

EXHIBIT F

FINANCIAL INDUSTRY
REGULATORY AUTHORITY
CASE NO. 2008-011-7152

IN RE
THE MATTER OF:

DAVID SMITH

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INVESTIGATIVE TESTIMONY OF

DAVID SMITH

WOODBIDGE, NEW JERSEY

APRIL 29, 2009

ATKINSON-BAKER, INC.
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REPORTED BY: JILL A. PRAML-BUSSANICH,
CSR NO. XI01807

FILE NO.: A301C1C

1 FINANCIAL INDUSTRY
2 REGULATORY AUTHORITY
3 CASE NO. 2008-011-7152

4 IN RE)
5 THE MATTER OF:)

6 DAVID SMITH)
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Investigative testimony of DAVID SMITH,
taken on behalf of FINRA, District 9 at 581 Main
Street, 7th Floor, Woodbridge, New Jersey,
commencing at 9:40 a.m., April 29, 2009, before Jill
A. Praml-Bussanich, CSR No. XI01807.

A P P E A R A N C E S

FOR FINRA:

FINRA

BY: STEVEN E. ROWEN, Senior Examiner
MICHAEL NEWMAN, Senior Regional Counsel
MICHAEL H. PAULSEN, Examination Manager
ROBERT MCCARTHY, Examination Manager
581 Main Street, 7th Floor
Woodbridge, New Jersey 07095

FOR DAVID SMITH:

STRADLEY, RONON, STEVENS & YOUNG, LLP
BY: DAVID C. FRANCESKI, JR., ESQUIRE
2600 One Commerce Square
Philadelphia, Pennsylvania 19103-7098

1 I N D E X

2 Witness: DAVID SMITH

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6 E X H I B I T S

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25

1

2

3

DAVID SMITH,

4

having first been duly sworn, was

5

examined and testified as follows:

6

7

8

MR. ROWEN: We're on the record at

9

approximately 9:41 a.m. on April 29, 2009.

10

11

EXAMINATION

12

BY MR. ROWEN:

13

Q. Will the witness state and spell his

14

full name for the record?

15

A. Davis L Smith, S-m-i-t-h.

16

Q. We're here today to interview David

17

Smith in connection with Routine Examination Number

18

2008-011-7152 of McGinn Smith & Company, Inc., CRD

19

Number 8453.

20

My name is Steve Rowen, Senior Examiner

21

with the member regulation department of FINRA.

22

With me today is Michael Newman, Senior Regional

23

Counsel, Michael Paulsen, Examination Manager with

24

FINRA and Robert McCarthy, Examination Manager with

25

FINRA.

1 This investigation is by FINRA to determine
2 whether there have been any violations of
3 Association rules or Federal securities laws.

4 MR. ROWEN: At this time I would like
5 to have this marked Exhibit 1.

6 (Letter dated January 21, 2009 was
7 received and marked FINRA Exhibit 1 for
8 identification.)

9 Q. BY MR. ROWEN: I'm handing you
10 Exhibit 1 in this matter. It is a copy of a letter
11 on FINRA letterhead dated January 21, 2009
12 requesting your testimony in this matter pursuant to
13 FINRA Rule 8210.

14 FINRA Rule 8210 requires you to answer the
15 staff's questions and answer them truthfully.
16 Failure to do so could lead to the imposition of
17 disciplinary proceedings.

18 Mr. Smith, are you represented by counsel
19 today?

20 A. I am.

21 MR. ROWEN: Could counsel identify
22 himself.

23 MR. FRANCESKI: David Franceski from
24 Stradley, Ronon, Stevens & Young in Philadelphia.

25 MR. ROWEN: Do you represent Mr. Smith

1 as his counsel today for the purpose of this
2 proceed?

3 MR. FRANCESKI: I do.

4 Q. BY MR. ROWEN: The staff controls the
5 record. And, as such, the court reporter will only
6 go off the record at our instruction. Should anyone
7 here want to be off the record for any reason,
8 please address your request to me. If appropriate,
9 I'll instruct the court reporter to go off the
10 record.

11 At any time you wish to consult with
12 counsel, please just say so, and we can make this
13 room or another available for that purpose.

14 I normally take breaks at reasonable
15 intervals. If anyone needs a break for any
16 reasonable, address your request to me and I'll try
17 to accommodate you.

18 If you do not understand a question, please
19 say so, and I'll rephrase it, if necessary.

20 Please remember to give verbal responses to
21 my questions, as the court reporter cannot record a
22 nod of the head.

23 Mr. Smith, are there any other names by
24 which you are known?

25 A. No.

1 Q. What is your educational background?

2 A. Starting in college or before that?

3 Q. Start with college.

4 MR. FRANCESKI: Before you go there,
5 with respect to Exhibit 1, I wanted to make one
6 comment for the record. The date of the deposition
7 in Exhibit 1 was set as February 19, 2008. I wanted
8 to make sure the record reflected that the date was
9 postponed and we're here by mutual agreement of both
10 sides.

11 MR. ROWEN: Yes.

12 A. I have a four-year degree in
13 economics, BA in economics from Hamilton College in
14 Clinton, New York.

15 Q. How many years have you worked in the
16 securities industry?

17 A. I worked in the securities industries
18 since 1972, that would be 37th year.

19 Q. What securities licenses do you
20 maintain?

21 A. I maintain a 7, 63, 24. And you'll
22 have to excuse me if I can't keep track of all the
23 numbers. I'm an options principal. I'm a municipal
24 principal. And that's it.

25 Q. What other licenses or designations do

1 you maintain?

2 A. I have a CFP, but I believe -- I have
3 not kept it active.

4 Q. Are you currently registered with a
5 broker-dealer?

6 A. I am.

7 Q. By whom?

8 A. McGinn Smith & Company.

9 Q. What capacity are you employed?

10 A. I serve as its president and CEO.

11 Q. How long have you been employed with
12 McGinn Smith?

13 A. This is our 29th year.

14 Q. Please describe your responsibilities
15 at McGinn Smith?

16 A. Primary responsibility is to manage
17 the business of the firm.

18 I also have supervisory responsibilities.
19 And I also maintain some level of account
20 participation in the various capital markets.

21 Q. Could you describe your supervisory
22 responsibilities?

23 A. Sure. I primarily supervise the head
24 of our retail group, which is a gentleman by the
25 name of Andrew Gazeti (phonetic). He reports to me.

1 I directly supervise Steven Smith, who is
2 our chief compliance officer.

3 Branch managers, Brian Mare (phonetic) of
4 our New York City office. And Andrew Gazeti now who
5 is up at Clifton Park also reports to me in that
6 capacity.

7 Q. You mentioned you also have accounts
8 that you manage?

9 A. That I still in some cases manage but
10 basically interact with in terms of securities
11 transactions, yes.

12 Q. Approximately how many accounts is
13 that currently?

14 A. Probably 20. Those are the active
15 ones. There are probably more than that assigned to
16 my account number, but in terms of actual working
17 with them, it's probably closer to 20.

18 Q. What means do you use to communicate
19 regarding business matters at McGinn Smith?

20 A. We have periodic meetings. There is a
21 sales meeting every Monday, of which I participate
22 not every Monday, but on occasion, particularly if
23 there is something that needs to be communicated
24 beyond sales practices.

25 We have an annual meeting, which all the

1 officers and board is present.

2 And then as a small firm, my office is open
3 to anyone who can find the time to walk in and raise
4 any questions they want.

5 And obviously I communicate telephonically
6 with branch managers and individual brokers on a
7 periodic basis.

8 MR. NEWMAN: Have you ever testified
9 before?

10 THE WITNESS: Yes.

11 MR. NEWMAN: What context?

12 THE WITNESS: I've been deposed in
13 various legal lawsuits.

14 MR. NEWMAN: Can you elaborate? How
15 many times?

16 THE WITNESS: Probably three or four.

17 MR. NEWMAN: When you say lawsuits,
18 can you describe who was involved in the lawsuits?
19 Were any of these regulatory matters?

20 THE WITNESS: No.

21 MR. NEWMAN: Civil lawsuits?

22 THE WITNESS: Yes.

23 MR. NEWMAN: When was the last time
24 you testified?

25 THE WITNESS: I believe probably about

1 a year ago.

2 MR. NEWMAN: What was the case?

3 THE WITNESS: The case was a case of
4 Key Bank versus I believe they M & S Partners was
5 named.

6 MR. NEWMAN: Were you named in that
7 lawsuit?

8 THE WITNESS: Not individually. I
9 think M & S Partners, which is a partnership I'm
10 included in.

11 MR. NEWMAN: That's McGinn Smith
12 Partners?

13 THE WITNESS: It's McGinn & Smith.

14 MR. FRANCESKI: Is it named M & S
15 Partners?

16 THE WITNESS: Correct.

17 MR. PAULSEN: Is that different from
18 MS Partners?

19 THE WITNESS: No.

20 MR. NEWMAN: MS Partners was named in
21 a lawsuit by Key Bank?

22 THE WITNESS: Correct.

23 MR. NEWMAN: Can you give me a general
24 description of that matter?

25 THE WITNESS: Key Bank had extended a

1 major line of credit to various entities that we
2 used to raise capital for primarily in the home
3 security alarm business. One particular
4 transaction, Capital Trust was the name of it, was a
5 trust that they had funded. And the fund had run
6 into some adversity. It was -- the collateral
7 behind it was in default. And Key Bank is, I guess,
8 it's still ongoing -- we haven't heard from them for
9 some time -- was trying to make the case that M & S
10 had a responsibility or guarantee to this defaulted
11 amount, which is not accurate.

12 MR. NEWMAN: Was MS Partners an
13 underwriter.

14 THE WITNESS: We had arranged
15 financing and been designated as the administrator
16 of the accounts.

17 MR. NEWMAN: You don't know the
18 current status of the lawsuit?

19 THE WITNESS: I have not heard from
20 them for about six months.

21 MR. NEWMAN: As far as you know, the
22 case has not been dismissed against M & S Partners?

23 THE WITNESS: That's correct.

24 MR. NEWMAN: Where is that case
25 pending?

1 THE WITNESS: Albany.

2 MR. NEWMAN: State court?

3 THE WITNESS: I believe so.

4 MR. NEWMAN: What other times have you
5 testified?

6 THE WITNESS: There is another
7 litigation that is going on by a gentleman whose
8 with Waterford Mortgage. He's a single individual.
9 I believe he also named M & S Partners and a public
10 company that we promoted called IASG Integrated
11 Alarm.

12 And the nature of that lawsuit is that
13 he purports to be entitled to some compensation for
14 having referred LaSalle Bank, who offered a line of
15 credit to Integrated Alarm. Integrated Alarm is a
16 public company. He evidently makes this claim on
17 the basis he had introduced LaSalle Bank to us for
18 another entity that did provide financing. We paid
19 him a finder's fee.

20 The claim was -- has pretty much been
21 demised. Probably will be in the next couple
22 months.

23 The testimony from the bank officers
24 have indicated they never heard of this guy. They
25 made their decision on the loan based on the

1 chairman of the board of Integrated Alarm, which was
2 Timothy McGinn. The line of credit was for \$30
3 million, which was effective for approximately two
4 days.

5 And this gentleman is making a claim
6 he's entitled to some outrageous amount of money. I
7 don't think it's going anywhere.

8 MR. NEWMAN: Where is that pending?

9 THE WITNESS: That is pending down
10 here in Philadelphia, I believe.

11 MR. NEWMAN: State court?

12 THE WITNESS: I think so.

13 MR. NEWMAN: Were there any
14 allegations in either of the lawsuits that you or
15 any entities you're involved in violated Federal or
16 State securities laws?

17 THE WITNESS: No.

18 MR. NEWMAN: What about the other time
19 you testified? You said there were three.

20 THE WITNESS: I can't recall at the
21 moment.

22 MR. NEWMAN: Have you ever testified
23 before the SEC or a securities regulator before?

24 THE WITNESS: No.

25 MR. NEWMAN: Are these the only two

1 occasions in which you or an entity you've been
2 involved with has been sued?

3 THE WITNESS: No.. I doubt it. I'm
4 trying to think what else might be --

5 MR. FRANCESKI: Mr. Newman's parlance,
6 arbitrations would be lawsuits as well.

7 THE WITNESS: Thank you. Clear --
8 McGinn Smith has been sued under various
9 arbitrations over the years. I was trying to recall
10 civil suits outside of the NASD.

11 MR. NEWMAN: Are the arbitrations
12 disclosed on your CRD record?

13 THE WITNESS: Yes.

14 MR. NEWMAN: In terms of anything
15 non-produced by the arbitrations, any other civil
16 lawsuits that you remember?

17 THE WITNESS: There was another
18 lawsuit involving an employee of ours, fellow by the
19 name of Keith Serconi (phonetic). That did not go
20 through the arbitration process. That went through
21 civil.

22 His claim was that he had been
23 dismissed improperly. And that was ultimately
24 settled.

25 MR. NEWMAN: Have you been the subject

1 of any customer complaints over the last couple
2 years, your firm?

3 THE WITNESS: Sure. Yes.

4 MR. NEWMAN: How many?

5 THE WITNESS: Last couple of years,
6 probably three to five, somewhere in that area.

7 MR. NEWMAN: What was the last
8 customer complaint the firm received?

9 THE WITNESS: There is presently a
10 complaint by Stuart.

11 MR. NEWMAN: S-t-u-a-r-t?

12 THE WITNESS: Correct. That's been
13 settled.

14 MR. NEWMAN: Stuart an investor in --
15 of your offering?

16 THE WITNESS: Yes.

17 MR. NEWMAN: Which offering?

18 THE WITNESS: His primary complaint
19 was some offerings in an entity called CCI,
20 Caribbean Club. The broker is a gentleman by the
21 name of Mark Casolo (phonetic).

22 MR. NEWMAN: What was McGinn Smith's
23 involvement in that offering?

24 THE WITNESS: Casolo was a broker who
25 had undertaken -- he was part of our investment

1 banking group. He had undertaken the process of
2 raising capital to purchase a resort in the
3 Caribbean.

4 He had formed a couple of entities
5 that helped raise the money for that. One was, I
6 think, called Atlantis Strategic and Atlantis
7 Income.

8 Ultimately, CCI failed. And the
9 client claimed suitability.

10 MR. NEWMAN: What was the claim and
11 what was the settlement amount?

12 THE WITNESS: The settlement amount
13 was for \$50,000. I think the claim was for
14 \$320,000.

15 They were also suing Casolo's
16 successor broker. Casolo left us in July of 2005,
17 and joined Westrock Securities out of New York City,
18 where most of this activity took place.

19 Both firms were named. We settled.
20 I'm not sure what Westrock has done.

21 MR. NEWMAN: What other customer
22 complaints besides that one?

23 THE WITNESS: There is presently a
24 complaint by a gentleman by the name of Malmid
25 Bernard (phonetic).

1 MR. NEWMAN: What is the basis of that
2 complaint?

3 THE WITNESS: Suitability.

4 MR. NEWMAN: What deal?

5 THE WITNESS: He owns McGinn Smith
6 preferred. He owns some income notes.

7 He basically left the firm about two
8 years ago, asked for the securities to be
9 transferred.

10 We sent him the papers to be
11 transferred. He came back, asked to be liquified.
12 We sent the papers to liquidate them. He chose not
13 to. We don't know why.

14 Subsequently when these things became
15 illiquid and not able to be sold, he's filed a
16 complaint.

17 MR. NEWMAN: Has that complaint been
18 resolved?

19 THE WITNESS: No. I think it's
20 scheduled for a July arbitration.

21 MR. NEWMAN: What other complaints?

22 THE WITNESS: There are, I think, two
23 other complaints pending, again Casolo related. And
24 names of them escape me.

25 MR. NEWMAN: How big is your firm and

1 how many registered employees do you have?

2 THE WITNESS: Firm is about 60
3 employees, maybe a little less now.

4 Registered employees are somewhere in
5 the area of about 40.

6 MR. NEWMAN: What is your firm's
7 primary business, main source of revenue?

8 THE WITNESS: Basically, three areas:
9 Private placement area, which focuses primarily on
10 fixed income returns, securitization of cash flows.

11 Second area of business, which used to
12 be a lot more active than it is today as a result of
13 the capital markets being where they are is the
14 syndicate business. Almost exclusively public
15 preferred stocks.

16 And then the third area would be
17 normal transaction business in virtually all capital
18 markets, with the exception of commodities.

19 MR. NEWMAN: How many offices does
20 your firm have?

21 THE WITNESS: Three.

22 MR. NEWMAN: Where are they located?

23 THE WITNESS: Primary office, our
24 headquarters is located in Albany, New York.

25 We have a branch office in Clifton

1 Park, which is north of Albany, and an office in New
2 York City.

3 MR. NEWMAN: You work in the Albany
4 office personally?

5 THE WITNESS: I do, yes.

6 MR. NEWMAN: These affiliated
7 companies you have, I think we're going to go
8 through several of them.

9 MS Partners you mentioned. There are
10 other ones.

11 Are they all physically located in the
12 same building where McGinn Smith is located?

13 THE WITNESS: Yes.

14 MR. FRANCESKI: He didn't finish the
15 list of arbitrations. Do you care?

16 THE WITNESS: I said there was a
17 couple. Chang is open. And then there is another
18 Casolo one, which I can't -- just the name escapes
19 me.

20 Chang is the name of the claimant.

21 MR. NEWMAN: Which matter is that?

22 THE WITNESS: That is a matter of
23 income notes that he was looking to get liquid and
24 they are no longer available.

25 He's saying, again, seems to be the

1 traditional theme these days, unsuitability.

2 MR. NEWMAN: Who is the issuer of the
3 notes?

4 THE WITNESS: Various LLCs, limited
5 liability companies. I think First Independent
6 income notes and maybe First Excelsior.

7 MR. NEWMAN: How much is he seeking,
8 approximately?

9 THE WITNESS: I think his total
10 liability is about somewhere around a million
11 dollars.

12 MR. NEWMAN: What is the --

13 MR. FRANCESKI: The claim is higher
14 than that.

15 MR. NEWMAN: What is the status of the
16 claim?

17 THE WITNESS: It's going through the
18 process. Dave is handling it for us.

19 MR. NEWMAN: What is your ownership
20 equity interest in McGinn Smith?

21 THE WITNESS: My personal ownership is
22 50 percent.

23 MR. NEWMAN: Mr. McGinn owns the other
24 50?

25 THE WITNESS: He owns 30 percent. A

1 gentleman by the name of Mr. Livingston owns
2 20 percent.

3 MR. ROWEN: At this time I would like
4 to have this marked Exhibit 2.

5 (Letter dated November 4, 2008 was
6 received and mark FINRA Exhibit 2 for
7 identification.)

8 Q. BY MR. ROWEN: I'm handing you
9 Exhibit 2. This is a copy of a statement signed by
10 you detailing your business affiliations.

11 Does this letter contain all entities you
12 have been affiliated with in the last three years?

13 A. Well, I think the answer to that
14 question, this was in response to a question
15 regarding outside employment. And there was a
16 question of what is considered outside employment
17 and what is considered affiliation.

18 And I believe that these entities here,
19 whether they fit into that category or --
20 affiliations or outside employment, my response was,
21 and I'll repeat it for the record even though we may
22 have a disagreement on this, is that all of these
23 entities here, with the exception of CMS Financial
24 Services, are directly related to our business. So,
25 I considered them not outside interest but rather

1 affiliates.

2 I think in terms of the one area that is --
3 one group that is not on there that comes to mind is
4 Pine Street Capital. That would be an outside
5 interest, and I believe is so designated.

6 I think there might be one inactive outside
7 interest, which is First Integrated Capital Corp. I
8 think that's showing on my U4, but that's inactive.

9 Looking at this, MS Holdings, which is a
10 holding company for MS Partners and MS Capital
11 Holdings is not listed there.

12 MR. NEWMAN: What was the name of the
13 entity?

14 THE WITNESS: MS Holdings. It's
15 listed on the bottom, but it's not listed in the
16 first paragraph.

17 MR. NEWMAN: Why not?

18 THE WITNESS: Well, I think because I
19 was responding to the -- to these entities. So, I
20 put them down below I show the organizational chart
21 and I showed MS Holdings.

22 MR. NEWMAN: What is the difference
23 between MS Capital Holdings and MS Holdings, LLC?

24 THE WITNESS: MS Holdings is a holding
25 company that basically owns the two entities listed

1 here, McGinn Smith Capital Holdings and McGinn Smith
2 Advisors.

3 MS Holdings is not a particular active
4 company. It was formed initially to ultimately own
5 the broker-dealer. We eventually didn't do that.
6 And they own the two entities there.

7 Another entity that is owned by MS
8 Holdings that has -- is not listed there is 107
9 Associates, Inc. Another comes to mind I mentioned,
10 Pine Street Capital.

11 I think that's inclusive, at least
12 what I recall at the moment.

13 MR. NEWMAN: Why was that not listed
14 on your chart, MS Holdings owns 107 Associates?

15 THE WITNESS: I believe just an
16 oversight. I'm not sure that had come up in that.
17 I attempted to do it. And just plain oversight.

