smith's financial statement; *see also Id.* at ¶¶ 7, 8.).

Given these newly discovered, undisputed facts, it is now clear that the Trust was formed for the benefit of David and Lynn Smith, and not their children. None of the arguments advanced by the defendants rebut this inescapable conclusion. Defendants attempt to dismiss the relevance of the annuity agreement by arguing that it merely creates a contingent future contractual right to annuity payments and does not invest the Smiths with any interest in the Trust itself. This asks the Court to ignore the reality behind the Trust's façade. The Trust was created right after the Smiths had been sued by a business partner, right after McGinn Smith was

subject to an examination by the SEC, after Smith had already memorialized his deep concerns that the business methods of McGinn Smith could land himself and his partner Timothy McGinn in jail and while McGinn Smith were in the process of launching a series of new investment funds that violated securities laws and defrauded investors.

The Trust was intended to shield the Smiths' retirement assets from creditors while providing David Smith with de facto control over these assets through the annuity agreement. Ms. Smith's effort to mislead this Court regarding the true nature of the Trust is further evidence that it was formed to protect the Smiths' assets from their creditors.

The defendants' actions since the July 7 Order are further evidence that the Trust was created for the benefit of David and Lynn Smith. Since the July 7 Order, the Trustee has disbursed $449,878 directly to Lynn Smith (in connection with the purchase from her of the lake front vacation property), $296,000 to Geoffrey Smith, $83,500 to Lauren Smith, and paid over $100,000 to the Dunn Law Firm. (Declaration of Lara Shalov Mehraban ("Mehraban Decl."), dated September 14, 2010, Ex. A). Geoffrey and Lauren Smith have each used $75,000 of the money transferred to them to make a down payment to Lynn Smith to purchase the property. Thus, Lynn Smith has received approximately $600,000 from the Trust while keeping her vacation property within the family's control. Geoffrey Smith has also "invested" $200,000 in Capacity One Management, a company formed on July 1, 2010 and whose business address is David and Lynn Smith's home address of 2 Rolling Brook Drive, Saratoga Springs, N.Y. (*See* Mehraban Decl., Exs. B and C). The children have also used over $21,000 to pay unspecified credit card debts. (Mehraban Decl., Ex. A).

Defendants' argument that the annuity agreement should have been discovered through the exercise of due diligence by the SEC is contradicted by their own heated protestations of

ignorance regarding the existence of the annuity agreement despite their own due diligence and greater access to unfiltered information from their clients. Finally, this Court has jurisdiction over the Trustee and Geoffrey and Lauren Smith (the "Trust Defendants") as they are currently named defendants in this action and within the reach of the Court's broad equitable powers.

Accordingly, the Court should unwind all distributions from the Trust after July 7, 2010 and freeze those and all other Trust assets.

LYNN SMITH'S CONCEALMENT OF THE ANNUITY AGREEMENT DEMONSTRATES THE FRAUDULENT NATURE OF THE TRUST

In his affidavit, Mr. Featherstonhaugh states that: "although [Ms. Smith] did recall executing the Private Annuity Agreement after I showed it to her, she stated, understandably, that she had no recollection of it prior to my calling it to her attention, and reaffirmed that her intention when creating the trust was to provide for her children." Featherstonhaugh Aff. at 5. Although Mr. Featherstonhaugh cavalierly, and without further explanation, characterizes Ms. Smith's alleged failure to recall the annuity agreement as "understandabl[e]," it is anything but. It defies common sense that Ms. Smith would create the Trust, sell $4,450,000 in stock to it pursuant to an annuity agreement, obtain the right to future repayments from the Trust in amounts significantly exceeding the current value of the contributed stock, defer a sizeable capital gain tax and not recall any of those details whatsoever.

It is also inconceivable that Ms. Smith could repeatedly, and indeed even now, claim that "her intention when creating the Trust was to provide for her children" when in fact, if the Trust honors its contractual obligations to her and her husband, it likely will have no money to distribute to her children. The stock sold to the Trust represented a sizeable portion of the Smiths' net worth. They surely intended to preserve and protect those assets for their retirement, as opposed to donate them without restriction to their children as Ms. Smith falsely testified. It is

also inconceivable that Mr. Urbelis, the Trustee hand-picked by Mr. Smith and his lifelong friend, would do anything to dissipate those assets without Mr. Smith's knowledge and consent.[1]

Furthermore, the fact that neither child took one penny from the Trust between the date of its creation in 2004 and the Court's order unfreezing the Trust assets almost six years later, despite Lauren Smith's obvious financial difficulties, and Geoffrey Smith's modest employment income, is further evidence that the Smiths, their children and the Trustee well knew that the assets were parked in the Trust for the benefit of David and Lynn Smith and not their children.

