

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

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

vs.

McGINN, SMITH & CO., INC., McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP., FIRST ADVISORY INCOME
NOTES, LLC, FIRST EXCELSIOR INCOME NOTES, LLC, FIRST INDEPENDENT
INCOME NOTES, LLC, THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, AND DAVID L. SMITH,

Defendants, and

LYNN A. SMITH,

Relief Defendant.

**MEMORANDUM OF LAW OF RELIEF DEFENDANT, LYNN A. SMITH, IN
OPPOSITION TO PLAINTIFF'S MOTION FOR A PRELIMINARY
INJUNCTION**

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STATEMENT OF FACTS

This action was commenced by the Plaintiff Securities and Exchange Commission (“Commission” or “SEC”) by the filing of a Summons, Complaint, Order to Show Cause, and related papers on April 20, 2010 against seven corporate defendants and two individual defendants, Timothy McGinn and David Smith, alleging violations of the Securities Act of 1933, the Securities Act of 1934, the Investment Advisors Act of 1940, and the Investment Company Act of 1940.¹ The Commission’s Complaint also names Lynn Smith as the lone relief defendant alleging that she has received and retained ill-gotten gains from defendant’s alleged fraud.

Simultaneously on April 20, 2010, the Court issued an Order to Show Cause, Temporary Restraining Order, and Order Freezing Assets and Granting Other Relief (the “Order”) that, among other things, froze the Relief Defendant’s assets, directed the Relief Defendant to provide verified accounts, and set the date for a preliminary injunction hearing on May 3, 2010.

On April 29, 2010, James D. Featherstonhaugh entered a Notice of Appearance as counsel of record for Relief Defendant Lynn Smith. Also on April 29, 2010, the Relief Defendant filed a List of Accounts pursuant to Part V of the Order. Pursuant to the Court’s April 30, 2010 Consent Order Extending Dates In Order to Show Cause, the date for a preliminary injunction hearing was rescheduled for May 18, 2010.

On May 5, 2010, the Relief Defendant filed a Statement of Net Assets as of March 31, 2010. On May 7, 2010, the Court issued a Consent Order whereby the date for a preliminary injunction hearing was rescheduled for June 2, 2010. Pursuant to the May

¹ Prior to its April 20, 2010 filing, the SEC did not issue a Wells Notice notifying the parties that it intended to recommend enforcement proceedings be commenced.

7, 2010 Consent Order, opposing papers from the Defendants and Relief Defendant in response to the Order were required to be served no later than May 21, 2010 and the Commission had until May 26, 2010 to serve any reply papers.

It is the contention of the SEC in their complaint that Lynn Smith “has received and retained ill gotten gains from defendants fraud” and that Mrs. Smith “was a recipient without consideration, of proceeds under circumstances in which it is not just, equitable, or conscionable for her to retain the illegal proceeds.”

It is the contention of the Relief Defendant that the Commission has failed to satisfy its burden that she received ill-gotten funds from the Defendants and that the evidence demonstrates that she has a legitimate claim to her funds.

As a relief defendant, Lynn Smith is not accused of any wrongdoing and the Court can permit recovery from a relief defendant only when such person possesses ill-gotten funds derived from the unlawful acts or practices of liability defendants and has no legitimate claim to the property.

It is the Relief Defendant’s further contention that the Plaintiff has not only failed to submit sufficient evidence to justify its request for a Preliminary Injunction to continue the asset freeze of her accounts, but it also failed to meet its burden in substantiating its broad allegations against the Relief Defendant as set forth in its Complaint.

The frozen accounts of the Relief Defendant were originally inherited from her father over four decades ago and have always been held in her name alone. Over time the Relief Defendant’s accounts, which were managed by the Relief Defendant’s husband Defendant David Smith, grew steadily in value. In seeking a Preliminary Injunction to continue the asset freeze of the Relief Defendant’s accounts, the Commission cites two

specific amounts of money that were transferred into Mrs. Smith's brokerage account in 2009: \$335,000 and \$100,000. These figures represent repayments and partial repayments by Defendants to the Relief Defendant in consideration for personal loans the Relief Defendant independently made from her personal account to the Defendants. Mrs. Smith has a legitimate interest in her accounts based on agreements entered into well before the underlying SEC enforcement action against the Defendants and the resulting freeze order. Mrs. Smith retains sufficient legitimate ownership interests to preclude treating her as a relief defendant and freezing her accounts. Consequently, the Relief Defendant, against whom no wrongdoing has been alleged in this matter, maintains her personal ownership interests in and legitimate claims to the proceeds of her accounts that were managed by the Defendants firm just as hundreds of other investors do.