18 MR. NEWMAN: What went into MS
19 Holdings acquired interest in 107 Associates?

20 THE WITNESS: When it was formed,
21 which was sometime in 2007 --

22 MR. NEWMAN: This is MS Holdings?

23 THE WITNESS: No. 107.

24 MR. NEWMAN: What is the purpose of MS
25 Holdings holding an interest in 107? What is the

1 business reason for that?

2 THE WITNESS: That's -- advice of
3 counsel, decided to have all these things under one
4 uniform name, as opposed to individual names.

5 MR. NEWMAN: So, MS Holdings, LLC,
6 you're 50 percent owner of that; is that correct?

7 THE WITNESS: Yes. The ownership for
8 MS Holdings, as it is, for McGinn Smith & Company.

9 MR. PAULSEN: Is -- would you say then
10 as MS Holdings is a -- owns 107 Associates?

11 THE WITNESS: That's correct.

12 MR. PAULSEN: So, that the pro rata
13 ownership would be the same described in this
14 document for MS Holdings as for 107: 50 percent for
15 yourself, 30 to Mr. McGinn, would that distribution
16 be the same for 107?

17 THE WITNESS: No. Because MS Holdings
18 owns 100 percent of 107, as it does each of these
19 other entities.

20 MR. NEWMAN: MS Holdings is the owner
21 of 107 and 50 percent owner of --

22 THE WITNESS: On a pass through, yeah,
23 but in terms of an actual structural --

24 MR. NEWMAN: In actuality, you're
25 50 percent --

1 THE WITNESS: Sure.

2 MR. NEWMAN: Half owner of the holding
3 company.

4 Where are all the documents that show
5 the ownership interest in these entities?

6 THE WITNESS: They are maintained at
7 99 Pine Street, Albany, New York, our corporate
8 headquarters.

9 MR. NEWMAN: Is that where McGinn
10 Smith is located?

11 THE WITNESS: Yes.

12 MR. NEWMAN: Who is the custodian of
13 those records?

14 THE WITNESS: Joseph Carr, who is our
15 in-house counsel.

16 MR. NEWMAN: You mentioned this --
17 there is Pine Street Capital. What is Pine Street
18 Capital?

19 THE WITNESS: It's a mezzanine fund of
20 which the ownership as it relates to me is in my
21 name. The distribution basically McGinn Smith
22 becomes the nominee. If there are any benefits, we
23 pass it through to McGinn Smith & Company.

24 MR. NEWMAN: When you say mezzanine --

25 THE WITNESS: It's an LLC.

1 MR. NEWMAN: When was Pine Street
2 Capital formed?

3 THE WITNESS: I believe 2004.

4 MR. NEWMAN: These LLCs, what states
5 were they formed in?

6 THE WITNESS: I believe it was formed
7 in New York.

8 MR. NEWMAN: Does that apply to all
9 the LLCs listed on the letter?

10 THE WITNESS: To the best of my
11 knowledge, yes.

12 MR. NEWMAN: Are there any entities
13 that you individually or through any of your
14 affiliated companies listed here or LLCs have an
15 interest in that is not disclosed on this letter?

16 THE WITNESS: Other than the Pine
17 Street and 107 -- Mike, you want to go back to the
18 beginning of time or are we talking about reasonably
19 active?

20 We have formed in our 28 years a
21 variety of partnerships and entities of which my
22 name would still be associated with it. If we do
23 that, that -- I would be happy to try to remember
24 them all.

25 MR. NEWMAN: I don't want to go back

1 that far.

2 THE WITNESS: I'm trying to give you
3 the more active ones.

4 MR. NEWMAN: Let's stick with the last
5 two years.

6 THE WITNESS: I think that's
7 inclusive.

8 MR. NEWMAN: Are any of these entities
9 generating revenues?

10 THE WITNESS: Sure.

11 MR. NEWMAN: Which once?

12 THE WITNESS: They all generate
13 revenues, other than MS Holdings, which is -- I
14 guess if you take the position that earnings
15 ultimately get distributed upstream, you would
16 include that.

17 In terms of an active operation, MS
18 Holdings as designated, it's a holding company.

19 M & S Partners is an entity that has
20 existed since 1981.

21 McGinn Smith Capital Holdings is
22 probably 1985 maybe. I can't remember that far
23 back, but that would be my guess.

24 SMS Financial Services is a more
25 recent entity that was used to acquire an insurance

1 company. I think this office is quite familiar with
2 that.

3 The four listed LLCs for income notes
4 were MS Advisors, who was the sole managing member
5 and derived income.

6 Pine Street Capital is an ongoing
7 mezzanine fund that produces fee income and capital
8 gains.

9 MR. NEWMAN: Who is MS Financial?

10 THE WITNESS: MS Financial?

11 MR. NEWMAN: Yes.

12 THE WITNESS: I guess I don't see
13 that. Where is that? I'm not familiar with MS
14 Financial.

15 MR. NEWMAN: We're going to get into
16 the Coventry offering, but there is a reference in
17 the Coventry memorandum to MS Financial.

18 THE WITNESS: I don't know, unless
19 it's an attempt to be an abbreviation of McGinn
20 Smith Capital Holdings.

21 MR. NEWMAN: McGinn Smith Financial
22 Services Corporation, are you familiar with that
23 entity?

24 THE WITNESS: No.

25 MR. NEWMAN: Never heard of it before?

1 THE WITNESS: McGinn Smith Financial
2 Services Corp.? Not that I can think of, no.

3 MR. NEWMAN: You mentioned First
4 Integrated Capital Corp.

5 THE WITNESS: Yes. That's one that
6 goes way back. When we first -- back in the early
7 '90s, we got into the securitization of the home
8 security alarm business.

9 I believe the first entity that we
10 formed to do that was an entity called First
11 Integrated Capital Corp. Ultimately it was a
12 successor to Integrated Alarm, which became a public
13 company, etc., etc.

14 Q. BY MR. ROWEN: Is First Integrated
15 Capital Corp. active?

16 A. No. It's still exists, but it's not
17 active. I'm not sure why it still exists.

18 MR. NEWMAN: Looking under these LLC,
19 First Independent Income Note, would you say that
20 generates revenues?

21 THE WITNESS: Yes.

22 MR. NEWMAN: How?

23 THE WITNESS: It -- well, it generates
24 revenues by -- I guess let me ask you is the
25 question do they generate revenues to me or does the

1 LLC generate revenues?

2 What it is, it's a company that
3 primarily makes loans to businesses, generates
4 interest which is used to service the notes.

5 The management of that entity is MS
6 Advisors, which I thought that's where your question
7 was leading. That generated advisory fees to MS
8 Advisors.

9 MR. NEWMAN: The LLC lends money
10 essentially?

11 THE WITNESS: That's correct.

12 MR. NEWMAN: Then it receives back
13 notes and receives income on those notes?

14 THE WITNESS: That's correct.

15 MR. NEWMAN: MS Advisors is paid a
16 fee --

17 THE WITNESS: -- for managing that
18 process.

19 MR. NEWMAN: The same applied to the
20 other three LLCs?

21 THE WITNESS: Yes.

22 MR. NEWMAN: First Excelsior, Third
23 Albany and First Advisory?

24 THE WITNESS: Yes.

25 MR. FRANCESKI: Just to caution, you

might want to allow Mr. Newman to finish the question. It's difficult for the court reporter to get you two talking over each other.

MR. PAULSEN: These note offerings, they are generating revenues for the advisor?

THE WITNESS: The management of that LLC generates fees for the advisor, yes.

MR. PAULSEN: Are there any -- has there been any return to investors for these offerings?

THE WITNESS: Certainly. The structure of all four of them were done in a senior -- senior subordinate and a junior, of which the senior notes were paid, as one would expect, a lesser rate of interest, between 5 and 7. Senior subordinates generated between 7, 7 and a half. And the juniors, 10 and a quarter. All of which were current up until October of 2008.

MR. NEWMAN: At which -- what occurred at that time?

THE WITNESS: At which time we proposed a restructuring. Seniors are still current. The senior subordinates and juniors are deferred.

MR. NEWMAN: That applies to whichever

1 these?

2 THE WITNESS: All four.

3 MR. NEWMAN: So, these entities, these
4 LLCs they are lending money -- who are the
5 individual whose are making the determination as to
6 who the money is going to be lent to?

7 THE WITNESS: Primarily MS Advisors,
8 which consists of myself and other support of McGinn
9 Smith & Company.

10 MR. NEWMAN: These entities will have
11 records there have been loans made to entities?

12 THE WITNESS: Sure.

13 MR. NEWMAN: To generate the interest
14 income?

15 THE WITNESS: Yes.

16 MR. NEWMAN: First Independent, how
17 much money has First Independent lent?

18 THE WITNESS: They were totally
19 capitalized with approximately \$20 million.

20 MR. NEWMAN: Was that money raised
21 from investors?

22 THE WITNESS: That's correct.

23 MR. NEWMAN: That was raised through
24 what particular vehicle?

25 THE WITNESS: Through a private

1 placement.

2 MR. NEWMAN: Over what period of time?

3 THE WITNESS: Probably two months,
4 three months.

5 MR. NEWMAN: It raised \$20 million?

6 THE WITNESS: Yes.

7 MR. NEWMAN: Who was the underwriter
8 for that?

9 THE WITNESS: McGinn Smith & Company.

10 MR. NEWMAN: What was McGinn Smith's
11 fees for that underwriting, roughly?

12 THE WITNESS: The fees were 2 percent
13 per year for four years.

14 MR. NEWMAN: On top of that, there is
15 an ongoing advisory fee?

16 THE WITNESS: Yes. Of 1 percent.

17 MR. NEWMAN: That's to basically
18 operate the LLC?

19 THE WITNESS: That's correct.

20 MR. NEWMAN: It's a management fee?

21 THE WITNESS: Exactly that, yes.

22 MR. NEWMAN: How much has been repaid
23 to the investors of First Independent?

24 THE WITNESS: Basically, they have
25 received a lending rate of 8 and three-quarters,

1 9 percent probably over four years. That's 9 times
2 20, that's a million eight, four years, probably 7
3 or \$8 million.

4 MR. FRANCESKI: You mean over the
5 various tranches?

6 THE WITNESS: Yes.

7 MR. NEWMAN: How much income has been
8 generated from lending money activity for this LLC?
9 How much has it generated in interest?

10 THE WITNESS: It generated virtually
11 the same up until 2008 when things started to hit
12 the wall. We had a number of investments that have
13 not paid. Some of them public investments. Some of
14 them private investments.

15 MR. NEWMAN: When you say investments
16 have not been paid, moneys being lent?

17 THE WITNESS: That's right.

18 MR. NEWMAN: People have defaulted?

19 THE WITNESS: That's correct.

20 MR. NEWMAN: Is money being lent to
21 any affiliated companies of McGinn Smith or actual
22 companies?

23 THE WITNESS: It's being lent to
24 companies and other investment entities.

25 Give you have an example, Merrill

1 Lynch did a trust preferred offering of which we
2 took a \$3 million position.

3 Trust preferred were in a variety of
4 banks. They were current up until a year ago. Then
5 they stopped paying.

6 Another one we did through Sandler
7 O'Neil. They lent trust preferred offering to
8 insurance companies. We were current up until about
9 five days ago when I hadn't gotten a payment.

10 So, then there are individual
11 businesses that we have lent to that for the most
12 part were current up until last year.

13 MR. NEWMAN: Are any of these
14 businesses affiliates of McGinn Smith?

15 THE WITNESS: We have lent some money
16 to -- there is a couple of -- lent money to Century
17 Same Day Surgery, which I don't think it was an
18 affiliate, but we had some -- we had underwritten
19 it. There was clearly a connection.

20 There is a limited amount of money to
21 a couple of our cable deals. TDM Verifies is a name
22 that comes to mind.

23 I think there is some money to M & S
24 Partners, maybe \$300,000 out of 80 million. I don't
25 know. I would have to check. Very de minimis in

1 terms of that.

2 MR. NEWMAN: You raised \$20 million
3 from investors on the premises the money was going
4 to be lent --

5 THE WITNESS: It was going to be lent
6 to invest.

7 MR. NEWMAN: The offering document
8 describes either lending --

9 THE WITNESS: Correct.

10 MR. NEWMAN: Has the \$20 million been
11 lent or invested?

12 THE WITNESS: Yes.

13 MR. NEWMAN: All \$20 million?

14 THE WITNESS: Yes.

15 MR. NEWMAN: You would be able to provide
16 records to show how that \$20 million has been
17 utilized?

18 THE WITNESS: Absolutely.

19 MR. NEWMAN: Where is First
20 Independent located?

21 THE WITNESS: All domiciled at 99 Pine
22 Street.

23 MR. NEWMAN: What about bank accounts,
24 where would First Independent's bank account be?

25 THE WITNESS: M & T in Albany.

1 MR. NEWMAN: Is the account under --
2 First Independent, LLC account?

3 THE WITNESS: Right. I'm not sure
4 there is a lot of -- I think there is an operating
5 account for each of those four at M & T.

6 MR. NEWMAN: Are you signatory on
7 those accounts?

8 THE WITNESS: Yes.

9 MR. NEWMAN: Who else is a signatory
10 on those accounts?

11 THE WITNESS: Probably Dave Reis, who
12 is our CFO. And maybe Brian Cooper. I'm not sure
13 of that. I don't think so. I think just Dave Reis
14 and myself.

15 MR. PAULSEN: Is Dave Reis still
16 employed by the company?

17 THE WITNESS: No.

18 MR. NEWMAN: When was he terminated?

19 THE WITNESS: He resigned about a week
20 ago. He was not terminated. Maybe two weeks ago.

21 MR. PAULSEN: He's no longer
22 registered or employed by McGinn Smith?

23 THE WITNESS: That's correct.

24 MR. NEWMAN: Do you know why he
25 resigned?

1 THE WITNESS: Took another job.

2 MR. NEWMAN: Where does he work now?

3 THE WITNESS: Working at a collection
4 law firm in Albany, New York.

5 MR. NEWMAN: He's an attorney?

6 THE WITNESS: No. He took a job as
7 CFO.

8 MR. NEWMAN: For the \$20 million that
9 was raised, customers only received -- investors got
10 back 7 or \$8 million?

11 THE WITNESS: That's in interest,
12 yeah.

13 MR. NEWMAN: Is this \$20 million in
14 principal sitting around in some account somewhere?

15 THE WITNESS: No. They are
16 investments. Some of them -- some of the
17 investments are worth what we paid for them and some
18 are not. That's why we had to restructure the
19 notes.

20 MR. FRANCESKI: There is some detail
21 on the return in the answer to the statement of
22 claim for Chang. They were in -- I think they were
23 in all of these notes.

24 MR. PAULSEN: You mentioned an
25 investment of partial funds -- funds in part of the

1 \$20 million for the First Independent income notes,
2 moneys were given to Century Same Day Surgery?

3 THE WITNESS: Yes.

4 MR. PAULSEN: You said that McGinn
5 Smith broker-dealer was involved in the
6 underwriting.

7 Can you elaborate on the money lent to
8 them, and the approximate time you lent it to them,
9 and how it may have impacted your involvement on --
10 McGinn Smith's involvement with the underwriting?

11 THE WITNESS: The underwriting was
12 done, I believe, in 1990. On which Century Same Day
13 Surgery is a 24-hour emergency surgical center,
14 which you're probably familiar with.

15 The total amount of loans I believe,
16 to the best of my recollection, are about \$80,000.

17 It was designed to purchase equipment.

18 MR. PAULSEN: When was that money
19 lent?

20 THE WITNESS: Probably three years
21 ago.

22 MR. PAULSEN: Do you or any associate
23 or entity owned by MS Holdings have any financial
24 interest in Century Same Day Surgery?

25 THE WITNESS: None of the entities.

1 Ownership in Century Same Day Surgery, Mr. McGinn is
2 an owner.

3 MR. PAULSEN: What percentage?

4 THE WITNESS: I believe 20 percent.

5 MR. PAULSEN: Do you see investments
6 that you make -- of the total amounts collected by
7 or raised, I should say, by these note offerings, do
8 you see any potential conflict of interest in taking
9 those funds and lending them to either owners or
10 affiliates under the McGinn Smith umbrella?

11 THE WITNESS: Sure. It's well
12 disclosed. It's a small portion, but it's -- you
13 can make the argument there is conflict of interest
14 in everything.

15 If we've been an underwriter or we
16 have a relation, a client relationship, which is the
17 case in some cases, and it's fully disclosed.

18 Q. BY MR. ROWEN: So, in the memoranda
19 for these four entities that you raised, one raised
20 \$20 million, it discloses that funds may be invested
21 in entities that you or someone or McGinn Smith
22 might be affiliated with?

23 A. That's correct.

24 MR. NEWMAN: How about First
25 Excelsior, how much was raised in that?

1 THE WITNESS: 20 million?

2 MR. NEWMAN: How much has been paid
3 back in interest payments to investors?

4 THE WITNESS: Virtually all of these,
5 Mike, are the same. They have run the same course
6 of time.

7 We did First Independent in 2003. We
8 did First Excelsior in late 2003. Third Albany and
9 First Advisory were done in 2004. Maturity dates
10 were 2009, 2010 for the last two. First two were
11 maturity dates were 2008.

12 MR. NEWMAN: Have any payments been
13 made to investors in these LLCs based on capital
14 raised in another offering?

15 THE WITNESS: These are all notes that
16 investors held with a fixed rate of return, which
17 was, as I indicated, current until 2008.

18 MR. NEWMAN: Do you understand the
19 question I'm asking you? I'm asking you about the
20 source of the funds that have been paid in these
21 LLCs, these people receiving back what you described
22 as interest payments?

23 THE WITNESS: That's exactly what they
24 are.

25 MR. NEWMAN: The source of that money,

1 is any of that money that's being used to pay back
2 the notes, any of that money derived from another
3 one of these LLC offerings or any other offering?

4 THE WITNESS: No. Interest is derived
5 from the income or interest from the investments.

6 MR. NEWMAN: You can demonstrate that?

7 THE WITNESS: Sure.

8 MR. NEWMAN: How would you be able to
9 demonstrate that? What records would you have to
10 verify that?

11 THE WITNESS: We would have the
12 original loan documents. We would have records of
13 the receipt of the income. And we would have
14 records of distribution to the investors.

15 MR. PAULSEN: You mentioned that two
16 of them matured in 2009 and two matured in 2008?

17 THE WITNESS: I know First Independent
18 matured in 2008. I think First Excelsior matured in
19 January of 2009.

20 And I believe the other two mature
21 in -- one late 2009 and one in 2010.

22 MR. PAULSEN: The First Independent
23 income notes, to your knowledge, did mature in 2008?

24 THE WITNESS: Correct.

25 MR. PAULSEN: Was there -- what type

1 of communication took place with the investors of
2 those notes at the time or -- prior to or at the
3 time of maturity?

4 THE WITNESS: A letter written by me.

5 MR. PAULSEN: How long before maturity
6 was that letter sent?

7 THE WITNESS: The letter was written
8 in October of 2008. It was written approximately
9 two months, three months.

10 MR. PAULSEN: Matured at year's end?

11 THE WITNESS: I believe 12 -- 15.

12 MR. NEWMAN: Did investors express
13 interest in seeking the return of capital?

14 THE WITNESS: The letter pointed out
15 there was inability to give them return of capital.
16 The one particular arbitration we discussed, the
17 Chang, that is what it's driven by. They were
18 seeking their return of capital.

19 MR. PAULSEN: Has there been an
20 offering made by McGinn Smith, to your recollection,
21 that at maturity the capital was returned to the
22 investors?

23 THE WITNESS: Yes. Literally hundreds
24 of millions of dollars. We raised from 1992 to
25 probably 2003 when we took the company public

1 probably \$700 million in notes that matured and
2 never missed a payment, either principal or
3 interest.

4 MR. PAULSEN: How about in the last
5 five years, ten years?

6 THE WITNESS: The only entities that
7 have not returned their capital are these four. And
8 there is one other entity, which was in the alarm
9 business, called Security Associates International,
10 SAI, which was a public company we raised money for
11 and these were basically foreclosed on, I think it
12 was July of 2008. And the note holders had received
13 in payments about 90 percent of their capital back.
14 But they didn't get the full capital back.

15 MR. PAULSEN: You would have records
16 housed at 99 Pine Street which would support the
17 repayment of capital on the offerings you're
18 referring to?

19 THE WITNESS: Yes. The -- just to be
20 clear, on the SAI, what I stated was they got -- in
21 payments which included interest and capital, I
22 believe it was approximately 90 percent of their
23 money back.

24 A lot of that was interest. Initially
25 this deal goes back probably 2003, maybe even

1 earlier, 2002. And they were paid interest
2 regularly. Then SAI came back and restructured the
3 notes. They brought in new lenders.

4 I negotiated not just interest only.
5 I wanted capital paid back. It was amortizing.

6 And then in October of 2007, they got
7 a \$25 million investment from another private equity
8 firm.

9 And in January of 2008, they ceased
10 payment to us. Told us they would be making
11 payments within weeks -- when all this credit stuff
12 came, their senior lender foreclosed on the
13 collateral. Took it all. And basically we had no
14 ability to meet the remaining payments.