Ms. Smith's other arguments are equally unavailing. The argument that the Ian Meyer complaint was settled with a letter of apology is irrelevant. Regardless of the merits or outcome of the Meyers lawsuit, it certainly put Ms. Smith on notice as to how vulnerable the Smiths assets were to creditors of her husband's business. Further, Mr. Smith's handwritten letter vividly demonstrates that he was well aware that the conduct that he and Mr. McGinn were engaged in subjected them both civil and criminal liability. While David Smith's letter, believed to have been written in 2000, states that he has not shared his concerns with his wife as of that time, by August 2004 Ms. Smith was well aware that the use of the Charter One stock and other monies to further her husband's business interest could subject those monies to attack by creditors, as she herself was sued by Ian Meyers.

THE ANNUITY AGREEMENT FURTHERED THE FRAUDULENT CONVEYANCE TO THE TRUST

The defendants present a report by David Evans to support their claim that the annuity agreement merely grants the Smiths a contract right to payments from the trust but does not grant them property rights in the assets of the Trust. The Trust Defendants argue that: "Any contractual

[1] It is also telling that neither Ms. Smith nor either the former or current Trustee submit affidavits attesting to the extent of their knowledge and recollection of Trust's annuity arrangement with the Smiths and instead fall back on second-hand admissions through affidavits of counsel.

rights of third parties are secondary to the rights and interests of the beneficiaries of the Trust ...." (Dunn Aff. ¶ 23). This argument ignores the reality behind the Trust and the annuity agreement.

The Trustee's contractual obligation to make payments to the Smiths possibly in excess of $10,000,000, far exceeding the initial funding, since diminished, of only $4,450,000, makes the alleged beneficiaries' interests in those assets secondary, if not moot. Indeed, the Trustee's own expert admits that: "The annuitant-creditors relationship with the Trustee is that of contract." And that "New York law imposes on the Trustee the obligation to follow the agreed upon terms of their agreement." Evans Report at ¶ 27. While the Trustee does not have a fiduciary obligation to the Smiths, he has a contractual obligation to them and New York law does not allow the Trustee to breach his contractual obligation by reason of any fiduciary responsibilities he may have. *Id.*

Indeed, the Trustee's expert report supports the Commission's argument that the Trust was created for the benefit of David and Lynn Smith. The expert notes that by selling the Charter One stock to the Trust before the capital gains tax was realized, the assets "undiminished by income taxes [are] available to the Trust to support the Trust's general contract obligations to the annuitant-creditors." Evans Report ¶ 25. He further states that an annuity agreement was used to spread the income taxable gain generated by the sale of highly appreciated assets over the life expectancy of the sellers. *Id.* at ¶ 28. Finally, the expert acknowledges that the anti-alienation clause contained in the annuity contract was designed to prevent creditors of the Smiths from reaching the assets placed in the Trust until those assets are distributed to the Smiths. (Evans Report, ¶¶ 33-34).

The annuity agreement now makes clear why David Smith listed the Trust as his asset on two separate financial documents and why no monies were distributed by the Trust to the Smith children from its formation in 2004 until after the July 7 Order - because the assets were parked in the Trust for the benefit of David and Lynn Smith, not their children. Similarly, the Court's finding that David Smith did not own the Charter One stock is contradicted by the annuity agreement which reveals that David Smith and his wife jointly sold the stock to the Trust and he obtained an individual contractual right to future payments in return for this sale.

Although the Court originally concluded that 'the record does not support the conclusion that David Smith considered the Trust his own property" July 7 Order at 39-40, that conclusion was reached without knowledge of the annuity agreement, due to Ms. Smith's deceptions and misrepresentations. The Court is entitled to, and should, disregard the Trust form where the circumstances surrounding the Trust's creation support a finding that it was a fraudulent conveyance intended to defraud current and future creditors. (Commission Mem. of Law, at 15-18).