POINT I

**THE SECURITIES AND EXCHANGE COMMISSION
HAS FAILED TO SATISFY ITS BURDEN THAT
LYNN SMITH RECEIVED ILL-GOTTEN FUNDS
FROM THE DEFENDANTS AND LYNN SMITH HAS
DEMONSTRATED SHE HAS A LEGITIMATE
CLAIM TO HER FUNDS.**

A person's status as a relief defendant is an "obscure common law concept" that has come to be applied in the context of the Securities Exchange Act of 1934. CFTC v. Kimberlynn Creek Ranch, Inc., 276 F.3d 187, 191 (4th Cir. 2002), citing, SEC v. Cherif, 933 F.2d 403 (7th Cir. 1991). A relief defendant, sometimes referred to as a "nominal defendant," has no ownership interest in the property that is the subject of litigation but may be joined in a lawsuit to aid the recovery of relief. SEC v. Cavanagh, 155 F.3d 129, 136 (2nd Cir. 1998). A relief defendant is not accused of wrongdoing, but a federal court may order equitable relief against such a person where that person (1) has received ill-gotten funds, and (2) does not have a legitimate claim to those funds. CFTC v. Walsh, 2009 U.S. Dist. LEXIS 71617 (S.D.N.Y. Aug. 4 2009), citing, Cavanagh, 155 F. 3d at 136. The Court in Kimberlynn Creek Ranch, Inc. discussed the theory behind the relief defendant concept in that:

A 'nominal defendant' is a person who can be joined to aid the recovery of relief without an additional assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation. Because a nominal defendant has no ownership interest in the funds at issue, once the district court has acquired subject matter jurisdiction over the litigation regarding the conduct that produced the funds, it is not necessary for the court to separately obtain subject matter jurisdiction over the claim to the funds held by the nominal defendant; rather, the nominal defendant is joined purely as a means of facilitating collection. In short, a nominal defendant is part of a suit only as the holder of assets that must be recovered in order to afford complete relief; no cause of action is asserted against a nominal defendant.

Kimberlynn Creek Ranch, 276 F.3d at 191-92 (citations and quotations omitted).

The decisional law only requires an “ownership interest” or “legitimate claim” in the funds sought to be frozen to preclude a person from being a proper relief defendant. Janvey v. Adams, 588 F.3d 831 (5th Cir. 2009); SEC v. Cavanagh, 155 F.3d 129, 136 (2nd Cir. 1998); SEC v. Founding Pttrs. Capital Mgmt., 639 F.Supp 2d 1291 (M.D. Fla. 2009). See also, Bronson Partners, LLC 674 F. Supp 2d 373, 392 (D. Conn. 2008)(A legitimate claim to funds is established when a relief defendant shows that some services were performed for consideration). Such an ownership interest or legitimate claim “does not require possession of the full bundle of ownership rights that may exist in various types of property.” SEC v. Founding Pttrs. Capital Mgmt. at 1294.

As demonstrated in the attached affidavits and documents submitted in opposition to the Plaintiff’s motion, the Securities and Exchange Commission (“Commission” or “SEC”) has not only failed to submit sufficient evidence to justify its request for a Preliminary Injunction to continue the asset freeze of Lynn Smith’s accounts, but it also failed to meet its burden in substantiating its allegations against the Relief Defendant as set forth in Paragraphs 12, 68, 71, 94 and 141 of the Commission’s Complaint.

When the Relief Defendant’s father died in 1969, his will created a trust that allowed a portion of his estate to pass to Mrs. Smith immediately and a portion to pass to her five years later. The estate included her father’s home in Amsterdam, New York, her father’s life insurance proceeds, his stock account, which had approximately \$60,000 in it, and property located on Great Sacandaga Lake. As an only child, the entire inheritance from her father’s estate has always been the separate, independent property of Lynn Smith. Moreover, the stock account and the real property have always been held in

the Relief Defendant's name alone throughout her marriage to the Defendant David Smith.

Following her mother's death in 1968, the Relief Defendant married Defendant David Smith and took a position as a school teacher. Some years later Defendant David Smith became a stock broker. As a licensed stock broker and her account manager, the Relief Defendant allowed her husband discretion in making investment decisions for her stock account, however, ultimate decisions regarding the account were made by the Relief Defendant and such accounts were at all times in the sole ownership of Mrs. Smith.