15 That was all communicated to
16 investors.

17 MR. PAULSEN: When you refer to SAI,
18 you're referring to Strategic Alarm?

19 THE WITNESS: It was Security Alarm
20 International. It's a public company. It was a
21 pink sheet company. Been around for a while. But
22 they are now demised.

23 Q. BY MR. ROWEN: What is Coventry Care
24 Link?

25 A. Coventry Care Link is a long-term care

1 insurance company that has recently been merged with
2 McGinn Smith Capital Holdings to acquire another
3 long-term care insurance company, USA -- United
4 Insurance Company, secured insurance company.

5 That's their only business. Basically,
6 they have a unique -- which they like to believe
7 it's unique, we're somewhat agreeable -- form of
8 long-term care insurance, which is more of a
9 concierge service where they basically have a
10 wellness program and a support program where if
11 you're a policy holder, you not only are given
12 long-term care, but other services if you're
13 infirmed or elderly or you need support services
14 for -- have your snow shoveled or roof fixed or food
15 delivered, whatever it may be.

16 The concept is to basically keep the policy
17 holder in the home as long as possible, and not put
18 them in an institution where most people have some
19 resistance to going.

20 Q. How were you or your broker-dealer
21 introduced to Coventry Care Link?

22 A. Well, actually the introduction goes
23 way back to, I guess, around 1990 when Travelers
24 Insurance Company, who we had done some financing
25 for a client with and knew us, referred a gentleman

1 by the name of Robert Holtermann, who was running
2 Coventry Care Link, what was known as Coventry
3 Resources. Coventry Resources was in the -- what we
4 call the CCRC business, continuing care retirement
5 community business.

6 That's where he basically built a facility.
7 A lot of it's done in condo format. And you provide
8 nursing care, continuing care, and the client or
9 prospect buys an interest in that. And then has a
10 lifetime promise that they will provide that care as
11 it progresses from sort of daycare right on through
12 nursing.

13 He brought to us a project in a place
14 called Shelburn, Vermont, and we ended up financing
15 that project for him.

16 We went through a long process with our
17 friends in Vermont that were somewhat resistant to
18 having a facilities that might infringe on their
19 views of the lake. It was on Lake Champlain.

20 Ultimately, it was successfully done. Our
21 investors did very well with it. We were quite
22 impressed with Mr. Holtermann.

23 And so he probably in the late '90s started
24 moving from the continuing care to more of an
25 insurance concept long-term care. And sought our

1 help in financing the company.

2 And in 2003, we provided some financing for
3 him.

4 That company has now evolved into CMS,
5 which is a combination of Coventry, McGinn Smith
6 Capital Holdings formed for the purpose of acquiring
7 the insurance company that I referred to.

8 I, my personal involvement, was I served on
9 the board. I had recommended as a board member that
10 the company look -- seek to acquire an ongoing cash
11 flowing business. The board agreed.

12 They identified USA. We raised the
13 capital, which is you're familiar with the document
14 of CMS. That's what that was all about.

15 Q. When you say you served on the board,
16 the board of Coventry Care Link?

17 A. Coventry.

18 Q. What was your ownership of Coventry
19 Care Link?

20 A. I don't believe I had any ownership.
21 Well, that may not be true. We -- back in 1995,
22 1996, I think M & S Partners made a \$100,000
23 investment. To be honest with you, I'm not sure if
24 it was equity or debt. It may have been equity.
25 It's a -- it's an insignificant amount of ownership

1 at that time.

2 Subsequent to that, when we formed -- when
3 McGinn Smith Capital Holdings form CMS, McGinn Smith
4 Capital Holders got ownership in CMS.

5 The ownership rests in McGinn Smith Capital
6 Holdings, not in Dave Smith, if you're asking me
7 specifically.

8 MR. NEWMAN: CMS -- McGinn Smith
9 Capital Holdings owns CMS?

10 THE WITNESS: They own an interest in
11 CMS. That interest is approximately 9 percent.

12 MR. NEWMAN: CMS owns Coventry?

13 THE WITNESS: CMS owns Coventry. CMS
14 is sort of a joint venture of Coventry and McGinn
15 Smith Capital Holdings. CMS owns Coventry if that's
16 your question.

17 MR. NEWMAN: 100 percent?

18 THE WITNESS: That is correct.

19 MR. NEWMAN: Who owns the remaining
20 part of CMS. You said 9 percent --

21 THE WITNESS: There is a variety of
22 owners. There are preferred shareholders, the
23 original stake holders in Coventry. Exact
24 breakdown, as I'm trying to remember the -- the
25 preferred A shareholders had common stock in CMS,

1 which amounts to about 20 percent. B shareholders
2 own about 10 percent. The original stake holders
3 own about 24 percent. The new investors were to
4 originally own 45 percent. And they ended up with
5 probably a third of that, 15, maybe 20 percent.

6 Are we up to 100 yet?

7 It's all laid out in the prospectus
8 precisely.

9 MR. ROWEN: At this time I would like
10 to have this marked as Exhibit 3.

11 (Confidential Private Placement
12 Memorandum was received and marked FINRA Exhibit 3
13 for identification.)

14 Q. BY MR. ROWEN: I'm handing you
15 Exhibit 3 in this matter. This is the cover page
16 and additional relevant pages of a Coventry Care
17 Link bridge loan note private placement memoranda
18 dated February 7, 2007.

19 Are you familiar with this private
20 placement?

21 A. Yes.

22 Q. What was your involvement with this
23 private placement?

24 A. As it indicates, we raised capital for
25 them in anticipation of a larger equity raise. And

1 I believe we ultimately raised about \$2.2 million.

2 Q. What was the status of Coventry Care
3 Link at the time of this placement?

4 A. Status?

5 Q. What was the involvement? What were
6 its revenues?

7 A. I don't know. It was an operating
8 company. It had not -- its revenues were not
9 significant.

10 They had a licensed arrangement with Med
11 America, which is a large long-term care company. I
12 think they are in Pennsylvania.

13 They had been attempting to roll out their
14 Coventry Care Link program. They had designed to
15 hire their own brokerage staff, their own agents.
16 They were developing their agents. None of it was
17 working particularly well.

18 They had revenues, but I can't tell you at
19 this time what they were.

20 MR. NEWMAN: Do you know what its
21 balance sheet looked like?

22 Was there a going concern issue with
23 the firm, the company at that time?

24 THE WITNESS: I don't believe there
25 had been a going concern issue raised. They were

1 certainly in terms of their liabilities and assets,
2 I would say their liabilities exceeded their assets.

3 MR. NEWMAN: Was it a profitable
4 company?

5 THE WITNESS: It was not a profitable
6 company.

7 Q. BY MR. ROWEN: Who was involved in
8 creating the private placement memorandum?

9 A. Mr. Holtermann, the issuer.

10 Q. Were you involved in creating the
11 document?

12 A. I was involved in negotiating the
13 dealing. I was not involved in creating the
14 document.

15 Well, correct myself. I reviewed it. In
16 terms of creation, it was done by Mr. Holtermann.

17 MR. NEWMAN: What type of due
18 diligence did McGinn Smith do for this offering?

19 THE WITNESS: I was on the board of
20 Coventry Care Link. We had dealt with the company
21 for five years.

22 MR. NEWMAN: You understood what the
23 company's operating and financial situation was at
24 the time of this note offering?

25 THE WITNESS: Absolutely.

1 MR. NEWMAN: There was no other due
2 diligence type of research done by you or your firm?

3 THE WITNESS: Sure. The company
4 provided me with a warehouse full of records. If
5 you would like them, I can provide them.

6 Mr. Holtermann is quite prolific in
7 terms of grinding out information. We had all sorts
8 of financial information, due diligence information.
9 I have literally reams of it.

10 MR. NEWMAN: You said you were
11 director and knew what was going on?

12 THE WITNESS: Yes.

13 MR. NEWMAN: On top of that, there was
14 an investigative research/due diligence effort
15 undertaken?

16 THE WITNESS: Yes.

17 MR. NEWMAN: Was that undertaken by
18 you or somebody else?

19 THE WITNESS: Primarily myself.

20 MR. NEWMAN: Is there anything you
21 discovered during your due diligence you weren't
22 aware of based on your being director of Coventry
23 Care Link?

24 THE WITNESS: No.

25 MR. NEWMAN: In terms of McGinn

1 Smith's involvement in reviewing the private
2 placement memorandum, you said you reviewed it on
3 behalf of the firm?

4 THE WITNESS: Yes.

5 MR. NEWMAN: Did you have comments to
6 that memorandum?

7 THE WITNESS: I'm sure I did. But I
8 can't recall what they were.

9 They would have been more procedural
10 in terms of how we were going to design the deal,
11 but not necessarily from a legalistic standpoint.

12 Holtermann is a securities lawyer.
13 Basically undertakes these things himself.

14 MR. NEWMAN: Did you propose any
15 changes, revisions to the disclosure?

16 THE WITNESS: Not that I can recall.

17 MR. NEWMAN: Did you believe that
18 McGinn Smith had any responsibility to ensure the
19 disclosures in the offering document were accurate,
20 complete?

21 THE WITNESS: Certainly.

22 MR. NEWMAN: Was it your belief and
23 understanding upon reviewing that document that the
24 document provided necessary disclosure to potential
25 investors?

1 THE WITNESS: I did. I do.

2 Q. BY MR. ROWEN: Who solicited sales of
3 the private placement?

4 A. Our brokers, McGinn Smith brokers.

5 Q. Did you as well?

6 A. I don't recall -- I don't think I had
7 any clients -- you're talking about this offering
8 here?

9 Q. Yes.

10 A. I don't believe I had any of my own
11 specific clients in the offering. Most of it was
12 done from our New York City group.

13 Q. How were solicitations made?

14 A. Made as any private placement is made.
15 They have a client who is prequalified to invest in
16 these types of things. They have a general
17 conversation to see if there is any interest. If
18 there is some interest, they provide a prospectus,
19 which the client has the ability to review and read
20 and ask questions.

21 And upon conclusion of that, if he's
22 interested in subscribing, he has a subscription
23 agreement he must complete, along with a
24 questionnaire. And it is then reviewed and accepted
25 and the transaction is closed.

1 Q. You mentioned clients being
2 prequalified. Is that only solicited to existing
3 clients?

4 A. Yes. As far as I know.

5 Q. How is suitability determined for
6 selling this product?

7 A. Suitability is determined by, A, the
8 broker knows the client, has generally information
9 on the client, and asks the question.

10 Then we provide a questionnaire that is
11 completed by the client.

12 Q. What clients were deemed suitable, I
13 guess, what types of clients were deemed suitable
14 for this investment?

15 A. Risk oriented. Clearly this was a
16 high-risk investment. Income oriented that wanted
17 cash flow. And people who, in effect, believed in
18 the concept.

19 Q. You say believed in the concept. What
20 representations were made about the concept to
21 solicit investors?

22 A. Generally, a discussion of long-term
23 care. McGinn Smith was originally involved with
24 this company because they have a strong belief that
25 long-term care is a major problem and, slash,

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1 opportunity. And we continue to believe that,
2 despite some of the difficulties.

3 MR. NEWMAN: Why would you consider
4 this to be a high-risk investment?

5 THE WITNESS: Because it was basically
6 a startup. Its revenues were, as I indicated, de
7 minimis. They had a fair amount of liabilities.
8 They had not been able to demonstrate that the model
9 worked beyond a limited number of clients.

10 They hadn't gotten registered in all
11 the states that they ultimately would propose to get
12 registered in.

13 And all of those things lead to
14 suggest it's a high-risk venture.

15 MR. NEWMAN: They weren't licensed to
16 conduct insurance business anywhere, were they?

17 THE WITNESS: Oh, yes, they were.
18 They were registered, I believe, in three states,
19 maybe four.

20 MR. NEWMAN: Is Maryland one of those
21 states?

22 THE WITNESS: Yes. Illinois,
23 Pennsylvania and maybe Delaware.

24 MR. NEWMAN: You think Maryland too?

25 THE WITNESS: I'm pretty sure.

1 MR. NEWMAN: It's a Maryland company?

2 THE WITNESS: Yeah.

3 MR. NEWMAN: Did you verify, as part
4 of your due diligence, did you verify the state
5 insurance status of the firm, of the company?

6 THE WITNESS: As a member of the
7 board, I knew which states they were registered in.

8 My recollection is wrong, I will look
9 at it, but as a member of the board, I knew they
10 were registered in states.

11 MR. NEWMAN: You indicated you also --
12 your firm did due diligence. As part of that due
13 diligence, did your firm attempt to confirm or
14 verify what states Coventry Care Link had insurance
15 licenses in?

16 THE WITNESS: No.

17 MR. NEWMAN: What type of guidance was
18 given to the sales force of McGinn Smith in terms of
19 selling this particular offering?

20 Was there any specific guidance given
21 to them or instructions in terms of how this should
22 be sold and presented?

23 THE WITNESS: It should be sold and
24 presented as a high-risk investment. And it was a
25 startup.

1 Virtually all the brokers were
2 familiar with the company, because we had a prior
3 offering in 2003. So, they knew the company.

4 And -- yes, they were presented with
5 the facts and all the disclosures and all the risk
6 disclosures.

7 MR. NEWMAN: Who provided that
8 information to the sales force?

9 THE WITNESS: Mr. Holtermann.

10 MR. NEWMAN: Were you present when
11 that information was communicated?

12 THE WITNESS: Yes.

13 MR. NEWMAN: Was it in a meeting?

14 THE WITNESS: Yes.

15 MR. NEWMAN: When did the meeting take
16 place?

17 THE WITNESS: I don't recall exactly.

18 MR. NEWMAN: Where did it take place?

19 THE WITNESS: It took place in both
20 Albany and New York City.

21 MR. NEWMAN: The purpose of the
22 meeting was what?

23 THE WITNESS: To basically introduce
24 the offering and discuss the risk factors and
25 discuss the prospects for the company.

1 MR. NEWMAN: Were there any e-mails
2 sent to the sales force of McGinn Smith describing
3 some of these issues?

4 THE WITNESS: I don't know with
5 certainly, but I doubt it. It isn't how we
6 communicated. We can communicate by a telephonic
7 conference or an actual meeting where Mr. Holtermann
8 would show up.

9 MR. NEWMAN: Were there any minutes or
10 notes maintained of that meeting by you or anyone
11 else at McGinn Smith?

12 THE WITNESS: I'm sure.

13 MR. NEWMAN: You or -- did you
14 maintain notes of -- make notes of that meeting?

15 THE WITNESS: I believe that the
16 presentation notes are part of our record.

17 MR. NEWMAN: There was a PowerPoint of
18 some kind?

19 THE WITNESS: Yes.

20 MR. NEWMAN: You have the PowerPoint
21 for that presentation?

22 THE WITNESS: I believe so. As I've
23 indicated, Mr. Holtermann is a prolific provider of
24 information. And I'm sure I would be able to find
25 it. It's among many. I literally have a warehouse

1 full.

2 MR. NEWMAN: It's your testimony that
3 during the presentation Mr. Holtermann presented the
4 risk factors involved with this offering?

5 THE WITNESS: Yes.

6 MR. NEWMAN: Was there a discussion
7 about the financial and operational status of the
8 firm?

9 THE WITNESS: Yes.

10 MR. NEWMAN: In fact, the firm had not
11 operated at a profit?

12 THE WITNESS: All the brokers were
13 aware of that.

14 MR. NEWMAN: I'm asking you about the
15 meeting. Was that discussed?

16 THE WITNESS: I believe so, yes.

17 MR. NEWMAN: What was your involvement
18 in terms of reviewing the -- if any in terms of
19 supervisory involvement in reviewing the
20 investments?

21 THE WITNESS: In reviewing the
22 subscription documents?

23 MR. NEWMAN: Yes.

24 THE WITNESS: I reviewed the
25 subscription documents and looked for errors in any

1 information that would lead me to approve it. And
2 then approve it by initialing the subscription
3 documents.

4 MR. NEWMAN: You were the McGinn Smith
5 principal that reviewed from a supervisory
6 standpoint the investments made in Coventry?

7 THE WITNESS: That's correct.

8 MR. PAULSEN: You determined that
9 those investments were suitable for those investors
10 that you approved?

11 THE WITNESS: That's correct.

12 MR. NEWMAN: Did the offering
13 memorandum disclose the financial and operating
14 conditions of Coventry?

15 THE WITNESS: I believe so.

16 MR. NEWMAN: I reviewed it, and I
17 didn't see any disclosure in the document about
18 going concern issues, lack of profitability, balance
19 sheet. I didn't see any of that disclosure in the
20 Coventry Care Link memorandum.

21 MR. FRANCESKI: You don't have to
22 agree with that. It's not a question.

23 MR. NEWMAN: You believe that's in the
24 document?

25 THE WITNESS: I believe that

1 information was provided, yes.

2 You also used a number of times going
3 concern issue. I don't recall whether they were
4 official a going concern issue at that time.

5 MR. NEWMAN: When did -- when did
6 they -- they become a going current issue, or do you
7 know?

8 THE WITNESS: I don't know.

9 MR. NEWMAN: You knew at the time the
10 money was -- Coventry Care Link was the entity that
11 was supposed to be repaying the notes; is that
12 correct?

13 THE WITNESS: That's correct.

14 MR. NEWMAN: What happened with the
15 2003 offering of Coventry? What type of offering
16 was that?

17 THE WITNESS: That was a debt
18 offering.

19 MR. NEWMAN: How much was raised?

20 THE WITNESS: Approximately
21 \$9 million.

22 MR. NEWMAN: That was raised by McGinn
23 Smith --

24 THE WITNESS: That's correct.

25 MR. NEWMAN: -- as the underwriter?

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1 Was all the money raised?

2 THE WITNESS: Correct.

3 MR. NEWMAN: Was that money repaid?

4 THE WITNESS: It has not.

5 MR. NEWMAN: Was it a note offering?

6 THE WITNESS: Correct. It was
7 converted into preferred and common equity in the
8 CMS offering.

9 Q. BY MR. ROWEN: The 2003 offering was
10 converted through the CMS offering?

11 A. Yes.

12 MR. NEWMAN: CMS offering was in 2007?

13 THE WITNESS: No -- yes. Excuse me.
14 It was in -- losing track of the years, October
15 of 2007.

16 MR. NEWMAN: Between 2003 and 2007,
17 how much was repaid, if any?

18 THE WITNESS: None was repaid.

19 MR. NEWMAN: Was that disclosed to the
20 people who were solicited for the 2007 offering,
21 that the previous note offering had not resulted in
22 any repayment to --

23 THE WITNESS: There has been a
24 disclosure.

25 MR. FRANCESKI: Let Mr. Newman finish

1 the question.

2 MR. NEWMAN: I think I finished it.

3 THE WITNESS: I don't know.

4 MR. FRANCESKI: The question ended
5 with "to." I don't know who it was disclosed to.

6 MR. NEWMAN: Was it disclosed to the
7 2007 investors in a note offering?

8 THE WITNESS: A discussion of the
9 conversion to equity was discussed in the memorandum
10 specifically I don't -- I can't remember the
11 memorandum well enough to know if it was
12 specifically stated that it was not paid.

13 MR. NEWMAN: Do you think that's
14 something that should have been disclosed to 2007
15 investors, the previous note offering had not
16 resulted in any payments to the individuals who
17 invested \$9 million in 2003?

18 MR. FRANCESKI: I object to that. He
19 gave you the answer to that question; that it was
20 disclosed.

21 MR. NEWMAN: I don't think he did. I
22 think your answer was talking about a conversion.

23 MR. FRANCESKI: If it's converted,
24 it's not repaid.

25 MR. NEWMAN: The fact -- is it your

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1 testimony that in the 2007 offering document there
2 was disclosure to the prospective note investors in
3 that offering that the prior note investors in the
4 2003 offering for the same entity had not received
5 repayment of the \$9 million that was raised?

6 THE WITNESS: That was not testimony.
7 My testimony is I don't recall well enough the
8 prospectus whether it specifically stated that.

9 MR. NEWMAN: Do you think that's
10 something that should have been disclosed in the
11 offering document in 2007?

12 THE WITNESS: I think the discussion
13 of conversion to equity was sufficient.

14 MR. NEWMAN: You don't think it was
15 necessary to -- you don't think it was a material
16 fact that the -- the prior note investors for the
17 same entity in 2003 had not been repaid a dime by
18 the same issuer?

19 MR. FRANCESKI: I'm going to object to
20 that. He's not a lawyer.

21 MR. NEWMAN: He's a securities
22 professional and an underwriter.

23 MR. FRANCESKI: These things are
24 reviewed by lawyers. He has in-house counsel. He
25 can't comment on materiality.

1 MR. NEWMAN: I disagree.

2 MR. FRANCESKI: Answer as a
3 non-lawyer.

4 THE WITNESS: First of all, they
5 weren't not paid a dime, as you characterized it.
6 They were paid interest for at least two years.

7 In terms of the disclosure, the
8 memorandum is replete with risk and the financial
9 difficulties the company is in. It talks a great
10 deal about the acquisition, which was really what
11 the offering was primarily about, the acquisition of
12 USA, which is where the prospects and the benefits
13 of the offering resided.

14 We were purchasing a \$22 million
15 insurance company that was earning \$3 million a
16 year. That was the material fact of the offering.