THE COMMISSION HAS MET ITS BURDEN OF PRESENTING NEW EVIDENCE NOT PREVIOUSLY AVAILABLE

The Trust Defendants and Lynn Smith argue that the Commission has failed to satisfy its burden of presenting newly discovered evidence not previously available to it because it should have been on notice of the annuity agreement based on one reference to a "private annuity trust" in a cover letter from David Smith to the Trustee. [2] This argument should be rejected for numerous reasons. First, as demonstrated more fully in the Stoelting Affidavit (¶¶ 9-34), the Commission served broad discovery requests on Lynn Smith and the Trustee concerning all

[2] The cases cited by Ms. Dunn concerning the legal standard for a motion for reconsideration (Op. Br. at 7-10) simply reaffirm the standard for reconsideration under Federal Rule of Civil Procedure 54(b) set forth in Plaintiff's opening memorandum of law.

documents related to the Trust, obtained a court-ordered financial statements from Lynn Smith, and questioned numerous witnesses during days of deposition and hearing testimony regarding all aspects of the Trust. No witness referred to the Trust as a private annuity trust, or referred to any private annuity agreement, or admitted that the Charter One stock was "sold" to the Trust. No one produced a single document referring to the existence of a private annuity agreement. To the contrary, Ms. Smith's testimony affirmatively misled the Commission and the Court into believing the stock was "transferred" to the Trust solely for the benefit of the Smith children, with no restrictions.

Second, Ms. Smith failed to disclose the annuity agreement when the Commission asked her why her husband listed the Trust as an asset on his financial statements (PI Hrg. Tr. at 303-311) and failed to report her right to annuity payments on her court-ordered financial statement, as her counsel now concedes she should have done.

Third, the Smith cover letter makes no reference to any private annuity "agreement"; the Trust document itself is not called a Private Annuity Trust, but rather an Irrevocable Trust, and it makes no reference to any private annuity agreement between the Trust and the Smiths. Thus, David Smith's one reference to a private annuity "trust" was most reasonably understood to be either a misunderstanding or mischaracterization by him. The Commission obviously could not question David Smith directly, given his refusal to answer questions in reliance on his Fifth Amendment right not to incriminate himself.[3]

Finally, while the defendants vigorously chastise the Commission for not unearthing the annuity agreement sooner, they themselves claim to have been totally ignorant of its existence despite their own due diligence in preparing for the hearing and their obvious greater

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[3] While the Trust document did give the Trustee the power to enter into annuity agreements, it was just one of many powers granted to the Trustee.

opportunities to inquire freely of their clients as to all of the circumstance surrounding the creation of the Trust. Accepting counsel at their word, they cannot have it both ways, arguing that the Commission failed to exercise due diligence while claiming that their own due diligence failed to unearth the agreement. (*E.g.*, Dunn Aff. ¶¶ 47-50).

The Trust Defendants also argue that the Commission should have asked the Trustee about the reference to the private annuity trust. However, Mr. Urbelis did not produce the private annuity agreement in response to the Commission's document request, and he represented to Ms. Mehraban that he had produced all documents relevant to the Trust. (Mehraban Decl. ¶5.) Ms. Dunn attempts to excuse Mr. Urbelis' failure by stating that his production of documents and deposition testimony were voluntarily. (Dunn Aff. ¶ 54-58). However, the Commission was entitled to assume that, as an officer of the court, Mr. Urbelis made a diligent search for all relevant documents whether his production and appearance was voluntary or compelled and he so represented to Ms. Mehraban. The Trust Defendants' argument is also defeated by Ms. Dunn's admission that, despite her own due diligence (Dunn Aff. ¶¶ 47-50), she too was unable to discover the existence of this agreement from the Trustee.

Finally, the argument that the Commission did not serve any discovery requests on the Trust is also beside the point given that Ms. Dunn states that neither she nor the current Trustee were in possession of the annuity agreement.[4]

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[4] The Trust defendants erroneously argue that the Commission proffers the evidence relating to 1) the 2003-2004 broker/dealer audit, 2) the loan of the Charter One stock from October 2002 to July 2003 to further David Smith's business interest; and 3) the Ian Meyer lawsuit as newly discovered evidence. (*See, e.g.*, Dunn Aff. at ¶¶ 11-16). However, the Commission does not contend that this evidence was discovered after the July 7 hearing. Rather, the Commission submits that, in order to avoid manifest injustice to investors defrauded by the Smiths, the meaning, relevance, admissibility, weight and conclusions to be drawn from all relevant evidence should be reassessed by the court in light of the newly discovered evidence concerning the annuity agreement and the blatant fraud perpetrated by Ms. Smith in concealing and lying about the Trust.