In 1982, the Relief Defendant left her teaching position to stay at home to raise her two children and manage the household. Under the management of her stock broker husband, the Relief Defendant's account grew steadily over time and by the late 1990's had accumulated upwards of \$6,000,000. In 2004, given her experience with her father's unexpected death at age 50, the Relief Defendant personally funded the David L. Smith and Lynn A. Smith Irrevocable Trust as part of an estate plan to provide security for her children's future. This trust was entirely funded by the Relief Defendant through the transfer of 100,000 shares of Charter One Bank stock, the origin of which was the Relief Defendant's purchase in 1992 of 40,000 shares of Albank stock at the Albany Savings Bank IPO for \$10 a share. The amount and value of these shares grew considerably over time as Albany Savings Bank and its successors were acquired by other larger banking institutions.

Throughout Defendant David Smith's time as a broker at various firms, including his time at McGinn, Smith & Co., Mrs. Smith maintained her brokerage account with her

husband as part of his overall client portfolio. Mrs. Smith received regular account statements from the clearinghouses which were under contract with the Defendant's firm, discussed general investment strategy and authorized transactions which required her specific approval and signature. As in any broker-client relationship, on occasions Mrs. Smith agreed with her husband's suggestions and on other occasions she disagreed and the transaction was consequently not undertaken. Throughout her marriage to Defendant David Smith, the Relief Defendant's brokerage account has been held solely in her name and operated without interruption since the Relief Defendant's father first established it in the 1950's.

In seeking a Preliminary Injunction to continue the asset freeze of the Relief Defendant's accounts, the Commission fails to substantiate or even effectively allege that the Relief Defendant's accounts represent anything other than a legitimate claim in the accumulation of assets through legitimate investments and returns on investments made on the Relief Defendant's behalf for more than forty years.

In its Complaint, the Commission casts an expansive net that unjustifiably implicates Lynn Smith as a relief defendant based upon broad and unsubstantiated allegations that she has "received ill-gotten gains" (Complaint ¶ 12) and was "a recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities." (Complaint ¶ 141) To support its very general allegations against Lynn Smith, the Commission cites two specific amounts of money that were transferred into Mrs. Smith's brokerage account in 2009: \$335,000 (*See* Complaint ¶¶ 68, 71 and 94) and \$100,000 (Complaint ¶94). The first payment referenced, \$335,000, in or about June and July of 2009 was actually two separate payments which are correctly stated in Paragraph

26 of the Complaint. Two payments, one for \$160,800 and one for \$175,000 were made to Mrs. Smith's account from TDMM Cable in repayment of a short-term loan in the amount of \$366,000 which she made to TDMM Cable from her stock account on June 5, 2009. Mrs. Smith made similar loans to provide "bridge" financing to facilitate the closing of various transactions that McGinn, Smith has handled over the course of many years.

With respect to Mrs. Smith's \$366,000 loan to TDMM Cable, the Commission is well aware that such loan was made, as the fact of the loan was asserted as an allegation in Paragraph 78 of the Declaration of Lara Shalov Mehraban submitted in support of the Commission's application for a restraining order. Ms. Mehraban has taken an e-mail from Mrs. Smith's husband (see App. Ex. 67, at 266), and asserted under penalty of perjury the content of the e-mail as an allegation of fact supposedly within Ms. Mehraban's personal knowledge, yet misrepresented a material fact in the e-mail by stating that the loan was made to McGinn Smith, when the e-mail clearly indicates that the loan was made to TDM Cable. (Compare Declaration of Lara Shalov Mehraban ¶78 and App. Ex. 67, at 266).

The undisputed fact is that a \$366,000 loan was made by Lynn Smith with her specific consent to TDM Cable and was carried out by Defendant David Smith. This loan is documented and demonstrated in Mrs. Smith's June 2009 NFS brokerage statement. It can only be surmised that the shorthand reference to the loan in the Defendant's e-mail ("I loaned") relates to the fact that the Defendant implemented the loan transaction on Mrs. Smith's behalf, and that the Defendant was following up to inquire about repayment. Nevertheless, this does not negate the fact that Lynn Smith

specifically discussed the loan with the Defendant, approved it as an investment from her own stock account, and was entitled to be repaid in consideration of her loan. In fact, TDMM still owes Mrs. Smith approximately \$35,000 in principal plus accrued interest. Attached as Exhibit A to Mrs. Smith's affidavit is a copy of the promissory note Mrs. Smith received when she loaned the \$366,000, and which was the consideration for the two payments of \$160,800 and \$175,000 from TDM to her stock account. The original note is held for the benefit of Mrs. Smith by her brokerage, McGinn, Smith & Co., just as it holds other securities issued to her and other clients and would be among the records seized by the federal government in this action.