17 MR. NEWMAN: My question to you, did
18 you -- do you believe it to be a material fact that
19 in terms of the 2007 offering document at that time
20 do you believe it was a material fact that the prior
21 note holders in 2003 had not received their
22 principal back for the \$9 million that was raised
23 through them?

24 THE WITNESS: I don't think it's a
25 material fact in light of what the offering was

designed to do, which was to acquire a \$22 million insurance company.

MR. PAULSEN: What was the initial length of the term of that debt offering in 2003?

THE WITNESS: I believe it was six years, but I'm not -- I can't recall with certainty. I think it was a six-year note.

Q. BY MR. ROWEN: How were the funds that were raised by this private placement used by Coventry Care Link?

A. They were used -- in this one here?

O. Yes.

A. They were used primarily for continued operations.

MR. FRANCESKI: The witness is referring to the offering that is Exhibit 3.

THE WITNESS: That's correct. The notes, the bridge loan notes.

Q. BY MR. ROWEN: Could you turn to page X of Exhibit 3, and review the bottom section which continued into page XI?

A. Okay.

Q. Who is McGinn Smith Financial Services Corp. referenced to in this section?

A. That question was raised earlier. I

1 think -- there is not entity McGinn Smith Financial
2 Services Corp. that I'm aware of.

3 Q. The section refers to a letter of
4 intent signed, received from McGinn Smith Service
5 Corp. Are you aware of this letter of intent?

6 A. I believe he means McGinn Smith &
7 Company.

8 MR. NEWMAN: Who is "he"?

9 THE WITNESS: Mr. Holtermann.

10 Q. BY MR. ROWEN: McGinn Smith & Company
11 had signed a -- had issued a letter of intent to
12 Coventry Care Link as referred to in this section?

13 A. That's correct.

14 MR. FRANCESKI: Are you sure you did
15 that, Dave?

16 THE WITNESS: Again, they have
17 requested who MS Financial is. And I'm not aware of
18 any entity MS Financial. And I'm saying it's
19 referring, I believe, to the McGinn Smith & Company,
20 who anticipated raising capital for them as
21 indicated.

22 Q. BY MR. ROWEN: Were there any other
23 ventures that have not been mentioned between
24 yourself or McGinn Smith with Coventry Care Link?

25 A. I don't believe so. When you say

1 ventures, you mean other offerings?

2 Q. Other offerings, other relationships?

3 A. No, not that I recall.

4 Q. Explain when CMS Financial Services
5 was created?

6 A. CMS Financial Services was created, I
7 believe, in early 2007.

8 Q. Why did McGinn Smith become involved
9 with Coventry, to create CMS?

10 A. We became involved because it was --
11 we had -- the company Coventry had identified a
12 prospect of acquisition. That had been the motive,
13 as I indicated earlier, by myself and other board
14 members as a way for Coventry to get the ultimate
15 platform to put their insurance program in force.
16 It had not been successful. I indicated that.

17 What we as McGinn Smith & Company were
18 concerned with is that if we made this acquisition
19 and if we raised more capital, we wanted to be able
20 to exercise more control over the entity. We felt
21 that some of the mistakes in the past that had been
22 committed by Mr. Holtermann and mistakes in our
23 judgment, by the way, not his, but ours, we wanted
24 to be in a position either through ownership or a
25 board representation or actually have someone that

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1 we felt comfortable with on the management side be
2 involved.

3 So, as part of the agreement to be further
4 involved in terms of capital raising, those were
5 some of the criteria that we laid out.

6 MR. NEWMAN: What mistakes did you
7 believe Mr. Holtermann had made?

8 THE WITNESS: I think they primarily
9 related around the marketing. I think
10 Mr. Holtermann had unrealistically attempted to do
11 two things, both of which in my judgment had not
12 been successful.

13 The first was build his own broker
14 network within. In other words, hire and train
15 brokers to ultimately act as agents, and sell these
16 policies.

17 The second mistake that he had made is
18 that they had a contracted with a outside group that
19 was to provide leads to group sales, primarily
20 through banking relationships that were purportedly
21 existed with this outside group. That had proven
22 less than fruitful. In fact, in my judgment, that
23 had not proven itself at all.

24 So, my concern and my judgment was
25 that Holtermann, who is a brilliant guy from -- and

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1 a very persistent guy, and a guy whose always been
2 successful and I ultimately believe will be
3 successful, seemed to not have a good enough grasp
4 on the marketing side.

5 So, I wanted to have some ability to
6 have, if you will, shepherd our client's money, and
7 have some, at least, input on future decisions.

8 MR. NEWMAN: He had been attempting to
9 sell this care plan or policy for several years?

10 THE WITNESS: That's correct.

11 MR. NEWMAN: And had not been
12 successful in that?

13 THE WITNESS: Only to a limited
14 extent. I would deem it unsuccessful.

15 MR. NEWMAN: Can you be specific?

16 THE WITNESS: He had sold maybe 100
17 policies.

18 MR. NEWMAN: How much money are you
19 talking about?

20 THE WITNESS: \$700,000.

21 MR. NEWMAN: Typical plan was about
22 \$7,000?

23 THE WITNESS: Typical premium, yes.

24 Q. BY MR. ROWEN: What are the functions
25 of CMS Financial Services?

1 A. CMS Financial Services is the entity
2 that now owns both the United Insurance Company and
3 Coventry Care Link.

4 Q. You mentioned your involvement on the
5 board of Coventry. What is your involvement with
6 CMS?

7 A. I presently serve as chairman of the
8 board.

9 Q. You mentioned earlier about the
10 ownership of McGinn Smith -- I'm sorry. The entity
11 was McGinn Smith Holdings had ownership of
12 9 percent?

13 A. Capital.

14 Q. Capital Holdings, which is owned by
15 McGinn Smith Holdings?

16 A. That's correct.

17 Q. What is the voting rights of McGinn
18 Smith Capital Holdings?

19 A. As part of the transaction, we agreed
20 to have various institutional clients give McGinn
21 Smith Capital Holdings proxy on their shares. The
22 reason for that, most institutional investors have a
23 strong resistance to investing alongside retail
24 customers, because when tough decisions have to be
25 made, they don't want to worry whether Dr. Jones in

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1 Albany understands or gets around to taking action.

2 So, as a way of -- quite frankly, retail
3 clients generally follow the lead of their broker or
4 their representative anyway.

5 So, we believe -- the recollection was that
6 anybody who made an investment less than \$250,000
7 would agree to give the proxy to McGinn Smith
8 Capital Holdings.

9 And, in the aggregate, I think our ultimate
10 voting ended up being around 30 percent.

11 MR. ROWEN: I would like to have this
12 marked as Exhibit 4.

13 (Confidential Private Placement
14 Memorandum was received and marked FINRA Exhibit 4
15 for identification.)

16 MR. NEWMAN: We'll take a short break.

17 (A short recess was taken.)

18 MR. ROWEN: We're back on the record
19 amount approximately 11:32.

20 Q. BY MR. ROWEN: I'm handing you
21 Exhibit 4 in this matter. This is the cover page
22 and relevant pages of a private placement dated
23 September 1, 2007.

24 Are you familiar with this private
25 placement?

1 A. I am.

2 Q. What was the status of CMS Financial
3 Services at the time of the private placement?

4 A. CMS Financial Services was a -- again,
5 a holding company, per se. It had been formed, I
6 believe, as I indicated, somewhere early in 2007,
7 January, February, March.

8 It was not an active operating company. It
9 was designed to simply acquire Coventry and the
10 United Insurance Company.

11 And at the time of the offering, the
12 primary purpose of raising the capital was to
13 acquire United Insurance Company.

14 Q. The purpose of the private placement
15 was the acquisitions?

16 A. Primarily, yes.

17 Q. Who was involved in creating this
18 private placement memorandum?

19 A. The memorandum itself was written by
20 Mr. Holtermann.

21 Q. Were you involved in creating the PPM?

22 A. In terms of creation, I was involved
23 in negotiating the terms of the agreement. I didn't
24 have any involvement in actually drafting of the
25 document.

1 Q. Who solicited sales of this private
2 placement?

3 A. The salesmen for McGinn Smith &
4 Company, those employed by McGinn Smith.

5 Q. How were these solicitations made?

6 A. Again, primarily with existing
7 accounts.

8 There was some, I believe, effort
9 institutionally. No names come to mind, but I know
10 there was some reach to small private equity firms
11 of which we were not successful, primarily due to
12 the startup nature, I think.

13 Whatever, we were not successful.

14 Q. Were you involved in making
15 solicitations of this investment?

16 A. Yes. I think -- in fact, I know I
17 was, yes. Why did I hesitate, yes.

18 Q. How was suitability determined for
19 this investment?

20 A. Suitability in this case certainly
21 risk-oriented clients. More equity-oriented clients
22 as opposed to the previous offerings, which were
23 more fixed income driven.

24 This was clearly an upside transaction, if
25 you will, that we again felt was -- if successful

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1 would be taking advantage of a long-term trend we
2 see in the health care industry, the need for it.

3 The acquisition of a company profitable for
4 22 straight years was felt was providing a platform
5 of some 2,500 independent agents that would finally
6 provide the vehicle and platform, if you will, for
7 the Coventry Care Link program to have an ability to
8 takeoff alongside the other policies that were being
9 sold by the existing agents.

10 Q. How were solicitation and placement
11 supervised at McGinn Smith?

12 A. Primarily by Andy Gazeti, head of
13 retail, and certainly in the case of the New York
14 office, Brian Mare, who is the manager down there.

15 Q. What supervision was conducted over
16 these sales?

17 A. Supervision would be that, again, the
18 brokers would be informed as to what prospect would
19 qualify. You had to have a risk-oriented client.

20 I think in all cases they were existing
21 clients of the firm. So, the broker would know his
22 customer, know whether he fits the risk profile and
23 objectives.

24 And then ultimately, when the subscription
25 agreement was complete and the questionnaire was

1 complete, there would be a review generally first by
2 the gentleman I mentioned, and ultimately I would
3 sign off on it.

4 Q. How was this product introduced to
5 your staff that were selling this product?

6 A. By meetings which Mr. Holtermann
7 attended. Some of it telephonically. And, again, I
8 know there was one meeting in Clifton Park for --
9 that's where most of our retail brokers reside and
10 one meeting in New York.

11 Q. PowerPoint presentation for this?

12 A. Yes.

13 Q. Was there e-mail correspondence
14 between yourself and Mr. Holtermann or yourself and
15 other registered persons at your firm regarding this
16 placement?

17 A. There is certainly e-mail
18 correspondence between me and Mr. Holtermann. He's
19 a guy that sends a lot of e-mails.

20 Whether it was -- I can't recall whether it
21 was specifically regarding this offering. It
22 certainly wouldn't be to your line of discussion
23 regarding sales practices, because he was not
24 involved in that process.

25 It may have been inquiries as to how it was

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1 going or questions that might have -- brokers might
2 have asked coming back whether it went directly to
3 Holtermann or me to Gazeti and I was seeking an
4 answer.

5 He was not involved in the marketing.
6 There wouldn't have been any e-mails regarding that.

7 Q. How about the development of the
8 placement in general?

9 A. When you say development, help me out
10 a little bit.

11 Q. Developing the relationship between
12 yourself and Mr. Holtermann regarding creation of
13 this private placement --

14 A. The relationship had existed for 20
15 years. There wasn't any actual development of the
16 relationship.

17 In terms of sort of the negotiations of
18 CMS, that took place over probably starting maybe in
19 November of 2006 through, again, the formation of
20 CMS in early 2007. And then throughout that whole
21 spring and summer of the -- to use your terms, the
22 development of the relationship was an ongoing
23 process as to how we would ultimately bring this
24 offering.

25 It was -- it was going down parallel paths.

1 Holtermann was negotiating with the seller of the
2 insurance company, looking to assure him there would
3 be financing available, and this thing would be
4 completed, because the seller had a strong interest
5 in making sure that happened.

6 Q. You would have ongoing e-mails with
7 Mr. Holtermann or other personnel at McGinn Smith
8 regarding CMS?

9 A. Sure. On a variety of issues. If
10 you're saying specifically with marketing, I would
11 dare say there is probably not any or a whole lot.
12 But, there are lots of e-mails from Holtermann.

13 Q. Are you involved in instance
14 messaging?

15 A. No.

16 MR. NEWMAN: Does McGinn Smith have an
17 e-mail policy?

18 THE WITNESS: Sure. In regards to
19 retention?

20 MR. NEWMAN: Yes.

21 THE WITNESS: Yes.

22 MR. NEWMAN: What is the policy?

23 THE WITNESS: They are all retained.

24 MR. NEWMAN: Does McGinn Smith allow
25 the use of personal e-mail accounts?

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1 THE WITNESS: In regard to conducting
2 business, no. Everyone in the firm has a McGinn
3 Smith -- whatever you call it -- address.

4 MR. NEWMAN: Do you use personal
5 e-mail to conduct business?

6 THE WITNESS: I do not.

7 Q. BY MR. ROWEN: How were previously
8 sold notes converted into this CMS offering?

9 A. The bridge loan notes were originally
10 designed to be paid off with the proceeds of the
11 offerings, if we raised the maximum.

12 There was also an opportunity if the note
13 holder so desired to convert his note to equity in
14 the offering.

15 That was an option available to the note
16 holder, which I believe maybe a third took advantage
17 of.

18 I'm trying to remember the numbers. Maybe
19 it was higher than that.

20 Q. How were the funds raised by this
21 private placement used by CMS Financial Services?

22 A. There were a variety of uses outlined
23 in the prospectus, which included primarily the
24 acquisition, which was the major reason for the
25 offering.

1 As I indicated, there was always fees to be
2 paid. There was part of the financing was Cohen &
3 Company, which was an investment bank that had
4 committed to raising \$15 million in trust
5 preferreds.

6 Initially it was 12 million. They
7 ultimately raised it to 15 million, which we were
8 quite happy with. Very good financing. So, there
9 was a fee due to them.

10 Honestly, there was commission fees due to
11 McGinn Smith for whatever they sold. I believe the
12 total acquisition was approximately \$21 million. 19
13 of it was for the actual acquisition. And there was
14 a million 8 for his pension retirement proceeds.
15 And then there was a lease arrangement where he
16 owned some property and that was purchased and
17 leased back.

18 And then there was -- the original
19 offering, which was at 15 million, roughly -- if we
20 had been successful in raising the whole amount,
21 roughly 7 million would have been used for working
22 capital.

23 That's the best of my recollection. It's
24 been a while since I looked at that prospectus.

25 Q. You didn't mention if 15 million was

1 raised for this, this how it was used.

2 Since 15 million was not raised --

3 A. Virtually what got sacrificed was the
4 working capital.

5 The acquisition was made. The fees were
6 paid to Cohen. There was a reserve, I believe -- I
7 think there was a million dollars reserve that was
8 supposed to be in place. My guess that either
9 wasn't funded fully or maybe not at all.

10 Our total raise was roughly \$21 million.
11 So, I mean, we were short by about \$9 million.

12 Q. When was the Cohen & Company
13 transaction -- you mentioned Cohen & Company raising
14 funds. When did that happened?

15 A. That happened concurrent with this.
16 Without them, we wouldn't have had the proceeds to
17 make the acquisition.

18 Q. What is the current status of CMS
19 Financial Services?

20 A. It's pretty good, knock on wood.

21 The underlying insurance company, USA,
22 increased their capital and surplus from
23 approximately 19 and a half million to 21 million
24 last year, increased by a million and a half.

25 The earnings were, I believe, about 2 and a

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1 half million dollars.

2 They -- sales were up about 8 percent.
3 Their investment portfolio got hit to about a half
4 million dollars. Unfortunately, they owned some
5 Lehman bonds, and that got whacked.

6 But other than that, it was a pretty good
7 year.

8 Q. What other business relations does CMS
9 currently have?

10 A. Zero.

11 Q. What are the revenues of CMS Financial
12 Services?

13 A. CMS Financial Services, per se, didn't
14 have any revenues. They are a holding entity
15 between these two. They don't have any
16 operational -- there is no operational business for
17 CMS.

18 Q. Nothing outside of the \$2.5 million
19 earned by USA last year?

20 A. That's correct.

21 Q. What additional funds have been raised
22 for CMS Financial Services?

23 A. Since this completion of the offering?

24 Q. Yes. Since that and the Cohen &
25 Company offering that you mentioned?

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1 A. Well, just so everybody is clear,
2 Cohen & Company offering was part of the capital
3 raised. It was all done and closed on the same day,
4 so we could make the acquisition. It was not a
5 subsequent or separate offering.

6 Cohen & Company offering would not have
7 happened if we hadn't raised this money and
8 conversely. And if they had not raised the money,
9 we wouldn't be able to complete the offering. They
10 were a part of the overall financing.

11 In answer to your question, we were -- when
12 this closed, which closed in October of 2007, we
13 spent another two to three months trying to raise
14 money. Things started to get really difficult out
15 there for lots of things, this including. We tried
16 lots of different ways without success.

17 Then we subsequently had a smaller
18 offering, and I don't recall the dates, but I'm
19 guessing it was probably March or April of 2008
20 where we took and tried to confine the offering just
21 to the insurance company, the acquired insurance
22 company, because we felt that -- I think Mike's
23 point earlier, there was baggage with Coventry Care
24 Link. We had liabilities, etc., etc. If we could
25 direct the investment just by selling the stock we

1 owned in the insurance company without the whole
2 thing, we would have what we thought would be better
3 luck.

4 I would say we had limited success. Best
5 of my recollection, we raised maybe another
6 \$200,000. That's the best I can recall.

7 It wasn't a lot. It wasn't what we were
8 looking for.

9 Q. Today, what is CMS Financial Services
10 ownership stake in USA Entity?

11 A. CMS owns all of the insurance company
12 and Coventry. Then other parties own pieces of CMS,
13 which I went through with you a while back.

14 And others -- these investors, the A
15 preferred, B preferred, the original stake holders,
16 McGinn Smith Capital Holdings, they are all
17 investors in CMS, but CMS owns the insurance
18 company.

19 Q. The subsequent offering that was of
20 USA --

21 A. Was being sold by CMS.

22 Q. So, the investment was in CMS, but
23 was --

24 A. CMS owned shares of USA. They were
25 then selling some of their shares in USA to raise

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1 capital. They owned the shares.

2 Q. What percentage of USA does CMS
3 currently own?

4 A. Other than the \$200,000, I guess they
5 own all of it.

6 Q. What is the status of the Coventry
7 bridge loan notes today?

8 A. The status is that we had a certain
9 number rolled over, and I believe there is
10 approximately 1.5 million left.

11 I apologize for not knowing the numbers. I
12 think it's somewhere in the 1.5 area, and they are
13 still outstanding. They have been extended. And
14 interest rate adjusted. And the owners are waiting
15 to get paid.

16 Hopefully, if they make some more, we're
17 presently looking at three other acquisitions. If
18 we are successful, those acquisitions, the capital
19 will be available to take those note holders out.

20 Q. The original notes were six-month
21 notes?

22 A. I think that's correct, yes.

23 Q. Those notes were extended?

24 A. They were extended to the last
25 extension I believe was March 31 of this year.

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1 They are presently being extended again.

2 Q. Were any funds paid during the
3 extension period? Was any interest or principal
4 paid during the extension period?

5 A. No.

6 MR. PAULSEN: In 2008 they were
7 extended for a year?

8 THE WITNESS: Yes.

9 MR. PAULSEN: Until March 31, 2009?

10 THE WITNESS: I believe so.

11 MR. PAULSEN: Payment has not been
12 made to those investors?

13 THE WITNESS: Yes.

14 MR. NEWMAN: Have there been
15 communications with those investors?

16 THE WITNESS: Yes.

17 MR. PAULSEN: Can you detail what that
18 has been?

19 THE WITNESS: Communication has been
20 basically that we're unable to pay your notes. We
21 seek an extension for another year, indicating the
22 rate of interest, which has gone to 18 percent. And
23 that's the essence of it.

24 MR. PAULSEN: Isn't that the rate of
25 interest that you gave them as part of the extension

1 in 2008?

2 THE WITNESS: I think that's right.
3 Maybe the extension number is 20 percent. I think
4 there was -- the first 14 percent, 16, I don't know.
5 There has been two extensions and two increases,
6 yeah.

7 I think I stand corrected. I think
8 it's now going forward is going to be 20 percent.

9 MR. PAULSEN: I guess at that time
10 where you were seeking their acceptance to the
11 extensions and offering 18 percent, was there
12 extension of payment?

13 THE WITNESS: Certainly. The
14 expectation was raising the equity. First guys out.
15 We haven't been able to raise the cash, not for lack
16 of trying.

17 MR. PAULSEN: Has anyone expressed
18 interest in having their capital returned?

19 THE WITNESS: I'm not aware of any
20 written communication. I would be shocked if some
21 of the investors have not conveyed to their brokers
22 that they are interested in having their capital
23 returned.

24 MR. NEWMAN: Are you aware of that as
25 a fact?

1 THE WITNESS: Yes. I think there
2 is -- there has been reference from a couple
3 brokers, I can't tell you who specific clients are,
4 but yes.

5 But, evidently, not in an aggressive
6 manner. They'll be quite happy if the equity is
7 raised and they are paid back, because of the rate
8 of return. The real question in their mind am I
9 going to get my capital back.

