GEORGE S. CANELLOS
REGIONAL DIRECTOR
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
New York Regional Office
3 World Financial Center
New York, NY 10281-1022
(212) 336-0174 (Stoelting)

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.	

MEMORANDUM OF LAW IN OPPOSITION TO CROSS-MOTION BY LYNN A. SMITH AND IN FURTHER SUPPORT OF PLAINTIFF'S MOTION TO AMEND THE PRELIMINARY INJUNCTION ORDER

Pursuant to Local Rule 7.1(c), plaintiff respectfully submits this memorandum of law in opposition to relief defendant/defendant Lynn Smith's cross-motion seeking a carve-out from the freeze order for attorney fees and living expenses and in further support of its motion to amend the preliminary injunction order.

PRELIMINARY STATEMENT

Lynn Smith's request that the Court relax the asset freeze to allow her to pay undocumented living expenses and attorney fees – six months after the Court imposed the asset freeze – should be denied.

First, although Mrs. Smith argues as if the carve-out is needed only for her own expenses, the scope of the claimed expenses, including mortgage payments, utilities, household payments, car payments, food, entertainment, pet care and "miscellaneous expenses," makes plain that this is actually a carve-out request for both David and Lynn Smith. As this case has proven, the assets and liabilities of David and Lynn Smith cannot be separated. As David Smith has refused to disclose his assets, Mrs. Smith's request should be denied.

Second, David and Lynn Smith have no legitimate claim to frozen assets because these assets do not rightfully belong to them. These assets were frozen in order to protect the Court's ability to provide for disgorgement. Defendants have no right to mount a legal defense, or to finance other expenses, from the proceeds of their wrongdoing. Courts have repeatedly denied similar requests where the frozen assets were insufficient for the payment of disgorgement. It is undisputed that the value of the frozen assets is far less than the amount fraudulently raised, which exceeds $100 million. To preserve assets for eventual distribution to victims, none of the frozen funds should be released.

Third, although Mrs. Smith seeks hundreds of thousands of dollars for payment of attorney fees and expenses, she fails to provide any documentation substantiating her purported

need for such funds. Significant questions remain about Mrs. Smith's finances and expenses, including the existence of undisclosed assets of her husband David Smith, the availability of financial support from her and her husband's immediate family and friends and the undocumented basis and lack of justification for many of the claimed expenses. For example, Mrs. Smith has failed to account most of the over $500,000 she apparently spent in the last two months. Without this information, neither the Commission not the Court can meaningfully evaluate the merits of the request. Courts have consistently denied motions to release frozen assets where, as here, a party fails to properly substantiate its need to access such assets.

Finally, Lynn Smith's assertion that she should be able to engage in unfettered use of her credit cards disregards the scope of the asset freeze as to her. Given her professed inability to meet her current living expenses, such unrestricted credit card use is likely to result in judgments against her and her frozen assets which could arguably take precedence over any judgments rendered in this case. She should not be allowed to continue to incur charges on her credit cards and jeopardize the amount of frozen assets available to make defrauded investors whole absent prior court approval.

ARGUMENT

I. The Court Should Deny Lynn Smith's Request for a Carve-Out

A. Lynn Smith's Request Includes Her Husband's Expenses

Lynn Smith's request for a carve-out includes expenses for both herself and David Smith. For example, her request includes, among many other things, the mortgages on her New York and Florida homes ($4,667 and $6,188 per month, respectively); home taxes ($1,480 per month for New York and $$1,875 per month for Florida); telephone ($400 per month); food ($1,250 per month for New York and Florida combined); cable/internet ($240 per month); utilities ($675 for

New York and $530 for Florida per month); landscaping ($475 for Florida per month)[1]; pet care ($160 per month); home maintenance ($500 for New York and $1150 for Florida per month); general retail/household ($400 per month). (DE 146, Exhibits C and D.) Such expenses clearly apply to both Lynn and David Smith. The Smiths should not be permitted relief from the asset freeze simply by labeling the expenses as belonging to Lynn Smith. The Court should therefore consider the request for a carve-out as applying to both Lynn and David Smith.

David Smith has asserted his Fifth Amendment rights and has never provided plaintiff or the Court with a list of his assets. Accordingly, neither plaintiff nor the Court can meaningfully evaluate the merits of the request.[2] Courts have routinely denied requests for carve-outs where defendants have not provided a full accounting of assets. *E.g., SEC v. Stein*, 07 Civ. 3125, 2009 WL 1181061, at *1 (S.D.N.Y. Apr. 30, 2009) (denying carve-out application in the absence of a full accounting); *see also SEC v. Cherif*, 933 F.2d 403, 417 (7th Cir. 1991) (affirming denial of carve-out where district court drew adverse inferences from defendants' refusal pursuant to the Fifth Amendment to provide an accounting). This Court should do the same.