THE COURT HAS JURISDICTION OVER THE TRUSTEE, LAUREN AND GEOFFREY SMITH

The Trust Defendants argue that this Court intended to limit the relief available to the Commission when it made a handwritten entry in the Order to Show Cause dated August 3, 2010: "deeming this application as a motion (1) to reconsider the portion of the order filed on July 7, 2010 [86] as to the trust, and (2) for a preliminary injunction as to Nancy McGinn." They argue that because they were not defendants prior to July 7, 2010, the Court lacks jurisdiction to order relief as to them when reconsidering its July7 Order. Dunn Memorandum of Law at 5-7. We respectfully believe that the Court's shorthand entry was not meant to intentionally limit the Court's ability to order remedies covering the Trustee or Geoffrey and Lauren Smith and respectfully submit that there is no basis to do so.

First, there is no reason to treat Geoffrey and Lauren Smith any differently from Nancy McGinn, as to whom the Court made clear it will entertain the Commission's preliminary injunction motion. Neither the Smith children nor Ms. McGinn were before the Court prior to July 7, 2010; all three are now named defendants over whom the Court has jurisdiction. Moreover, Geoffrey and Lauren Smith were not named defendants or relief defendants prior to July 7, 2010 because neither of them was in possession of any assets of the Trust prior to that time. This argument would put the Commission in the untenable Catch-22 position where it could not have sought relief as to Geoffrey and Lauren Smith prior to July 7 because they had not yet received funds from the Trust but where it is also barred from seeking emergency relief when they do receive such funds, because they were not previously named defendants. Not surprisingly, the Trust Defendants fail to cite any authority to support such an absurd result.

In addition, they cite no authority that would prevent the Court from modifying its July 7 Order, or entering a new order, to include individuals over whom it subsequently obtains jurisdiction, particularly where, as here, the facts supporting such relief arise after the date of the original order.

The Trustee argues that the Court does not have jurisdiction over him because he was not a named defendant at the time of the original order. However, he was a party to the litigation at that time and the Court accordingly had jurisdiction over him at that time. The Trustee is also currently a named defendant and the Court may grant relief as to him on that additional ground for the reasons set forth above.

Finally, the Trust Defendants argue that it would be unfair to freeze funds distributed by the Trustee to Geoffrey and Lauren Smith after July 7, 2010 because the distributions were made in reliance on the Court's order unfreezing the Trust's assets. However, the Trust's assets would not have been unfrozen but for Lynn Smith's fraud on the Court. As discussed above, most of the disbursements from the Trust have been for the benefit of Lynn and David Smith and she and her husband should not further benefit from their fraud. The Court's broad equitable powers to avoid manifest injustice and protect investors far exceed the restrictions in the New York Debtor and Creditor laws advanced by the Trust Defendants (See, Commission's Mem. of Law at 19-20).[5]

[5] Defendants' numerous inflammatory and pejorative attacks on the Commissions' attorneys are obviously designed to divert the Court's attention from their clients' actions, bespeak the lack of merit to their arguments, and are not otherwise worthy of response.

CONCLUSION

Thus, the Court should use its broad equitable powers to unwind all distributions from the Trust since July 7, 2010, return those assets to the Trust and freeze the Trust assets both because they are a result of a fraudulent conveyance and in order to prevent any further encumbrances on David Smith's right to annuity payments from the Trust.[6]

Dated: New York, NY
September 14, 2010

Respectfully submitted,

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[6] Nancy McGinn has not filed any opposition to the SEC's Motion for Emergency Relief. Accordingly, for the reasons set forth in the Commission's Motion, the McGinn residence at 26 Port Huron Drive, Niskayuna, N.Y., should be included in the asset freeze and Ms. McGinn's assets should be frozen to the extent of the approximately $65,000 that Timothy McGinn conveyed to her without consideration during the period of the fraud.