10 But I think the prospects of the
11 underlying company, at least by being positive and,
12 in fact, increasing year to year has given some
13 assurance that prospects are not totally dead.

14 MR. PAULSEN: You're saying CMS is a
15 profitable entity at this point?

16 THE WITNESS: I didn't say CMS. I
17 said United Insurance Company.

18 MR. PAULSEN: Of which CMS --

19 THE WITNESS: -- owns 100 percent,
20 minus the recent sales work.

21 You can't dividend that money up. The
22 insurance business is probably as tightly regulated
23 as our business. Maybe more so. You cannot
24 dividend moneys from capital surplus up to a holding
25 company without permission of the insurance

1 department.

2 And that is not feasible for us to go
3 in and take surplus, particularly in light of where
4 the insurance regulations are today. They are
5 extremely difficult. They are looking at ratings.
6 They are looking at capital surplus. Because lots
7 of cases the underlying insurance companies have
8 investments that not performing particularly well,
9 whether it be in the mortgage market or corporate
10 bond markets. They are not giving any ability for
11 you to diminish your surplus.

12 If, in fact, we did, we would find
13 further pressure on ratings and our ability to do
14 business.

15 Your ability to do business is all
16 connected with how much surplus you have. That
17 allows you to write premiums. If you take that out,
18 you don't have the ability to write premiums.

19 MR. PAULSEN: These investors are
20 investing in CMS, which is a holding company, which
21 they don't make -- they are making no money?

22 THE WITNESS: As a holding company.
23 They are not an operating company.

24 MR. PAULSEN: They are generating no
25 revenue?

1 THE WITNESS: That's correct.

2 MR. PAULSEN: And if the insurance
3 companies are generating revenues, but to the extent
4 they can not dividend up or pass through any revenue
5 up to their holding company, parent --

6 THE WITNESS: At this time.

7 MR. PAULSEN: How can you -- can you
8 please explain to me how investors potentially can
9 either be paid dividends or receive a return of
10 capital?

11 THE WITNESS: Well, they can -- let's
12 take the note holders, which seems to be the point
13 of focus that you have.

14 They are -- they can be repaid from
15 one of two ways. If we raise more equity, which was
16 always the objective, and still remains the
17 objective. We can take proceeds from that equity
18 raise and pay off our liability immediately.

19 So, if we -- and what drives the
20 ability to raise equity are two things: Performance
21 of the underlying company, and obviously the climate
22 in the investment -- in the capital markets.

23 Right now, the capital markets, I'm
24 sure you're only too aware, are not particularly
25 embracing of raising new capital.

1 So, the second way is that if the
2 earnings increased to a point that we have the
3 ability to, in effect, declare a dividend, they
4 will, in fact, get a dividend.

5 And if there is sufficient earnings
6 over and above the surplus needs they can be paid --
7 their notes can be paid in that manner.

8 MR. PAULSEN: At which point you would
9 need to receive insurance regulatory authority or
10 approval to be able to dividend those moneys up to
11 the holding company?

12 THE WITNESS: That's correct.

13 MR. PAULSEN: How does that -- then
14 you're saying that there would have to have an
15 approval to dividend to the investors. Where do
16 they differ? Where does the authority to dividend
17 up to the holding company or to the investor vary?

18 Where is it okay to dividend?

19 THE WITNESS: As I understand it, when
20 you infringe upon the capital that is required to
21 support the level of premiums that you are writing,
22 that if you go into that capital surplus --
23 generally you can dividend 10 percent without
24 regulatory authority. And, in fact, when we closed
25 this transaction, we grabbed -- not particularly

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1 artful term -- we acquired or had made available to
2 us a million 8 in dividends which was approved by
3 the insurance department.

4 That seemingly, as I understand that
5 10 percent level, is kind of an okay level. If
6 you -- to go beyond that, then you -- you always
7 need regulatory approval, but it's not going to
8 happen if it's over 10 percent.

9 We had \$18 million in surplus at that
10 time, and we took a million 8.

11 MR. PAULSEN: That was dividended up
12 to the holding company?

13 THE WITNESS: That was used for the
14 acquisition, yes. That was used to acquire as part
15 of the financing. I think quite certain that's
16 disclosed in the prospectus. It's part of the
17 sources.

18 MR. PAULSEN: I'm not following how
19 there was \$18 million in total investments of which
20 10 percent --

21 THE WITNESS: Surplus.

22 MR. PAULSEN: Of which there was
23 10 percent or approximately --

24 THE WITNESS: -- a million 8. We
25 acquired the company. Now we have the assets. They

1 belong to us.

2 In effect we took, just like if you
3 buy a company and they have cash in the bank,
4 belongs to you.

5 Acquire a company for stock and you
6 get all the assets, which include cash or whatever
7 it might be. In this case it's no different.

8 The difference is in terms of any
9 industrial company, if I buy it and they have
10 \$18 million in the bank I can take the 18 million
11 and do whatever I want -- I own the company -- if we
12 do it in a non-fraudulent way.

13 In an insurance company, they say no.
14 You've got to have a certain amount of assets in
15 surplus to support your premiums. You're concerned
16 you're able to support your policies.

17 So, you can't just go in and take it.
18 It's my understanding that you can take 10 percent.
19 I know we took 10 percent in the acquisition because
20 that's where we got million 8 came from.

21 On a going-forward basis, which I
22 think is what your question is, where are you going
23 to, in effect, get additional funds to pay these
24 notes. There are two sources. One is if we raise
25 more equity, which I went through, indicated that at

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1 the moment it's not a particular promising prospect.

2 Number 2 is if we get additional
3 revenues, add to surplus, we can get a hold of.

4 For example, the company last year
5 made an acquisition of what they call book business.
6 Another insurance company has policies on the books.
7 They don't want them.

8 I mentioned Med America that ran into
9 a 100 million dollar problem. And they are
10 scrambling around. They sell the policies. They
11 will sell the book.

12 The idea is to buy the book, generate
13 more money off the book as a return on your capital.

14 If you're successful in doing that
15 through your proper pricing, proper acquisition
16 cost, proper administration, proper holding those
17 policies in place, they don't go through attrition,
18 then you make money.

19 If you make money, you have money, to
20 answer your question, to pay people off.

21 We are in the process right now, we
22 have three different acquisitions that we are
23 talking to do, which will accomplish all those goals
24 if we're successful.

25 Those acquisitions, maybe in

1 anticipation of your question, the -- when you
2 acquire an insurance company, just like we did, you
3 sometimes get their capital, which you can use for
4 the acquisition.

5 We paid 1.1 times books for that. We
6 literally bought that company for the cash that they
7 had. That's great.

8 When you say why does a seller do
9 that? Where does he get his liquidity. He can't
10 get the cash. The insurance department wouldn't let
11 him have it, so you has to sell it. He sells it for
12 literally cash.

13 MR. PAULSEN: When you're saying
14 acquisition, you're acquisitions by USA?

15 THE WITNESS: That's correct. Good
16 point. That's exactly right.

17 MR. NEWMAN: 2003 Coventry raises
18 \$9 million in a note offering?

19 THE WITNESS: Correct.

20 MR. NEWMAN: That money is to be used
21 to acquire an insurance company --

22 THE WITNESS: No. In 2003, the money
23 was raised to, in effect, develop the insurance
24 product, build a sales force, and, in effect, build
25 the company.

1 That didn't go particular well.

2 Somewhere in 2005 or 2006 the board
3 concludes that this approach to try to build it and
4 they will come ain't working.

5 I suggested, and other board members
6 agreed, we have a great product here but you're not
7 selling it. Let's look at finding an acquisition
8 that has agents in place.

9 USA has 2,500 agents. How long would
10 it take us to build 2,500 agents? A long time.

11 So, that was the strategy. They spent
12 roughly a year, year and a half identifying the
13 target, the company that is for sale, and we would
14 be able to finance and ultimately acquire.

15 That was the one that happened.

16 We then identified the target and said
17 how do we get it financed? We go through a process
18 of getting it financed. The two primary vehicles
19 were trust preferred, which Cohen & Company
20 underwrote, \$15 million and McGinn Smith's 15
21 million of equity, which they raised six.

22 MR. NEWMAN: The 2003 note holders,
23 what were they told would be the source of repayment
24 for the \$9 million?

25 THE WITNESS: Basically they are now

1 stock holders and they are preferred shareholders
2 and there are common shareholders.

3 MR. NEWMAN: What were they told in
4 2003?

5 THE WITNESS: They were told that the
6 primary source of repayment would probably be
7 through refinance, as the company grew, we would be
8 able to go to the market and raise capital, equity
9 wise or debt wise.

10 MR. NEWMAN: The future offering was
11 going to be repayment of the notes?

12 THE WITNESS: Based on the growth and
13 earnings of the company.

14 MR. NEWMAN: The second note offering
15 raises about over \$2 million?

16 THE WITNESS: 2 something. Maybe as
17 high as 3. I think --

18 MR. NEWMAN: Roughly \$11 million in
19 total. How much in the third -- CMS how much new
20 money is raised? Not talking about money rolled
21 over.

22 THE WITNESS: Not counting the
23 rollover, about 4 million, maybe a little more. I
24 think one and a half to 2 million was the rollover.

25 MR. NEWMAN: Roughly 2 and a half

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1 million was infused through two different deals
2 essentially, right?

3 And have any of the note holders,
4 investors in any of the three deals received
5 repayment of principal?

6 THE WITNESS: No.

7 MR. NEWMAN: Have they received any --
8 any dividend payment?

9 THE WITNESS: Yes.

10 MR. NEWMAN: How much total?

11 THE WITNESS: Well, the original
12 \$9 million had a 12 percent coupon on it. I believe
13 that was paid through three years, two and a half to
14 three years.

15 The second note holders, roughly 2 to
16 \$3 million, the number I can't remember, I believe
17 were paid for the first year. But that was -- it
18 was reserve. It was -- you know part of the
19 offering I think we served money to meet their
20 interest payments. I would have to review it.

21 MR. NEWMAN: I'm talking about actual
22 payment?

23 THE WITNESS: It's actual payment.
24 They were paid.

25 MR. NEWMAN: These are the second note

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1 holders?

2 THE WITNESS: I believe -- the best of
3 my recollection. That one I'm a little foggy on.

4 MR. NEWMAN: How much has actually
5 been repaid in real money, not future shares and
6 preferred shares and rollover? How much money have
7 people gotten back?

8 THE WITNESS: 12 percent for three
9 years is about 36 percent of your capital for the
10 first guys.

11 If you're talking about money paid
12 back, it's not capital. It's interest. Obviously
13 there is a difference.

14 In terms of money they got back, it's
15 probably around 30, 36 percent.

16 Again, without being repetitive and
17 redundant, these bridge loan guys, I can't recall if
18 they got money or not. Some reason I think it was
19 accrued until maturity, so they wouldn't get paid.
20 I would have to review that.

21 Q. BY MR. ROWEN: Now, the CMS offering
22 was the offering that the bridge loan note holders,
23 many of them converted into?

24 A. That's correct.

25 Q. How did the 2003 note holders convert

1 their funds into the stocks that you mentioned
2 earlier?

3 A. They were given an exchange document
4 of which they agreed to and signed.

5 MR. NEWMAN: When was that?

6 THE WITNESS: Well, it was prior to
7 October of 2007. I would guess it was probably in
8 July.

9 MR. NEWMAN: Was there any disclosure
10 in the company of that form?

11 THE WITNESS: Sure. We indicated what
12 we were doing. By that time the note holders had
13 been in default. This was their, in our judgment
14 and presumably in theirs, the best opportunity to
15 get paid.

16 Their notes ran to Coventry.
17 Coventry, as we discussed, was not performing. The
18 prospects of acquiring the insurance company were
19 promising and have, in fact, proven to be promising.
20 The note holders made a decision to convert. And I
21 think it was a good decision.

22 MR. NEWMAN: What was the name of the
23 document you referred to that was sent to them that
24 was getting them to convert?

25 THE WITNESS: Exchange agreement.

1 Q. BY MR. ROWEN: Could you please turn
2 to page 105 of Exhibit 4, and read the bottom
3 paragraph.

4 A. So done.

5 Q. Can you please describe the subscriber
6 relief condition with respect to the Connecticut tax
7 plan disclosure?

8 A. The release condition was propagated
9 by myself designed to protect McGinn Smith &
10 Company. Really had virtually no relevancy to the
11 investor.

12 It was designed because having been in the
13 business 28 years, seeing the increasing litigation,
14 I didn't want to see in two years a client come back
15 to me and say, well, I really made the investment
16 predicated on the Connecticut tax credit, and I know
17 you disclosed in the memorandum there was a chance
18 it might not happen. But I didn't read that. And
19 your broker didn't tell me that. So I want to
20 rescission.

21 I said to Holtermann, we need to have a
22 provision that if that incident comes up, I can pull
23 this little piece of paper out of my file and say to
24 the plaintiff's lawyer, client didn't read it?
25 Here's the signed document that says he not only

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1 read it, that he agreed he wasn't making the
2 decision predicated on the Connecticut tax credit.

3 The real world, the real world in October
4 of 2007 it is very important for us to get this
5 closing for lots of reasons, not the least of which
6 of all my former investors, the 4 million, all of
7 which that's the source of repayment.

8 The company, in the meantime, has increased
9 their surplus by over a million dollars. So, if I
10 don't close on the due date, I know it's going to
11 cost me another million bucks, minimum.

12 MR. FRANCESKI: The company meaning?

13 THE WITNESS: The seller is going to
14 want another million dollars. It's accrued in his
15 account.

16 I also known there are penalties that
17 are substantial if we don't close on the due date.

18 At which point I make the decision I
19 will take more risk on myself to get that done.

20 So, as mostly the investors were the
21 note holders rolling over were all coming in very
22 late, knowing that I'm not going to get this letter
23 of -- addendum regarding the Connecticut tax credit
24 and get an agreement back in three days, it doesn't
25 happen in our world. You can send it out, but it

1 didn't happen.

2 I made a decision to make a negative
3 consent. Therefore, I put the firm, in my
4 judgement, probably at more risk if somebody wants
5 to rescind.

6 But the judgment is it has no impact
7 on the client. The client understood the
8 Connecticut tax credit was not likely to happen, and
9 it wasn't going to happen in three days. So, we
10 chose to do a negative consent.

11 So, the paragraph that you referred
12 to, which suggestions that we want a written consent
13 was, in fact, changed to a negative consent.

14 In other words, if you don't want it,
15 you have the right to call us and say no.

16 Nobody was going to do that, because
17 they were well aware of the situation anyway. And
18 they made the decision to invest. I was -- I was
19 trying to get the deal closed. That's the bottom
20 line.

21 I took additional risk.

22 Q. BY MR. ROWEN: How much time was given
23 to give the investors this document?

24 A. The negative consent?

25 Q. Yes.

1 A. I believe a letter went out on the
2 third. Approximately six days, maybe five days.

3 MR. NEWMAN: How was the letter sent?

4 THE WITNESS: Mail.

5 MR. NEWMAN: Certified, overnight?

6 THE WITNESS: No.

7 MR. NEWMAN: Did you get proof it was
8 actually mailed?

9 THE WITNESS: We've been asked that
10 and we don't. It was mailed out and we didn't --
11 there was no cover letter with it. The letter
12 itself in my judgment didn't need a cover letter.
13 It was self-explanatory. And we don't send things
14 certified. It was part -- it was part of the
15 prospectus. And we don't send prospectuses
16 certified.

17 MR. NEWMAN: Time was of the essence.
18 Why wasn't it sent overnight?

19 THE WITNESS: Really wasn't -- time
20 was of the essence if I needed to get them back. My
21 experience tells me that wasn't -- that wasn't going
22 to happen. I'm going to -- I made the decision not
23 to do it that way.

24 MR. NEWMAN: You didn't care what the
25 response was going to be?

1 THE WITNESS: I did care, because the
2 risk is mine. That's where the care is.

3 I've now taken out one of the
4 safeguards that I insisted Holtermann put in. I've
5 reduced it from a written consent to a negative
6 consent. So, if I'm faced with a situation that I
7 explained a few moments ago where I'm in a
8 litigation, I got a stronger hand if I can say to
9 the plaintiff's attorney you're guy not only said he
10 read it, now I have to say I never heard back from
11 him. What's the plaintiff's attorney going to say?
12 Well, how do I know the guy got the letter and read
13 the last paragraph. It was a pretty lengthy piece.
14 Pick your poison.

15 It was a risk that I basically chose
16 to take because I weighed it against not closing the
17 deal. It was a good business decision. I stand by
18 it.

19 MR. NEWMAN: You didn't think it was
20 important what the disclosure was to the people?

21 THE WITNESS: I don't think it matters
22 a lick to him.

23 MR. NEWMAN: It wasn't a material term
24 of the offering?

25 THE WITNESS: That's my opinion.

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1 MR. NEWMAN: It was -- it was
2 highlighted in the original --

3 THE WITNESS: Maybe. But my answer is
4 I don't see what relevancy it has to the customer.
5 He knows that the deal may or may not happen.
6 It's -- the prospectus is replete with discussion of
7 it. It was discussed by the broker.

8 So, the fact that he says I read it,
9 over a two-day period is irrelevant. It was all
10 done for my protection. And I did it for the very
11 reasons I disclosed, because I've been down this
12 road too many times.

13 You can have the best prospectus in
14 the world with all the disclosures and guys tell you
15 they didn't read it and somehow that's okay, so --

16 MR. NEWMAN: I'm -- in terms of that
17 response you've given us, you have in the -- this
18 was -- this was a term of the offering in which you
19 specifically provided in the disclosure document
20 there could be written consent -- depending on the
21 status of the tax credit, there would be a written
22 consent opportunity. It was deemed to be
23 significant enough to have attached a written
24 consent provision which is based on your
25 experience --

1 THE WITNESS: Protection for me.

2 MR. NEWMAN: Important enough to
3 highlight it in that manner for the customer?

4 THE WITNESS: It was for me. Not the
5 customer.

6 MR. NEWMAN: It was not important for
7 the customer, that's your determination?

8 THE WITNESS: Yes. How can it be
9 relevant to the customer? It's not.

10 MR. PAULSEN: It's not relevant to the
11 investor?

12 THE WITNESS: No. Why? That he's
13 read and -- you know he's read it. He signed the
14 subscription agreement that he read the prospectus.
15 All I was trying to do was say, look, pal, if I
16 see -- don't tell me you -- I didn't know about this
17 Connecticut thing, because I have a written
18 statement from you that you made the decision not
19 based on the Connecticut tax agreement.

20 I don't have that any more. I have a
21 negative consent. And clearly would have my
22 attorney argue it until the cows come home, but I
23 would be better off if I had the written statement.

24 I chose to take that risk. And I
25 would do it, because it's right. If the deal is not

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1 closed, I have lots of people -- a lot of people to
2 potentially blow out. That's a judgment that you
3 make all the time. That's one that I have
4 absolutely no reservations about having made.

5 Q. BY MR. ROWEN: Did you consult with a
6 legal opinion regarding this modification or this
7 change of terms?

8 A. I discussed it with my in-house
9 attorneys.

10 MR. FRANCESKI: Careful about what you
11 say. The fact of the discussion is fine, but not
12 the rest.

13 MR. NEWMAN: Did you receive a written
14 opinion from an attorney saying this was consistent
15 with, for example, securities laws?

16 THE WITNESS: No.

17 Q. BY MR. ROWEN: I'd like to discussed
18 107 & Associate?

19 A. Yes.

20 Q. We've gone into the ownership of 107
21 Associates and control.

22 Who makes the financial decisions of 107
23 Associates?

24 A. Basically, the same people who own it.
25 MS Holdings owns it, but MS Holdings is owned by

1 Dave Smith, Tim McGinn and Tom Livingston.

2 Q. Why was it formed?

3 A. It was formed to make investments,
4 various investments. This was the first and so far
5 is the only.

6 There had been another consideration when
7 the thing was formed. I believe it was formed back
8 in maybe March of 2007 or 2006 in anticipation of
9 another investment we did not make.

10 We had the vehicle and used that to make
11 this investment.

12 Q. To date 107 Associates has not no
13 other investments?

14 A. That's correct.

15 Q. What funds does the organization have,
16 does 107 Associates have?

17 A. They don't have any revenue source.
18 Just funds put in by myself and the owners and
19 entities.

20 Q. Who were the official signatories on
21 accounts of 107 Associates?

22 A. Well, I certainly am. Potentially
23 Dave Reis for a combination of banking purposes, but
24 I don't know for a fact.

25 Possibly Tim McGinn, but I don't know that

1 for a fact.

2 MR. NEWMAN: Is 107 Associates an LLC
3 or corporation?

4 THE WITNESS: LLC.

5 MR. NEWMAN: It's a New York LLC?

6 THE WITNESS: Correct.

7 MR. NEWMAN: What was your involvement
8 in its formation?

9 THE WITNESS: I'm a principal of MS
10 Holdings. Our attorneys formed it, drew it up.

11 MR. NEWMAN: At whose direction?

12 THE WITNESS: The principals'
13 direction, Mr. McGinn, Mr. Smith and Mr. Livingston.

14 MR. NEWMAN: Does 107 Associates have
15 a bank account?

16 THE WITNESS: I believe so.

17 MR. NEWMAN: Where is the bank
18 account?

19 THE WITNESS: That would be at M & T.

20 MR. NEWMAN: You said you're a
21 signatory on the account?

22 THE WITNESS: Usually the way it
23 works. I can't imagine anyone else. I can't
24 imagine that I'm not on it. The others I've
25 indicated may or may not be on it.