B. The Equities Favor Denying The Request

The amount of frozen assets is substantially less than the amount owed to victims of the fraud. This means that defendants' and relief defendants' ability to satisfy disgorgement will be severely limited. Under these circumstances, courts have found that requests for carve-outs for both living expenses and legal fees should be denied. S*ee, e.g., SEC v. Forte*, 598 F. Supp. 2d

---

1 The landscaping cost for the New York home is apparently included in the "home maintenance" line item.

2 For example, on October 1, 2010, Smith informed plaintiff that he had over $340,000 in a retirement account at John Hancock. Although Plaintiff had been aware that Smith had approximately $40,000 in an IRA account held at RMR Management, plaintiff was previously unaware of the existence of the John Hancock account.

689, 693 (E.D. Pa. 2009) ("Given the paltry assets that remain to compensate Defendant's alleged victims, any release of funds seems unwarranted."); *FTC v. USA Fin., LLC*, No. 08-899, 2008 WL 3165930, at *3 (M.D. Fla. Aug. 6, 2008) ("[I]f the frozen assets fall short of the amount needed to compensate [victims] for their losses, a court is within its discretion to deny an application for living expenses and attorney fees."); *SEC v. Current Fin. Servs.*, 62 F. Supp. 2d 66, 68 (D.D.C. 1999) ("The frozen assets clearly do not exceed plaintiff's approximation of liability, and thus, the Court will continue the freeze order."). *Cf. SEC v. Schiffer*, No. 97 Civ. 5853, 1998 WL 307375, at *7 (S.D.N.Y. June 11, 1998) (limiting carve-out to "necessary" expenses).

A party seeking to unfreeze assets must also show that doing so would be "in the interests of the defrauded investors." *SEC v. Grossman*, 887 F .Supp. 649, 661 (S.D.N.Y. 1995), *aff'd,* 173 F.3d 846 (2d Cir. 1999) (denying request for release of frozen funds to pay attorneys' fees and funeral and burial expenses since the expenses "bear no relation to the interest of other investors"); *see also SEC v. Dobbins*, No. 04 Civ. 0605, 2004 WL 957715, at * 2 (N.D. Texas 2004) ("[T]he Court must assess whether a modification … is in the best interests of the defrauded investors."); *SEC v. Coates,* No. 94 Civ. 55361 (KMW), 1994 WL 455558, at *3 (S.D.N.Y. August. 23, 1994) (defendant "offers no basis upon which this court could conclude that his legal defense is of critical importance to investors, such that the asset freeze should be modified on that ground, and I decline to do so."); *FTC v. Ameridebt, Inc.,* 373 F. Supp. 2d 558,564-65 (D.Md. 2005) (denying carve-out where public interest in preserving proceeds of fraud outweighed defendant's alleged personal hardship).

During a conference with the Court on September 8, 2010, the Court specifically granted David Smith and Timothy McGinn permission to seek carve-outs for their expenses, which they have not done. In fact, they have not made any request for a carve-out since the asset freeze was

imposed. Plaintiff can only assume that they have not done so because they are hiding assets and therefore they are not willing to provide the Court with lists of their assets. Under such circumstances, the Court should not permit any carve-out for expenses.

C. Lynn Smith's Request For a Carve-Out is Wholly Unsubstantiated

Lynn Smith's current request contains no supporting documentation whatsoever for any of the claimed and often sizeable expenses. For this reason alone, her request for a carve-out should be denied. In addition, many of the claimed expenses on their face appear exorbitant, or constitute luxuries rather than necessary and reasonable living expenses. Solely by way of example, there is no documentation of or justification for the need to incur $1150 in monthly "home maintenance" for the Florida residence, $400 in monthly telephone expenses, $135 in monthly cleaning bills, $416 in monthly gas bills, $1170 in monthly automobile payments, $240 in monthly cable/internet payments; $2180 in monthly insurance payments ($1280 of which is for a life insurance policy); $400 in monthly "retail/household expenses, etc. All of these expenses, and many others, appear on their face to be more than necessary and reasonable expenses.

In addition, the $1,250 per month for a "charitable pledge, $160 per month in "pet care" and many of the other expenses such as "restaurants, movies, leisure" are more accurately described as luxuries.

Questions regarding the Smiths' finances are also raised by the fact that Mrs. Smith has not explained how she spent more than $500,000 of the money she received from the "sale" of the camp house to the Trust. In this transaction – yet another demonstration of the fact that the only people ever to benefit from the Trust are David and Lynn Smith and not the beneficiaries – $449,878 was wired into Lynn Smith's bank account on July 23, 2010, and she received another $150,000 from her children as a "down payment," for a total amount of $599,878. Mrs. Smith

claims – again with no supporting documentation and little explanation – to have spent over $500,000 in the short period after she "sold" the lake property to the Trust. In her brief, Mrs. Smith states that she has only $96,700 left from these funds. Although her lawyer states that he has been paid $115,000 by Mrs. Smith, the source of those funds is not identified. Moreover, even if the legal fees were paid from the proceeds from the "sale" of the camp house, that still leaves $388,300 expended by Mrs. Smith since July 2010. Mrs. Smith should explain in a sworn accounting how she spent these funds before she is allowed to access frozen funds.

In addition, although Mrs. Smith claims $96,700 is left over from the "sale" (Br. at 3), she does not offset any of her claimed expenses with these funds. Further, she admits to receiving monthly payments from the Teachers Retirement System and the Social Security Administration (Br. at 6) and she does not account for this income in her carve-out request.