1 Q. BY MR. ROWEN: What other business do
2 you anticipate 107 Associates conducting?

3 A. Right now, zero.

4 Q. Where are the books and records of 107
5 Associates kept?

6 A. 99 Pine Street.

7 MR. NEWMAN: What books and records
8 would there be besides --

9 THE WITNESS: There wouldn't be.

10 MR. NEWMAN: Articles?

11 THE WITNESS: There is no revenues.
12 No expenses. So, bank statements, but there is the
13 corporate records and the -- that would be it.

14 Q. BY MR. ROWEN: When was 107 Associates
15 funded?

16 A. I believe it was funded in probably
17 September of 2007.

18 MR. PAULSEN: Do you know the
19 breakdown of that funding, who may have invested?

20 THE WITNESS: I do. Entity owned by
21 Mr. McGinn and myself invested a half million
22 dollars.

23 MR. NEWMAN: What is the name of that
24 entity?

25 THE WITNESS: Mr. Cranbury.

1 MR. PAULSEN: I'm not following that?

2 THE WITNESS: He asked me the name of
3 the entity.

4 MR. PAULSEN: That's a half million
5 dollars?

6 THE WITNESS: That's correct.

7 MR. NEWMAN: What is the nature of
8 that? Is that a corporation or LLC?

9 THE WITNESS: That's an LLC also, I
10 believe.

11 MR. NEWMAN: It's you and Mr. McGinn?

12 THE WITNESS: Correct.

13 MR. NEWMAN: When was that form,
14 Mr. Cranbury?

15 THE WITNESS: Three years ago maybe.

16 MR. NEWMAN: What business has
17 Mr. Cranbury conducted by owning a portion of this
18 107 Associates?

19 THE WITNESS: They make various
20 investments. We contributed our -- some of our
21 common stock in ISG and made various investments.

22 MR. NEWMAN: What other investments?

23 THE WITNESS: Some of it public
24 companies. Some of it bridge loan financing.
25 Mr. McGinn conducts it.

1 MR. NEWMAN: You don't know what
2 investments Mr. Cranbury has made besides 107
3 Associates?

4 THE WITNESS: They've made some
5 investments in public companies. And made some
6 investments in -- I think they made an investment in
7 TDM Verifier. They made an investment in -- I'm
8 having a senior moment. It's a \$3 million
9 investment in a company that does tracking of -- in
10 commercial buildings of -- sets up a program
11 software system for firemen and people to come into
12 and locate where there are positions of stress --
13 Zytech. Excuse me.

14 MR. FRANCESKI: If you have answers --
15 Tim knows this better.

16 MR. NEWMAN: You're a signatory on the
17 Cranbury account?

18 THE WITNESS: I believe so. But Tim
19 runs the account. I would guess I'm a signatory.

20 MR. NEWMAN: M & T bank account?

21 THE WITNESS: Again, if I'm a
22 signatory, that's where it is. That's the bank we
23 use.

24 MR. NEWMAN: Who else besides
25 Mr. Cranbury?

1 THE WITNESS: There is one other
2 possibility. It might be at the Mercantile Bank,
3 which is another bank we use. Again, it's in Tim's
4 direction.

5 MR. PAULSEN: Where are the records
6 for Mr. Cranbury maintained?

7 THE WITNESS: 99 Pine Street.

8 MR. NEWMAN: So, besides the \$500,000
9 from Mr. Cranbury --

10 THE WITNESS: Another company called
11 HSK put in a million dollars.

12 MR. NEWMAN: Who is HSK?

13 THE WITNESS: It's a corporation out
14 of Binghamton, New York run by two brothers, Bud and
15 Milt Kaufman, Milton.

16 MR. PAULSEN: To your knowledge, are
17 the Kaufmans the only owners of HSK?

18 THE WITNESS: I don't know that. I
19 think that's the case.

20 MR. PAULSEN: Do you have any
21 ownership in HSK?

22 THE WITNESS: I do not.

23 MR. NEWMAN: To your knowledge, does
24 Mr. McGinn or any other associates of McGinn Smith
25 have ownership in HSK?

1 THE WITNESS: They do not.

2 Q. BY MR. ROWEN: What is the
3 additional -- where did the additional funding --

4 A. Additional funds came from some of the
5 investment funds, the funds, First Independent,
6 First Excelsior, those funds.

7 I think in the aggregate, they invested
8 \$2 million, which was -- bring a total to 3 and a
9 half million dollars.

10 Q. What is the nature of these
11 investments, stock?

12 A. No. They are notes with equity
13 conversion, if so desired.

14 The HSK is a pure note.

15 MR. NEWMAN: Who negotiated that note?

16 THE WITNESS: Myself and Mr. Kaufman.

17 MR. NEWMAN: Have they received back
18 any money from this investment?

19 THE WITNESS: Yes.

20 MR. NEWMAN: How much?

21 THE WITNESS: They have been paid
22 interest. No capital.

23 MR. NEWMAN: What was the interest
24 they received?

25 THE WITNESS: Interest has been an

1 ongoing negotiation. It's probably averaged
2 14 percent. It's presently at 8 percent.

3 MR. PAULSEN: Would that be reflected
4 in the records of 107 Associates, those payments?

5 THE WITNESS: Some of them. Some of
6 them were paid by personal funds of Mr. McGinn and I
7 because we had no source of income at 107
8 Associates. We have kept him current.

9 MR. PAULSEN: Those payments -- you're
10 saying they were made out of your personal accounts?

11 THE WITNESS: They were -- I think
12 variety of accounts.

13 The original intent was to sell
14 sufficient units to pay him back. That hasn't
15 happened.

16 MR. NEWMAN: Why weren't these moneys
17 invested directly? What was the purpose of using
18 107 Associates as an intermediary to make these
19 investments from --

20 THE WITNESS: Because they are notes.
21 They weren't equity investments. There was no debt
22 investment at CMS. It's an equity investment.

23 MR. NEWMAN: I don't understand that.
24 Am I missing something? Why --

25 THE WITNESS: We borrowed the money to

1 make the equity investment. We borrowed the money
2 from the various entities I outlined for you.

3 MR. PAULSEN: 107 Associates entered
4 into notes with these parties, and then used that
5 equity to invest in CMS?

6 THE WITNESS: That's correct.

7 MR. PAULSEN: Was there a note between
8 Mr. Cranbury and 107 Associates?

9 THE WITNESS: Yes.

10 MR. PAULSEN: Am I correct in saying
11 there was a note with Mr. Cranbury, a note with HSK,
12 and a note from -- one more of those income
13 producing --

14 THE WITNESS: That's correct.

15 MR. NEWMAN: The idea was infuse 3
16 point something million dollars. Was there any
17 consideration given to having them directly invest
18 in the offering?

19 THE WITNESS: They didn't want to
20 invest --

21 MR. NEWMAN: That includes you and
22 your partner?

23 THE WITNESS: We already have a
24 substantial investment in the company. So, yes.

25 MR. NEWMAN: \$2 million was invested

1 from these other -- the other note offerings. I
2 thought you testified earlier one of the ways it was
3 contemplated either through loans or through direct
4 investments. Why is it necessary to use 107
5 Associates as an intermediary between the note
6 holders for these four offerings --

7 THE WITNESS: Because they wanted to
8 make a debt investment. Not an equity investment.
9 There was no debt investment available from CMS.

10 MR. NEWMAN: In the terms of the
11 offering for the note, the three or four note
12 offerings, there was no contemplation of a potential
13 equity offering?

14 THE WITNESS: They can, but the fact
15 is the essence of those funds are notes, fixed
16 income. You have to have the preponderance of your
17 investments in interest-bearing securities to be
18 able to pay interest. You can't make equity
19 investments and have the ability to make interest
20 payments.

21 So, there are limited equity
22 investments. The preponderance of your investment
23 has to be interest bearing. That's how you get your
24 cash flow to pay your notes.

25 MR. NEWMAN: These note investors in

1 terms of how they would get repaid, did the offering
2 documents describe the potential investors as being
3 the preponderance of debt-related investment versus
4 equity investments?

5 THE WITNESS: The description of the
6 investment ran the gauntlet that basically they
7 could be invested in notes, mortgages, leases,
8 equities, options, virtually any part of the capital
9 market one wanted to attempt to derive income from.

10 MR. NEWMAN: Why did Mr. Cranbury make
11 investment directly in CMS as opposed to 107
12 Associates as a vehicle?

13 THE WITNESS: They didn't want to make
14 an equity investment. They wanted to make a debt
15 investment.

16 Q. BY MR. ROWEN: 107 Associates was
17 taking these funds and investing it in equity. How
18 do they anticipate being able to payout these notes
19 with Mr. Cranbury, HSK and the --

20 A. Anticipated by being able to resell
21 their equity investment at CMS.

22 Q. Anticipated liquidity in CMS that 107
23 Associates would be able to sell?

24 A. That CMS would find investors to buy
25 their investment in CMS, yes -- 107 Associates would

1 find investors to buy their investment in CMS.

2 MR. ROWEN: At this time I would like
3 this marked this as Exhibit 5.

4 (Subscription Agreement was received
5 and marked FINRA Exhibit 5 for identification.)

6 MR. NEWMAN: At the time this
7 \$2 million is put in from the note offerings into
8 CSM through the 107 Associates vehicle, what was the
9 status of the notes themselves? I think --

10 THE WITNESS: They are all current.

11 MR. NEWMAN: As of the time of the
12 investment?

13 THE WITNESS: Yes.

14 MR. FRANCESKI: I think you two
15 understand which notes you're talking about, but can
16 we clarify, since we have several different levels
17 of notes going on?

18 THE WITNESS: I believe he's referring
19 to the notes of the LLCs.

20 MR. NEWMAN: Right.

21 MR. PAULSEN: Four of them
22 collectively: First Independent, First Excelsior,
23 First Albany and First Advisory?

24 THE WITNESS: They were all current.

25 MR. PAULSEN: You stated that there

1 was a total of \$2 million invested by these four
2 LLCs.

3 Was it -- was investment by each the
4 same or did that vary?

5 THE WITNESS: That varied. Not a
6 great deal. It wasn't a half million in each. It
7 might have been 700 in one and -- I think two of
8 them were a half a mil, and the two others had some
9 variations.

10 Q. BY MR. ROWEN: I'm handing you
11 Exhibit 5. This is a copy of CMS Financial Service
12 Corporation subscription agreement and questionnaire
13 for 107 Associates.

14 Are you familiar with this document?

15 A. Yes.

16 Q. Who was involved in the decision to
17 invest this money in the CMS offering?

18 A. Myself, Mr. McGinn and Mr. Livingston.

19 Q. We earlier discussed the suitability
20 of this product would be for entities or individuals
21 looking to -- that were looking to take on risk or
22 willing to take on risk.

23 I guess I'm looking to find out you
24 anticipated being able to sell this product in order
25 to pay back the note holders.

1 In making the decision to purchase this
2 product, did you take into account the risk?

3 A. Yes. I sure did. I'm recognizing it
4 right today.

5 Q. I'm confused as to the suitability of
6 the product towards someone willing to take risk and
7 your entity 107 Associates bought the stock in this
8 with borrowed funds that they would need to pay off?

9 A. That's right. The risk -- the risk of
10 107 Associates has a liability. Who's 107
11 Associates. It's Mr. McGinn, Mr. Smith and
12 Mr. Livingston.

13 I would argue I'm suitable to take on the
14 risk. Mr. McGinn is suitable and Mr. Livingston is
15 suitable to take on the risk.

16 Q. What additional benefits did you
17 receive as a result of this investments?

18 A. Personally?

19 Q. Yes.

20 A. The only personal benefits I got is I
21 got my investors protected by getting the deal
22 closed. It was helpful in providing sufficient
23 equity to get the deal closed.

24 No personal benefit.

25 Q. What was your awareness of the amount

1 of funds that had been raised and needed to be
2 raised in order to get the deal closed at the time
3 of the investment was made?

4 A. I don't know when we made that
5 decision. But it certainly was fairly late in the
6 game, if you will.

7 Probably certainly somewhere in September,
8 the offering was not going as one had hoped. And we
9 were looking at a deadline and trying to find ways
10 to get the transaction closed.

11 So, we were willing to assume some of that
12 risk.

13 Q. What payments has 107 Associates
14 received back from either CMS or Coventry Care Link?

15 A. Zero. The investment in CMS calls for
16 a preferred stock that accrues at a 7 percent
17 dividend. There is -- nobody invested in CMS has
18 received anything back.

19 Q. Have you received any payments
20 individually or through any entity, including McGinn
21 Smith affiliates, from CMS?

22 A. No. Other than commissions. I guess
23 you assume that. Right?

24 MR. NEWMAN: 107 Associates issued
25 notes to the -- these different entities?

1 THE WITNESS: That's correct.

2 MR. NEWMAN: How many notes were
3 issued?

4 THE WITNESS: Six, four entities,
5 Mr. Cranbury and HSK.

6 MR. NEWMAN: Were any disclosure
7 documents used in connection with the notes? Any
8 written disclosure given?

9 THE WITNESS: It's all -- other than
10 HSK, all the parties are the same parties.

11 Did I issue a disclosure document to
12 myself, no.

13 MR. NEWMAN: There was \$2 million put
14 in, from the --

15 THE WITNESS: I'm the managing member
16 of those funds, yes. I was well -- I'm well aware
17 of the risk and what the investment was.

18 MR. NEWMAN: I'm asking you whether or
19 not there was any disclosure document that was used
20 in connection with the notes, for 107 Associates?

21 THE WITNESS: No.

22 MR. NEWMAN: Did you receive any
23 opinion or -- legal opinion whether or not the notes
24 were secured or subject to any exemption from
25 registration, the notes issued by 107 Associates?

1 THE WITNESS: No. Private placement
2 done with all accredited investors. Clearly
3 qualified for an exemption.

4 MR. NEWMAN: All the investors in the
5 four note offering, First Independent, First
6 Excelsior, First Albany, First Advisors, they were
7 all accredited investors?

8 THE WITNESS: Yes.

9 MR. NEWMAN: You believe that was a --
10 as a -- I'm not sure how to describe your role, your
11 advisory role, principal role you felt that was a --
12 an investment in 107 Associates which was
13 essentially a shell, that was a prudent investment,
14 a suitable investment for the note holders?

15 THE WITNESS: Yes.

16 MR. FRANCESKI: I object to the
17 characterization, a shell.

18 You go on and answer.

19 THE WITNESS: The answer is yes. I
20 anticipated that the return of those notes would be
21 approximately 15 percent in what I anticipated the
22 ability to resell the notes in a three-month period.
23 That has not worked out that way, but it was my
24 anticipation.

25 MR. NEWMAN: 107 Associates has not

1 made any payments to the note holders other than
2 HSK?

3 THE WITNESS: That's correct. That is
4 not correct. I apologize. Because the --
5 Mr. Cranbury hasn't received any. But the notes
6 were made payments through I believe February
7 of 2008.

8 MR. FRANCESKI: The LLCs?

9 THE WITNESS: He's asking me investors
10 which are the respective LLCs, have they received
11 interest. The answer is yes, they received interest
12 through February of 2008 when the notes were first
13 designed to mature.

14 MR. NEWMAN: I'm talking about actual
15 payments?

16 THE WITNESS: Yes.

17 MR. NEWMAN: They have actually been
18 paid?

19 THE WITNESS: Yes.

20 MR. NEWMAN: How much have they been
21 paid?

22 THE WITNESS: I don't know. The
23 number was around the 15 percent number.

24 MR. NEWMAN: Has Mr. Cranbury received
25 any payments on its note?

1 THE WITNESS: That I don't know. I
2 don't know if they received interest or not.

3 MR. NEWMAN: You don't know if you --
4 you got any money back from 107 Associates?

5 THE WITNESS: That's correct.

6 MR. NEWMAN: You're paying yourself
7 back. You don't know if you paid yourself back any
8 money?

9 THE WITNESS: Right.

10 MR. NEWMAN: How would you determine
11 that?

12 THE WITNESS: I'd look at the books
13 and records.

14 MR. NEWMAN: Of what company?

15 THE WITNESS: Mr. Cranbury.

16 MR. PAULSEN: Did you characterize the
17 investments made by the six entities in 107 as a
18 note offering?

19 THE WITNESS: Yes.

20 MR. PAULSEN: Or private placement I
21 think you said.

22 THE WITNESS: Yes.

23 MR. PAULSEN: Which to your belief did
24 not require a registration because of the investors
25 that were involved?

1 THE WITNESS: Not only because of the
2 investors. The fact if you have under ten
3 investors, you don't even have to file.

4 MR. PAULSEN: Was there fees generated
5 by that placement? If so, who were they received
6 by?

7 THE WITNESS: There were not.

8 MR. PAULSEN: The total amount
9 received by 107 Associates was in turn made as an
10 equity investment in CMS?

11 THE WITNESS: Yes.

12 MR. NEWMAN: Those were the private
13 securities transactions?

14 THE WITNESS: I'm sorry.

15 MR. NEWMAN: Was it a private
16 securities transaction?

17 THE WITNESS: Yes.

18 MR. NEWMAN: Was that disclosed
19 consistent with NASD Rule 3040?

20 THE WITNESS: I would have to defer to
21 my attorney on that, but I believe so. You might
22 have to define 3040 for me.

23 MR. NEWMAN: You're not familiar with
24 Rule 3040?

25 THE WITNESS: In terms of disclosure.

1 It's my understanding that a private placement of
2 ten investors does not have to be filed, as well as
3 those investors are accredited and sophisticated,
4 which they are. HSK is probably worth a billion
5 dollar.

6 MR. NEWMAN: You're talking about the
7 registration. I'm talking about -- selling away,
8 are you familiar with that term, private --

9 THE WITNESS: Selling away, I'm
10 familiar with that. I don't see the relative --
11 selling away, if you're -- my understanding is
12 you're, as a registered broker in our case McGinn
13 Smith you're selling someone else's product and
14 receiving commissions for it. I don't see how that
15 is relevant here at all.

16 Q. BY MR. ROWEN: Could you please review
17 Exhibit 4 again, and review the first paragraph of
18 page 107 of the CMS Financial Services Corporation
19 PPM?

20 A. Yes.

21 Q. How did you consider whether 107
22 Associates's investment was consistent with this
23 disclosure?

24 MR. FRANCESKI: Which disclosure?

25 MR. ROWEN: First paragraph of page

1 107.

2 A. It states that purchases of the
3 securities may be made by the placement agent and
4 its officers, which is obviously me and Mr. McGinn
5 and Mr. Livingston.

6 And they are in effect the three owners of
7 107 Associates. And they are purchasing securities.

8 Q. Did you obtain the opinion of counsel
9 as to whether or not this can be considered -- the
10 investment of 107 Associates could be considered a
11 bona fide sale?

12 A. I did not.

13 Q. What consideration was made or what
14 discussions were had where you were involved in
15 regarding whether the investment of 107 could be
16 considered a bona fide sale as a true new
17 investment?

18 A. I guess the discussion is that the
19 logic would suggest if the three principals of the
20 placement agent are the same principals of 107
21 Associates, and that the offering allows the
22 placement agent to make the investment, I can't
23 possibly understand why there would be any question
24 as to why that would not be proper.

25 They are the same people. They are the

1 same entity. We own 100 percent of it. So, there
2 is no other parties involved. It's the same three
3 parties. The placement agent and the same three
4 parties of MS Holdings and the same three parties of
5 107 Associates.

6 I didn't deem that that process required
7 opinion of counsel to make that determination.

8 Q. Could you please turn to page 105 and
9 review the fourth paragraph from the top.

10 A. Yes.

11 MR. ROWEN: I would like to have that
12 marked Exhibit 6.

13 (Certification to Escrow was received
14 and marked FINRA Exhibit 6 for identification.)

15 Q. BY MR. ROWEN: I'm handing you
16 Exhibit 6. This is a copy of CMS Financial Services
17 corporation certification to escrow agent that all
18 terms of the offering had been met.

19 MR. ROWEN: At this time I would like
20 to have this marked as Exhibit 7.

21 (Letter Dated December 27, 2007 was
22 received and marked FINRA Exhibit 7 for
23 identification.)

24 Q. BY MR. ROWEN: I'm handing you
25 Exhibit 7 in this matter. This is a copy of CMS

1 Financial Service Corp.'s memo dated December 7,
2 2007 confirming the extension of the CMS Financial
3 Services offering.

4 Why was this offering extended to June 30?

5 A. So we can continue to sell it.

6 Q. Who was involved in the decision to
7 extend the offering?

8 A. The officers of CMS Financial
9 Corporation and the officers of McGinn Smith.

10 Q. Was there any documentation of
11 communication regarding the extension of this
12 matter -- communications between the parties
13 involved?

14 A. All parties agreed it was in their
15 benefit to continue to try to raise capital.

16 Q. Was there any written correspondence
17 regarding this?

18 A. I don't know. I doubt it.

19 Q. Were there e-mail correspondence
20 regarding this?

21 A. I don't know. But I doubt it. I'm
22 sure telephone conversation arose that said should
23 we extend the offering and everyone agreed we
24 should.

25 Q. How did you consider whether this

1 extension was consistent with the paragraph you
2 reviewed in the private placement memorandum?

3 A. It says if you haven't raised the \$15
4 million, we have the right to extend the offering.
5 And we clearly hadn't raised the \$15 million.

6 Q. Had the -- based on Exhibit 6, it's
7 your opinion the acquisitions had closed by that
8 date?

9 A. Correct.

10 Q. As detailed in the fourth paragraph of
11 page 105, "The company and the placement agent may
12 extend the offering in the circumstance in which the
13 minimum offering have been sold, but the acquisition
14 has not been closed." It's your understanding the
15 acquisitions had closed?

16 A. Correct. I think you're -- I'm sure
17 where you're going. I believe you are misreading.

18 Q. Is it your understanding that the
19 offering could be extended, even though the
20 acquisitions had closed?

21 A. Certainly.

22 Q. Even though the statement details --
23 that it's a circumstance in which the minimum
24 offering has been raised but the acquisitions have
25 not closed?

1 A. Yes. Both provisions provide. They
2 are trying to basically provide the opportunity to
3 continue to raise capital.

4 In the first instance, it says the offer
5 will terminate upon the date which all 15 million
6 have been sold, provided the company placement agent
7 retain the right to extend the offering for up to
8 six additional months.

9 If you haven't sold the 15 million, you
10 have the ability to extend the offering.

11 It says the company placement agent may
12 extend the offering in the circumstance in which the
13 minimum offering has been sold, but the acquisitions
14 have not been closed.

15 That was designed for whatever reason the
16 acquisition had not been closed upon, you wanted to
17 be able to continue to negotiate with the seller or
18 continue to have the offering.

19 They are not mutually exclusive. They are
20 designed to allow the offering to go forward under
21 any circumstance. They are not in opposition to
22 each other.

23 Q. It's your belief those are two
24 separate statements?

25 A. Absolutely.

1 Q. Do you think it's clear to an investor
2 reading the private placement memorandum?

3 MR. FRANCESKI: Objection to that
4 question.

5 A. I can't put myself in his position. I
6 know it's clear to me. And virtually -- I have to
7 be careful. Yes. I put myself in their -- in their
8 position, but it's designed to obviously be able to
9 get the offering extended, so that's beneficial to
10 everybody, to raise more capital. That's not in
11 dispute.

12 For those that made a minimum or -- those
13 investors who contributed to meet the minimum
14 investment, it's to their benefit to raise more
15 money. The more capital, the better off you are.
16 That's what we're trying to do.

17 We're trying to make sure that we have as
18 long as possible, as long as reasonably possible, to
19 continue to raise the capital. That's what we did.

20 Q. In your due diligence of this private
21 placement, did you obtain the opinion of counsel as
22 to whether or not the offering could be extended,
23 was consistent with that disclosure?

24 A. I don't recall, no.

25 I think it might be fair to state here,

1 because there is a lot of questions regarding
2 opinion of counsel, Mr. Holtermann was an attorney
3 himself, also has a securities attorney, Geraldine
4 Mullen, who works in his office and drafts these and
5 gives opinion.

6 For me to sit here and respond to those
7 questions is a little unfair. Really, I don't have
8 the personal knowledge of whether or not
9 Mr. Holtermann had that conversation with
10 Mrs. Mullen, but I suspect that virtually everything
11 in that prospectus has been not only reviewed, but
12 drafted and crafted by Mrs. Mullen.

13 MR. FRANCESKI: When it's convenient
14 to break.

15 MR. NEWMAN: We can take a break now.

16 MR. ROWEN: Off the record at
17 approximately 1:08.

18 (A short recess was taken.)

19 MR. ROWEN: We're back on the record
20 to the approximately 1:53.

21 MR. FRANCESKI: Mr. Smith has one
22 correction as to the times -- previous times he
23 testified about.

24 One of the cases he gave you -- he
25 does not think he testified in a deposition.

1 MR. NEWMAN: Okay.

2 THE WITNESS: It was the Key Bank
3 action lawsuit. And I evidently was mistaken. I
4 guess it's ongoing, but I haven't been deposed yet.

5 For some reason I thought I had been
6 deposed. As you get a little older, you can't
7 remember.

8 MR. NEWMAN: Not a problem.

9 Q. BY MR. ROWEN: We wanted to touch on
10 one area regarding the 2003, I believe you said,
11 placement of notes of Coventry Care Link.

12 A. Sure.

13 Q. Looking to find out is this something
14 that was disclosed to 2007 investors of either/or
15 the Coventry Care Link bridge loan notes or the CMS
16 Financial Services placements?

17 A. In what fashion? I guess in terms of
18 the liabilities, certainly, that it was there, and
19 showing.

20 And we discussed earlier that the
21 conversion is well discussed in the prospectus.

22 I guess one of the issues that Mike or Mike
23 brought up as to whether we specifically disclosed
24 they hadn't been paid. I don't recall that being
25 the answer. I think one assumes if they are being

1 converted that they were not paid.

2 But whether there was a definitive
3 discussion they were not paid, I don't know. I
4 would have to review the memorandum.

5 Q. Was there something brought up in the
6 PowerPoint presentations?

7 A. The brokers all knew because they had
8 been involved in that. Same people who had done the
9 2003 offering were still with us and still looking
10 at the new offering.

11 Yeah, didn't really have to tell them.
12 They knew it only too well.

13 MR. NEWMAN: The -- for the 107
14 Associates investment in the CMS offering, how is
15 the investment amount determined? There was 3.5
16 million that was invested?

17 THE WITNESS: Yes.

18 MR. NEWMAN: How was that amount
19 determined?

20 THE WITNESS: Well, we -- I guess we
21 started from what we thought we would need at the
22 very least. And we were anxious to try to have
23 something over and above what we would need.

24 And I guess, like any investment, what
25 we thought would work best for the offering and what

1 the capability of the parties were.

2 HSK, for example, we started with a
3 million dollars and that's where we ended.

4 The other five entities, it was
5 appropriate for both their cash resources and their
6 total corpus of what the investment meant in terms
7 of its overall percentage of investments. Sort of
8 backed into it, I guess, as I would put it that way.

9 MR. NEWMAN: This investment was made
10 basically contemporaneous or close in time to when
11 escrow was broken on the CMS offering?

12 THE WITNESS: I don't remember. The
13 decision was made prior to that. The funding was
14 probably made pretty damn close to closing. It was
15 something that had been discussed.

16 Obviously, Mr. Kaufmann didn't get a
17 phone call on the 7th and send us a check on the
18 9th. That's something we had been talking to him
19 for probably at least a month, so.

20 But, yeah, he would have wired the
21 money in fairly close to the closing time.

22 MR. NEWMAN: Mr. Kaufmann was one
23 million out of the three and a half?

24 THE WITNESS: Yes.

25 MR. NEWMAN: But for that three and a

1 half million, minimum would not have been satisfied?

2 THE WITNESS: I don't think that's
3 quite correct. We closed with -- I think it was six
4 one, so we had about two five or two six. Don't
5 hold me to that.

6 We could have -- if you review the
7 prospectus, which I know you have, we had the
8 ability to borrow of that 5 million minimum, we had
9 the ability to borrow another 2 and a half million
10 dollars on a straight debt basis with the
11 contingency I think it was 120 days, maybe 90 days,
12 if we hadn't, in effect, been able to sell the
13 equity within that time, to take that borrowing out,
14 they would agree to, in effect, be an equity
15 investor.

16 We didn't use that avenue. But that
17 was, to your point, we would have been able to close
18 had we gone that avenue and done a straight debt
19 infusion.

20 We would only need the 2.5, which is
21 what I think we had. I think the rollovers were
22 about two, two maybe. And couple other investors
23 for about three to \$400. I might not be totally
24 accurate on that.

25 MR. PAULSEN: Which investments were

1 deposited into the escrow account?

2 THE WITNESS: I believe all of them.

3 Well, I mean, rephrase that.

4 The rollovers, because there is no
5 exchange of cash, don't go into the escrow account.
6 But all the other cash went into the escrow account.

7 MR. PAULSEN: To your recollection,
8 what was that cash comprised of?

9 THE WITNESS: It was comprised of the
10 three five, and I believe that there was about two
11 to \$300 other. That's my recollection.

12 MR. PAULSEN: To your knowledge, the
13 escrow agreement stated that what was the minimum
14 amount to allow escrow to break?

15 THE WITNESS: Well, again, I think it
16 was -- it was 5 million or if you exercised this
17 other option, it was 2 and a half million.

18 You could break it with 2 and a half
19 and have this other 2 and a half debt over the 120
20 days sort of thing.

21 MR. PAULSEN: So, with 2 and a half
22 million dollars minimum and the total escrow funds
23 actually held in the escrow account being a 3 and a
24 half million dollars --

25 THE WITNESS: Plus whatever.

1 MR. PAULSEN: Based on the information
2 you provided to us earlier, was one additional
3 investment of 200,000.

4 THE WITNESS: Okay. I said -- I think
5 he said that.

6 MR. PAULSEN: Excluding the 107
7 Associates of 3 and a half million, clearly there
8 would not have been adequate funds to break escrow
9 without that investment?

10 THE WITNESS: That's if you consider,
11 which I would not, that the rollovers are not part
12 of the escrow. They are clearly equity investments.
13 The cash is not in there, but the notes have been
14 exchanged and deposited.

15 I don't want to get into the
16 lawyering. Certainly from our standpoint, that was
17 clearly part of the equity investment, was the
18 rollovers. That was the point.

19 It was talked about in the prospectus,
20 and maybe the prospectus didn't -- there is no way
21 you could have converted those to cash, right. How
22 can you get the rollovers into cash.

23 It has to be the paper. Maybe the
24 precise language should have said 5 million of
25 subscriptions, as opposed to cash. I wouldn't argue

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1 that point. But that's the perspective I'm coming
2 from.

3 Q. BY MR. ROWEN: Can you review -- look
4 at page 105 of Exhibit 4, the second paragraph from
5 the bottom.

6 A. Okay.

7 MR. NEWMAN: Is this what you're
8 referring to as far as the --

9 THE WITNESS: Yes.

10 MR. NEWMAN: -- portion of which may
11 be satisfied with new bridge financing of 2 and a
12 half million.

13 What is the new bridge financing?

14 THE WITNESS: It didn't happen. But
15 we could have. In other words, Mike asked the
16 question, did we have to be at 5 million in
17 subscriptions of the equity. And the answer I gave,
18 and I'm giving, no, you could have had 2 and a half
19 million, and somebody could have lend 2 and a half
20 million.

21 But to protect the first investors, if
22 you weren't able to raise an additional 2 and a half
23 to take out the debt, those people would have to
24 agree to convert their investment to the equity
25 investment -- into the subscription of the equity.

1 We didn't go that route. But that was
2 a possibility for us.

3 MR. NEWMAN: That was a possibility.
4 It didn't actually transpire?

5 THE WITNESS: Right.

6 MR. NEWMAN: Going back to the
7 question, given the fact there was not this 2 and a
8 half million dollar in new bridge financing, CMS
9 could not have broken escrow without having
10 \$5 million?

11 THE WITNESS: They -- the question
12 says subscriptions. Subscriptions were for
13 \$5 million.

14 MR. NEWMAN: But that includes the 3
15 and a half from 107 Associates?

16 THE WITNESS: Yes.

17 MR. NEWMAN: But for that -- going
18 back to the question, but for given the way things
19 transpired, but for the investment of 107
20 Associates, that 3 and a half million dollars
21 investment, there would not have been a sufficient
22 amount of money invested to satisfy the minimum
23 contingency?

24 THE WITNESS: We could have gone the
25 other way.

1 MR. NEWMAN: Yes or no?

2 MR. FRANCESKI: He said --

3 MR. NEWMAN: You didn't have that 2
4 and a half million in bridge financing. When escrow
5 was broken, it was based on the 3 and a half million
6 dollars was raised from 107 Associates and
7 additional moneys that were raised.

8 MR. FRANCESKI: He answered the
9 question.

10 THE WITNESS: Let me say, Mike. You
11 said I didn't have the 2 and a half million dollars.
12 You're wrong. We had 3 and a half million dollars.
13 The 3 and a half million dollars went into a debt
14 offering. We could have put it in the form of a
15 straight debt offering into CMS, as opposed to
16 running it through 107 Associates. We had it. We
17 raised it.

18 MR. NEWMAN: In terms of how this was
19 actually transacted, it was but for the 3 and a half
20 million dollars -- you didn't -- at the time the
21 escrow was broken, you did not have 2 and a half
22 million dollars in new bridge financing at that
23 point?

24 THE WITNESS: We could have. We had
25 it in the equity. We didn't need it.

1 MR. NEWMAN: Facts speak for
2 themselves.

3 MR. FRANCESKI: I think that's a good
4 place to leave it.

5 Q. BY MR. ROWEN: I think we're all set
6 with those exhibits.

7 Who is Joseph Bruno?

8 A. He's a gentleman from the capital
9 district. A businessman, but more -- and partly a
10 Senator. Serves the district of Albany.

11 More importantly, served as the majority
12 leader of the senate, which is a very important
13 position in New York State Government.

14 Q. What is your relationship with
15 Mr. Bruno?

16 MR. FRANCESKI: Was or is?

17 Q. BY MR. ROWEN: Start with is..

18 A. Friend. Had a business relationship.
19 Have known him probably since mid '80s or late '80s.
20 Socialized occasionally. Very occasionally. Played
21 golf a couple times.

22 Q. How was the relationship established?

23 A. Initially, it was established, I
24 believe, best of my recollection, through an
25 introduction of Jim Festinal (phonetic), all who is

1 a local attorney, who is partners of ours in a
2 building that our offices resided, was Mr. Bruno's
3 attorney. I think that's probably how I first met
4 Senator Bruno.

5 Q. Can you go into this business
6 relationship you had with Mr. Bruno?

7 A. Sure. Sometime in the early '90s, I
8 think it was around '92, '93, Mr. Bruno was not the
9 majority leader. Had his own business interest that
10 wound down.

11 Legislature of the State of New York is
12 part time. Virtually all of them seek employment
13 and means of generating income from other sources.

14 Most of them are lawyers, so they don't
15 have a problem doing that. But there are a few that
16 are not lawyers, of which Mr. Bruno is one of them.

17 And because he had been a local
18 businessman, because he had been in the area for a
19 long time, we engaged in a relationship with his
20 company. He had a company called -- I think
21 Business Consultants was the technical name, which
22 was a marketing company where he gave marketing
23 advice and consulting advice as to how one could
24 increase sales and get market share.

25 And we thought that that would be a good

1 means of having him be on retainer with McGinn
2 Smith, and hopefully introduce investment banking
3 prospects and/or account relationships that he had
4 developed over his lifetime of living in the capital
5 district.

6 So, somewhere around that 1993 time frame,
7 we started a relationship with Mr. Bruno where we
8 paid him fixed amount every month. And that
9 continued for I think until about 2005 when we
10 terminate the relationship, primarily as a result it
11 was not profitable and it run its course.

12 So I wasn't anxious to continue it. I
13 thought we had given him pretty of time to work.

14 We never got any investment banking from
15 him. Never introduced to any accounts.

16 Somewhere in that period, he had risen to
17 the point of being majority leader, which was an
18 important position. So probably he had less time
19 available to him than he did.

20 What he did do, he had some relationships
21 of accounts. Some of those accounts were union
22 accounts. And so when we were discussing how he
23 might be helpful, he mentioned he had a couple union
24 accounts.

25 I said, really. The only way you get that

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1 business is to manage their assets. And what you
2 need is an entry in those accounts. You get an
3 opportunity to present yourself, you don't have a
4 chance of getting the account.

5 I think I suggested that we had over the
6 years approached unions on our own several times
7 with other managers. Had always seemingly lost to a
8 group called Wright Investors out of Connecticut.
9 And Wright Investors had a reputation of handling
10 what they call Taft Hartley business, union
11 business.

12 And my own personal opinion is that
13 union -- this shouldn't be viewed in a denigrating
14 way at all. They are not financially sophisticated
15 guys. So, they do have business managers, but
16 sometimes they are not that sophisticated.

17 So, they have a tendency to follow where
18 other unions have gone. And so it seemed like every
19 time we presented, we lost. Wright got it. They
20 seemed to have all the unions in area.

21 When we were talking to Senator Bruno, we
22 suggested that instead of just going in with some
23 other manager, Wright would be the best place to do
24 it.

25 We introduced them to Wright Investors.

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1 They came down. They made a presentation as to
2 their record and success they had.

3 From that point on, Senator Bruno
4 introduced Wright to several unions, of which I
5 think they ultimately landed two accounts.

6 The relationship really started between
7 Bruno and Wright. If you -- I'm sure you do feel --
8 -- you understand how that business works, if you
9 don't -- when you bring in an account, you don't get
10 direct trades or compensation. An asset manager
11 will typically, if you bring him an account, he
12 doesn't give you the trades for that account. He
13 sort of looks at the overall relationship and says,
14 okay, McGinn Smith, you brought me \$5 million worth
15 of business. So, that's worth 50 grand worth of
16 commissions, just making up numbers.

17 So you get that business from anywhere.
18 Most of the time it's from trust accounts at
19 custodian banks. And they call up and say open an
20 account for X bank. You open the account. They say
21 buy 5,000 shares of IBM. You can put 4 cents on it
22 or 5 cents, whatever it was, it kept going down.
23 And that's how you get paid.

24 As you're well aware, ultimately, Mr. Bruno
25 was indicted for lapses of ethical behavior.

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1 MR. FRANCESKI: Alleged.

2 A. Most people in Albany have a different
3 opinion as to what this really is all about. He was
4 a very powerful figure in the capital district.
5 Elliott Spitzer, the new Democratic governor had a
6 vendetta to destroy Bruno and had almost succeeded
7 in doing it with a different scandal called
8 Troopergate. Unfortunately they got caught with
9 their hands in the cookie jar and that went away.

10 In the meantime, this federal investigation
11 started. Once they get started, they have a way of
12 continuing.

13 MR. FRANCESKI: I think you're past
14 the business relationship.

15 THE WITNESS: To layout the whole
16 relationship, we, as this investigation started, we
17 were brought into it to explain it.

18 In terms of whatever Bruno did for us
19 over the years, we generated over 12 years about
20 \$350,000 worth of commissions. I think we paid him
21 at least, if the paper is right, \$600,000 over those
22 12 years. So, obviously it proved not to be a
23 beneficial relationship to us. And we terminated it
24 in 2005.

25 Somewhere in 2007 I think they started

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1 this investigation. Maybe it was 2006. I really
2 don't know. I think we were ultimately approached
3 in maybe 2007.

4 And ultimately resulted in an
5 indictment for Bruno. And he will be defending
6 himself as the year goes forward.

7 McGinn Smith was never alleged to have
8 done anything wrong. The business is -- that's the
9 way the asset management business is conducted. The
10 firms that run the business direct commission to
11 those that bring it in.

12 Bruno was not paid commission. He was
13 not a salesman. He was basically a finder, of which
14 he was paid an ongoing consistent salary every
15 month. At some point it was reduced because it
16 wasn't providing the revenues. Ultimately
17 terminated.

18 Our relationship with Bruno was always
19 professional. He conducted himself, at least to our
20 knowledge, in ways that are beyond reproach. I'm
21 not privy to all that went on in the investigation.
22 There is other alleged ethical lapses, if you will,
23 but, we'll see how that checks out.

24 As far as the relationship with McGinn
25 Smith, it was aboveboard. It was professional. He

1 was paid. We got some money back. It was not a
2 good business relationship over that period of time.

3 That's pretty much the story.

4 Q. BY MR. ROWEN: So, how many
5 individuals were or how many unions were directed to
6 McGinn Smith over these 12 years?

7 A. That's my point. They are not. The
8 only knowledge I have is that he opened two
9 accounts. One was Teamsters and one was -- they
10 don't call them the restaurant workers. There is
11 some other name. That's the field they are in.

12 He may very well have opened other
13 accounts, but the unions did not invest with us
14 directly. They don't. They place their money with
15 an asset manager. In this case Wright.

16 Wright, in its attempt to, I guess,
17 recognize the fact that the account was given to
18 them, this is the way this business works, directed
19 commissions to us.

20 Not on a regular basis. Sometimes it
21 would -- you would go five months without a trade.

22 MR. FRANCESKI: You're not helping
23 Steve. Let him ask the questions. You're just
24 confusing him.

25 Q. BY MR. ROWEN: What records were

1 maintained regarding this relationship?

2 A. Pay -- retainer records. He's not an
3 employee of McGinn Smith. In other words, the
4 records of what we paid Business Consultants every
5 month.

6 Q. Do you have a contract with Business
7 Consultants?

8 A. No.

9 Q. Who else is involved with the Business
10 Consultants that you dealt with or you're aware of?

11 A. Nobody. Most of the relationship was
12 with Mr. McGinn. I don't believe there is anybody
13 else in that organization. It was a sole
14 proprietorship, if you will.