If the Smiths had been candid about the assets available to them, then the Commission would not be opposed to a modest carve-out for essential living expenses. As shown above, however, the Smiths have refused to be forthcoming regarding the assets available to them to pay living expenses and legal fees.

Especially considering the Court's prior concerns regarding Lynn Smith's lack of credibility, any request for a carve-out should be fully substantiated. Mrs. Smith and her husband should also be required to reveal how they have been funding their lifestyle for the past six months before being allowed to tap into frozen funds. Unless the Court knows which funding sources are available to the Smiths, a release of frozen funds is not appropriate.

II. Lynn Smith Should Not Be Allowed Unfettered Use of Her Credit Cards

Lynn Smith argues that there should be no restraint on her credit card use because she is named only as a relief defendant, and there is no ability to freeze assets other than the asset that

is the subject of the fraudulent conveyance claim under Section 278 of New York's Debtor and Creditor Law. (Br. at 7-9)

However, Mrs. Smith fails to address the Commission's concern that by incurring debt that she may not be able to repay, she may subject the frozen assets to judgments by her creditors that arguably may take precedence over any judgment obtained by the Commission. Mrs. Smith claims that "I have no means to pay these expenses" (L. Smith Aff. ¶¶ 8 and 10) (referring to the living expenses set forth in Exhibits C and D to her affidavit) without a court-approved carve out. Thus, Mrs. Smith's unfettered use of credit cards, with no available means for repayment, encumbers and jeopardizes her frozen assets' availability for making investors whole. The Court should exercise its broad equitable powers to prevent this potential further harm to investors. *See* Securities Exchange Act of 1934 § 21(d)(5) ("In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.").

Mrs. Smith's reliance (L. Smith Br. at 7-9) on the arguments set forth in David L. Smith and Timothy M. McGinn's October 4, 2010 Motion in Opposition to the Plaintiff's Motion to Amend the Preliminary Injunction Order is also unavailing. The two primary arguments set forth in that brief are: (1) that credit card use is unsecured debt that does not encumber the frozen assets (McGinn Smith Br. at 5-8) ; and (2) that McGinn and Smith and their prior counsel allegedly entered into the Consent Order with an understanding that it did not prohibit the use of credit cards. (McGinn Smith Br. at 8-13).

Regarding the first argument, McGinn and Smith do not even contest the Commission's legal authority that credit card companies could arguably obtain judgments that take precedence over any judgment rendered in this case, thereby jeopardizing the availability of the frozen assets

for investors. Instead, they advance several equally frivolous arguments. First, they try to assure the Court that the credit card companies will learn of the freeze order on their own, thereby preventing them from arguing they were creditors without notice and taking precedence over the SEC. This argument is particularly disingenuous given that defense counsel admits in the very same brief that they threatened the Commission with legal action if it notified the credit card companies of the existence of the freeze order. (McGinn Smith Br. at 4).

Next, they suggest the Court should ignore the threat of judgments and attachments to the frozen assets because the credit card companies might possibly shut down the defendants' credit cards use on their own, before they incur too much debt. The Court should not risk jeopardizing funds available to investors based on such uncontrollable contingencies, particularly where the defendants are threatening legal action if the credit card companies are notified of the freeze order.

They also argue that plaintiff has not shown that they are incapable of repaying their credit card debts. However, Mrs. Smith concedes that she does not have sufficient funds available to pay her monthly living expenses during the pendency of this case and her unfettered use of credit cards will surely result in debts that she cannot satisfy, thereby subjecting her and her frozen assets to judgments by her credit card companies.

Finally, as to McGinn Smith's second argument, McGinn, Smith and their prior counsel understood that the Commission's position was that the TRO prohibited credit card use. (*See* May 31, 2010 Email from David Stoelting, at Exhibit A to Declaration of Alison Cohen dated October 4, 2010.). By agreeing to the PI Order, which contained the same relevant language, plaintiff did not somehow agree that credit card use was suddenly permitted. The defendants consented to the PI Order knowing that the Commission's position was that credit card use

violated the terms of the Order. The Commission filed the instant motion after it received records showing that McGinn, Smith and Mrs. Smith's credit card use continued unabated.

Accordingly, Lynn Smith should not be allowed to accrue debt on credit cards without prior court approval.

CONCLUSION

For the reasons stated above and in plaintiff's opening memorandum of law, plaintiff requests that the Court amend the PI Order entered on July 22, 2010 as set forth in the proposed order and deny Lynn Smith's cross-motion for a release of funds.

Dated: New York, NY
October 8, 2010

Respectfully submitted,

s/ Kevin P. McGrath
Attorney Bar Number: 106326
Attorney for Plaintiff
Securities and Exchange Commission
3 World Financial Center, Room 400
New York, NY 10281
Telephone: (212) 336-0533
Fax: (212) 336-1322
E-mail: mcgrathk@sec.gov

Of Counsel:
Andrew Calamari
David Stoelting
Lara Shalov Mehraban
Linda Arnold