15 Q. Were 1099 forms issued to Mr. Bruno or
16 Business Consultants?

17 A. 1099s are not issued to corporations.
18 But we do have payment records of payments to
19 Business Consultants.

20 MR. NEWMAN: You have some accounting
21 records of that? Were there any tax forms issued to
22 that entity?

23 THE WITNESS: I don't think so. You
24 would have -- I would have to confirm with my
25 comptroller, but I think that's the responsibility

1 of the business that gets the money. I'm not sure
2 of that.

3 MR. NEWMAN: When did you and
4 Mr. Bruno formalize your relationship, this
5 consulting relationship?

6 THE WITNESS: It was -- sometime in
7 1992, 1993.

8 MR. NEWMAN: It was a verbal
9 agreement?

10 THE WITNESS: Yes.

11 MR. NEWMAN: Exactly what was the
12 agreement?

13 THE WITNESS: Basically, that we
14 agreed upon a payment. I can't remember what it
15 was. The records show we paid him about 600 grand
16 over 12 or 13 years. That's roughly 50 grand a
17 year.

18 MR. NEWMAN: What was he going to do
19 for you in return?

20 THE WITNESS: One of two things or
21 both if possible. He was to introduce us to
22 potential investment banking clients that might be
23 in the need of raising capital.

24 And, two, he was to introduce us or
25 them to, in the case, the designated money manager

1 to manage either pension funds, endowment funds,
2 whatever it might be.

3 MR. NEWMAN: Was the understanding
4 upon the introduction, the money manager would be
5 able to steer some brokerage business to your firm?

6 THE WITNESS: That's the way it always
7 is. If you bring in an account, you don't do it
8 without expectations you'll be paid.

9 MR. NEWMAN: Was Wright Investors a
10 designated money manager?

11 THE WITNESS: Yes.

12 MR. NEWMAN: Had you, prior to your
13 relationship with Mr. Bruno, had you attempted to do
14 business with Wright Investors?

15 THE WITNESS: No.

16 MR. NEWMAN: Mr. Bruno tell you about
17 Wright Investors?

18 THE WITNESS: We told Mr. Bruno what
19 we knew about Wright Investors, that they had been
20 our competition in previous attempts to solicit
21 business. And we always lost to them.

22 Instead of continuing to lose, we
23 decided it might be a good idea to put them on our
24 side.

25 MR. NEWMAN: How soon after you

1 reached this agreement with Mr. Bruno did you begin
2 getting brokerage business from Wright Investors?

3 THE WITNESS: I couldn't tell you. I
4 don't know when they landed the first accounts. I
5 am pretty sure they didn't give us any commissions
6 until they got some accounts. That's the way it
7 works. They are not doing it on a hope basis.

8 I don't know. We've got, in addition
9 to the payment records to Business Consultants, we
10 have a record of the commissions generated by Wright
11 Investors.

12 MR. NEWMAN: We're going to look at
13 records. We're going to see a starting point,
14 initial payment, which would be '92, 93?

15 THE WITNESS: That's correct.

16 MR. NEWMAN: How soon after you
17 reached this understand with Mr. Bruno did you begin
18 actually getting business from this arrangement?

19 THE WITNESS: I don't recall. I don't
20 know.

21 MR. NEWMAN: How many accounts -- you
22 said there were two union accounts?

23 THE WITNESS: Again, the accounts
24 aren't opened at our firm. Wright opened -- I bet
25 Wright opened probably 20 accounts. I think

virtually all of them were bank custodian accounts.

MR. FRANCESKI: At McGinn Smith?

THE WITNESS: Yes. To do the trades through.

In terms of the only reason I have a belief it's those two, he got those two union accounts is basically I read about them in the paper. They had no relationship to McGinn Smith.

MR. NEWMAN: Did you understand -- you understood that Wright Investors had done business with unions prior to your becoming involved with Mr. Bruno?

THE WITNESS: Absolutely.

MR. NEWMAN: That was part of your discussion with Mr. Bruno --

THE WITNESS: These guys have been successful.

MR. NEWMAN: Mr. Bruno represent to you or tell you what his -- what he had to offer in terms of dealing with union -- potential union business, what he could bring to the table?

THE WITNESS: He had relationships, which is what our business is. It's a relationship business. Half the battle in getting those accounts is getting in the door and making the presentation.

1 He had the ability to make a call to
2 the union leader saying when is the next time your
3 account is coming up for presentation?

4 They might say, well, it's six months
5 we're going to be looking at new managers.

6 At which point he would say I have one
7 I want you to look at.

8 MR. NEWMAN: Did he tell you he
9 thought he would be able to have some union accounts
10 opened through Wright Investors which could result
11 in business for your firm?

12 THE WITNESS: I believe the answer is
13 no. He didn't know until we told him about Wright
14 Investors.

15 MR. NEWMAN: Once you started talking
16 about Wright Investors --

17 THE WITNESS: I think he felt he had
18 sufficient relationships within that community that
19 he could at least get Wright in front of them.

20 MR. NEWMAN: Did you have an
21 expectation that by agreeing to pay him, I guess,
22 about \$50,000 a year, you would -- your firm would
23 get -- be able to generate some brokerage business
24 from that relationship through unions?

25 THE WITNESS: We had exceptions we

1 would do better than that.

2 MR. NEWMAN: Once this relationship
3 started, what contacts did you have with Wright
4 Investors other than them opening an account at the
5 firm?

6 THE WITNESS: Initially, again, I'm
7 trying to -- this is obviously way back. The first
8 couple of years I think we had maybe one or two
9 meetings with Wright Investors. I know we had an
10 initial meeting, because I can remember it was --
11 the restaurant it was held. Maybe one after that.

12 Subsequent to that, I never had a
13 discussion. I think my back office people did,
14 because they were tracking trades and commissions
15 and things like that.

16 But I personally, beyond maybe two
17 meetings early on, never met with them again.

18 MR. NEWMAN: You had a meeting in a
19 restaurant with Mr. Bruno and someone from Wright
20 Investors?

21 THE WITNESS: Yes.

22 MR. NEWMAN: Who was the person from
23 Wright Investors?

24 THE WITNESS: I can't remember the
25 name. He was a regional sales guy.

1 MR. NEWMAN: Tell us about that
2 meeting?

3 THE WITNESS: Well, we had lunch at
4 Jack's restaurant. We had invited Wright over for
5 the reasons that I've discussed; that we knew they
6 had demonstrated the ability to land those accounts.

7 We introduced the Senator to him. I
8 think there was only one person. Maybe there was
9 two.

10 And said, we're going to try to have
11 the Senator introduce you to some accounts. They
12 said great.

13 And we sort of left it at that. There
14 wasn't really a lot more to talk about.

15 Again, it's not -- there is no
16 question that when an asset manager brought an
17 account, if he wants to get another account or even
18 retain the account, he's supposed to send some
19 trades your way.

20 MR. NEWMAN: That wasn't expressly
21 discussed?

22 THE WITNESS: I'm sure it was. I'm
23 not saying that at all.

24 MR. NEWMAN: If I get you these
25 accounts, you're going to have to use McGinn Smith

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1 for some of the brokerage business, in so many
2 words?

3 THE WITNESS: Yeah. That's a good
4 assumption. I can't recall the specific language,
5 but I can't imagine I would have sat there and
6 pretended I didn't want brokerage business after
7 bringing him an account.

8 MR. NEWMAN: Once this business
9 started, it continued until 2005; is that correct?

10 THE WITNESS: I believe that's -- I
11 think that's when it was terminated.

12 MR. NEWMAN: Do you have any
13 discussions -- I think you had a relationship, a
14 social-quasi-business relationship?

15 THE WITNESS: Mine was small. I but
16 Tim really had a much stronger relationship with the
17 Senator than I did. My relationship was really
18 through Tim's.

19 MR. NEWMAN: In terms of the ongoing
20 discussions, did you or your partner, Mr. McGinn,
21 had with Mr. Bruno about this business relationship,
22 the payments and the business that was generated by
23 Wright Investors, did you have -- did you ever
24 discuss with Mr. Bruno the amount of activity that
25 was flowing to your firm, the nature of it, too

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1 much, too little, who is doing it, any specifics
2 like that?

3 THE WITNESS: I never had that
4 conversation with Mr. Bruno.

5 I did have that conversation with
6 Mr. McGinn. And I don't recall the time frame, but
7 it would be pretty easy to figure out, because I
8 strongly suggested we needed to cut back on what we
9 were paying him, because it wasn't footing out, if
10 you will.

11 And so we had that conversation.
12 Again, I don't remember the specifics, but the
13 retainer fee was reduced.

14 MR. NEWMAN: Do you remember when that
15 occurred?

16 THE WITNESS: No.

17 MR. NEWMAN: Who was tracking this?
18 Was it you or Mr. McGinn?

19 THE WITNESS: Both of us. I was -- I
20 was particularly sensitive to it, because I'm always
21 looking to see how the hell we're going to --

22 MR. NEWMAN: Do you know what the
23 change was, from what to what?

24 THE WITNESS: I don't. I shouldn't
25 guess. It was probably reduced by a third. It

1 might have gone from six a month to four a month.

2 MR. NEWMAN: Did Mr. Bruno complain
3 about that?

4 THE WITNESS: No. It was, look, he's
5 a savvy guy. He's a business guys. We're not
6 making money on you. Guess what, we have to reduce
7 the retainer. And we obviously hope that you can
8 generate more business. And if you do, we can
9 potentially review at a later date. But at the
10 moment it's not working.

11 MR. PAULSEN: For nearly 12 years you
12 were paying Mr. Bruno?

13 THE WITNESS: That's right.

14 MR. PAULSEN: At what point, and
15 I've -- if I'm asking this and if you already stated
16 this, I apologize. At what point did you realize
17 that it wasn't worth it, in your words, I guess?

18 THE WITNESS: Well, I can tell you it
19 was in 2005, because that's when we terminated the
20 relationship.

21 It wasn't easy, Mike, because there
22 was, not surprisingly, it was fluctuations. It
23 wasn't a steady state of every month we were losing
24 money. There were times when we were ahead of the
25 game, because of the way Wright did things.

1 They didn't do things on a consistent
2 basis. They might do nothing for five or six
3 months. There was always the prospect it would get
4 better.

5 I think in the other part of the
6 discussion is, is that we were really -- if not
7 Senator Bruno, we were focused on the investment
8 banking side -- the transaction business, as you
9 guys know too well, is not a great business
10 particularly -- they started out giving us, going
11 back to 1992, 1992 it was probably 6 cents a share.
12 By 2005 it was 2 cents a share. You can't make a
13 lot of money on 6 cents, let alone 2 cents.

14 Our focus was really the opportunity
15 to introduce a client on the investment banking
16 side. From a business judgment standpoint, as Bruno
17 got into the position of majority leader, I think
18 it's fair and honest to assess that his ability to
19 probably find those clients had grown, just by the
20 nature of his profile and who he was.

21 It never happened. It may have never
22 happened because he was too damn busy as majority
23 leader. It may have been he viewed potential
24 conflict of interest, because he was always -- these
25 guys were always in front of him on a legislative

1 basis, and he might of felt that wasn't right.

2 There is one point that I should bring
3 to your attention, that when we started this
4 process, we got from Bruno -- he went in front of
5 the ethics committee and got approval. And we
6 received that. That has been acknowledged.

7 They acknowledge he didn't disclose
8 all of whatever. But that's an issue for somebody
9 else, not for us.

10 Again, as a part-time legislator,
11 these guys are not restricted from conducting
12 business.

13 Cheryl Silver is the majority leader
14 of the Senate. He's about the dumbest lawyer you'll
15 ever meet. His law firm pays him 2 and a half
16 million, if you think they are paying 2 and half
17 million because he's brilliant, you know, I got a
18 bridge to sell you. Because he's a rainmaker, he
19 can bring in money.

20 MR. FRANCESKI: Let's stay on people.

21 THE WITNESS: The editorializing is
22 too good. I want that all off the record.

23 Q. BY MR. ROWEN: Did Mr. Bruno bring any
24 investment banking prospects to you over 12 years?

25 A. Not that I can recall.

1 Q. That was the main reason for the
2 relationship?

3 A. I think the relationship was joint,
4 Steve.

5 But, as I just mentioned to Mike, as time
6 went on, that asset management business got sicker.
7 When you go from \$0.06 to \$0.02 and paying a
8 clearing agent, not a lot left for the good guys.

9 In hindsight, we probably should have
10 severed the relationship earlier. We didn't. So,
11 you're looking for facts, those are the facts.

12 Q. Consulting relationship was a finder's
13 fee being paid whether --

14 A. The relationship was a retainer, a
15 monthly retainer. That's his business. We didn't
16 have a written contract, but that was the contract.
17 It was a verbal contract.

18 What we expected in return was him to find
19 accounts, managed accounts, or investment banking
20 accounts. That's his role.

21 MR. NEWMAN: The approval from the
22 State Ethics or State Senate Ethics Committee for
23 New York, was that written clearance you received?

24 THE WITNESS: I believe it was. I
25 don't think we got a copy. It's not in dispute.

1 It's been acknowledged by the US attorneys that are
2 prosecuting. They acknowledged he got it.

3 I don't think we have a written copy
4 of it.

5 MR. NEWMAN: When is the last time you
6 spoke to Mr. Bruno?

7 THE WITNESS: Maybe last summer.
8 Might have seen him at the Saratoga races.

9 MR. NEWMAN: Have you spoken to
10 Mr. Bruno since he's been entitled?

11 THE WITNESS: I have not.

12 MR. NEWMAN: Have you spoken with his
13 attorney?

14 THE WITNESS: His attorney, no.

15 MR. NEWMAN: Mr. Bruno's attorney?

16 THE WITNESS: No.

17 MR. NEWMAN: Have you seen a copy of
18 the indictment against Mr. Bruno?

19 THE WITNESS: I have.

20 MR. NEWMAN: When did you look at
21 that?

22 THE WITNESS: On the date it was
23 issued. I got a call from the US attorney. They
24 are announcing the indictment at 12. Called me at
25 10:30. Give me a heads up it was coming.

1 Apologized we were going to be mentioned, because
2 she thought it would probably bring some adverse
3 publicity.

4 But gave me a heads up and she faxed
5 it over to me, not e-mail.

6 At that point I read it. And that's
7 probably the last time I read it and last time we've
8 seen it.

9 MR. NEWMAN: I want to show you a
10 portion of the indictment that pertained to your
11 firm and go over a couple things with you.

12 THE WITNESS: Sure.

13 MR. ROWEN: Can we have this marked as
14 Exhibit 8.

15 (Indictment was received and marked
16 FINRA Exhibit 8 for identification.)

17 Q. BY MR. ROWEN: I'm handing you
18 Exhibit 8. This is a copy of the US District Court
19 indictment against Joseph Bruno.

20 MR. NEWMAN: I want to direct your
21 attention to page 16 of the indictment.

22 THE WITNESS: Okay.

23 MR. NEWMAN: I want to ask you about
24 paragraph 35. Do you have it?

25 THE WITNESS: I do.

1 MR. NEWMAN: Basically, I'm going to
2 paraphrase.

3 Basically it was -- the allegation is
4 that in December of 1992 McGinn Smith proposed
5 hiring defendant Bruno in a letter to the defendant
6 Bruno -- is that an accurate statement?

7 THE WITNESS: I don't know. I can't
8 remember the letter. I have no reason to believe it
9 isn't. It's accurate in terms of what we were
10 discussing with him.

11 MR. NEWMAN: Was the letter -- the
12 form of a letter agreement or a letter outlining
13 some --

14 THE WITNESS: I don't know. I haven't
15 seen the letter -- who knows. Maybe I signed the
16 letter. I don't know. I have not seen it since
17 1992.

18 It wasn't in the form of a contract,
19 because we didn't have a contract. I guess it was a
20 welcoming --

21 MR. FRANCESKI: Don't guess.

22 THE WITNESS: Okay.

23 MR. NEWMAN: Once you saw the
24 indictment, did you make an attempt to see if you
25 had a copy of the letter?

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1 THE WITNESS: We had been asked for
2 all documentation prior to the indictment. The
3 authorities had subpoenaed us and it was done.

4 To the best of my knowledge, and I was
5 not involved in the collection of the records, the
6 only thing we had was the records of payment.

7 MR. NEWMAN: Going to paragraph 36,
8 talks again about I think what you referred to as a
9 written request for an opinion regarding his
10 proposed McGinn Smith employment, and he being
11 Mr. Bruno.

12 And I think you said earlier you
13 weren't sure of whether or not there is -- you ever
14 got a written opinion?

15 THE WITNESS: I don't believe it's in
16 our records, other than -- we were very familiar
17 with it. We asked for it. But I don't think we
18 have it -- got it in our records.

19 MR. NEWMAN: Paragraph 37 begins, I'm
20 taking out the inflammatory language, McGinn Smith
21 earned fees as a broker when it was directed by
22 Wright and traded assets corresponding to three
23 union funds.

24 THE WITNESS: I would say that's
25 incorrect.

1 MR. NEWMAN: How is that incorrect?

2 THE WITNESS: Because, as I indicated
3 earlier, I don't believe we had any accounts
4 specifically opened as union fund accounts. I think
5 the only accounts we had were custodian accounts and
6 we don't know who those accounts were held for.

7 We clearly were directed fees and
8 commission from Wright. But this language here
9 suggests -- it says traded assets corresponding to
10 three union funds. I suppose maybe that's language
11 with -- that would suggest they weren't direct
12 accounts with us, but --

13 MR. NEWMAN: You don't know exactly
14 who the accounts were behind the Wright accounts?

15 THE WITNESS: No.

16 MR. FRANCESKI: You said fee --
17 commissions or fees or both?

18 THE WITNESS: They are commissions.

19 MR. FRANCESKI: This says fees. In
20 the brokerage business, that's a term of art.

21 THE WITNESS: They are not in the
22 brokerage business. It was commissions. Get paid
23 for doing a transaction, executing a transaction.

24 MR. NEWMAN: Wright directed trades to
25 McGinn Smith pursuant to the request from Bruno.

1 This produced the only revenue the defendant Bruno
2 generated from McGinn Smith.

3 THE WITNESS: I think that's an
4 accurate statement.

5 MR. NEWMAN: Paragraph 38, Joseph
6 Bruno was paid by McGinn Smith \$632,000; is that
7 correct?

8 THE WITNESS: Best of my knowledge. I
9 don't -- I have no reason to believe it isn't.

10 MR. NEWMAN: Did you ever seek an
11 opinion as to whether or not this business
12 relationship that Mr. Bruno had was consistent with
13 FINRA rules, or did you seek any legal opinion --
14 did you ever seek a legal opinion regarding the
15 proprietary of this relationship?

16 THE WITNESS: I did not.

17 MR. NEWMAN: With Mr. Bruno?

18 THE WITNESS: I researched the
19 finder's fee sort of relationships that are
20 appropriate. I believe that there is absolutely
21 nothing inappropriate about conducting business this
22 way.

23 MR. NEWMAN: What about this
24 relationship led you to that conclusion?

25 THE WITNESS: It's a business

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1 relationship. People refer clients to you all the
2 time. And if they are not a -- obviously, it would
3 be a commission salesman and to be paid directly for
4 business generated, you have to be a registered
5 representative, which he was not and is not.

6 On the other hand, people employed in
7 our industry are expected to develop business.
8 That's why I hired him. And our case, he was not an
9 employee, but we hired an outside consultant, if you
10 will, that was his firm, to try to generate business
11 for us.

12 That's what we do every day. We wake
13 up in the morning and try to find ways to generate
14 business.

15 This was one that didn't work out.
16 But, you know, never bat 100 percent.

17 MR. ROWEN: We're finish with our
18 questioning.

19 If you wish, you may add or clarify
20 any points you've made today.

21 If you need a moment off the record to
22 have discussions with your counsel, we can do so
23 now.

24 THE WITNESS: Okay.

25 MR. FRANCESKI: Thank you.

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1 THE WITNESS: I trust him implicitly.

2 MR. FRANCESKI: We have nothing to add
3 at this time.

4 MR. NEWMAN: FINRA reserves the right
5 to call you should we need additional information.
6 Please do not talk about your testimony with anyone
7 except for counsel.

8 THE WITNESS: Forever? I can't speak
9 to Mr. McGinn?

10 MR. FRANCESKI: He can't require you
11 not to talk to anybody. That's his request.

12 THE WITNESS: I will duly honor your
13 request, to the best of my ability.

14 MR. ROWEN: We'll go off the record at
15 2:49.

16 (Ending time: 2:49 p.m.)
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REPORTER'S CERTIFICATE

I, JILL A. PRAML-BUSSANICH, CSR No. XI01807, Certified Shorthand Reporter, certify; That the foregoing proceedings were taken before me at the time and place therein set forth, at which time the witness was put under oath by me; That the testimony of the witness and all objections made at the time of the examination were recorded stenographically by me and were thereafter transcribed;

That the foregoing is a true and correct transcript of my shorthand notes so taken.

I further certify that I am not a relative or employee of any attorney or of any of the parties, nor financially interested in the action.

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

Dated this 11th day of May, 2009.

JILL A. PRAML-BUSSANICH,
CSR NO. XI01807