The only other specific payment the Commission alleges in its Complaint that was paid into the Relief Defendant's brokerage account was a \$100,000 check in May 2009. (Complaint ¶ 94). This figure represents a partial repayment by Defendant McGinn to the Relief Defendant in consideration for a \$1.1 million personal loan the Relief Defendant independently made from her account to Defendant McGinn in 2003 (the original promissory note of which the Relief Defendant holds).

It is undisputed that the Relief Defendant received loan payments pursuant to written loan agreements with Defendants, which gives Mrs. Smith certain rights and obligations with regard to the loan proceeds. There has been a debtor-creditor relationship between Mrs. Smith and the Defendants based on agreements entered into well before the underlying SEC enforcement action against the Defendants and the resulting freeze order. These constitute sufficient legitimate ownership interests to preclude treating Mrs. Smith as a relief defendant. SEC v. Founding Ptnrs. Capital Mgmt. at 1295. See also, Janvey v. Adams, 588 F.3d 831, 835 (5th Cir. 2009).

In keeping with the Court's findings in Cavanagh, when the SEC proffers sufficient evidence to the court showing that a specific amount of ill-gotten funds are alleged to have been received by a relief defendant, the inquiry turns to whether the relief defendant has a legitimate claim to such funds. Consequently, "the burden rests with the Commission to show that the funds in the possession of [Lynn Smith] are ill-gotten." (*See FTC v. Bronson Partners, LLC* 674 F. Supp 2d 373, 392 (D. Conn. 2008), citing, FTC v. Direct Mktg. Concepts, 569 F. Supp 2d 285 (D. Mass 2008).

To be clear, the following is the universe of allegations and statements proffered by the Commission against the Relief Defendant excerpted verbatim from its Complaint:

Complaint

¶ 12. Lynn Smith, as relief defendant, has received and retained ill gotten gains from defendants' fraud.

¶ 22. Lynn A. Smith, age 64, is the wife of David Smith and a resident of Saratoga Springs, New York.

¶ 68. Not satisfied with the disclosed fees, MS & Co., used a total of at least 54% of the funds raised to: (i) make payments to ... relief defendant Lynn Smith...

¶ 71. McGinn also transferred...more than \$335,000 to Smith's wife, relief defendant Lynn Smith.

¶ 94. MS Capital transferred \$335,000 to accounts in the name of Smith's wife, relief defendant Lynn Smith. Lynn Smith received many other payments from McGinn Smith Entities. On May 4, 2009, for example, Smith directed that a \$100,000 check be issued to his wife's account at National Financial Services. Smith also testified that his salary was generally paid to his wife, Lynn.

¶141. Relief Defendant Lynn A. Smith was a recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities alleged above. The Relief Defendant profited from such receipt or from the fraudulent and illegal sales of securities alleged above by obtaining illegal proceeds under circumstances in which it is not just, equitable, or conscionable for her to retain the illegal proceeds. Consequently, Lynn

Smith has been named as a Relief Defendant for the amount of proceeds by which she has been unjustly enriched as a result of the fraudulent scheme or illegal sales transaction.

142. By reason of the foregoing, Lynn Smith should disgorge her ill-gotten gains, plus prejudgment interest.

Courts have continuously acknowledged “the basic principle that burdensome forms of interim relief require correspondingly substantial justification.” SEC v. Unifund SAL, 910 F.2d 1028, 1042 (2nd Cir. 1990). This “substantial justification” standard is surely not met by merely stating unsupported assertions that “Lynn Smith, as relief defendant, has received and retained ill gotten gains from defendants’ fraud”(Complaint ¶ 12) or that “Relief Defendant Lynn A. Smith was a recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities.” (Complaint ¶ 141) In seeking to freeze the accounts held independently for decades by the Relief Defendant for whatever period of time the Commission may take to prepare for trial, given the paucity of evidence offered by the Commission which is founded upon speculation and conjecture, it is clear that the SEC has failed to meet its burden that the Relief Defendant has received ill-gotten funds.

Given the lack of evidence put forth by the Commission to substantiate its allegations that the Relief Defendant has received ill-gotten funds in this matter, it is apparent that the Commission has taken “a sue-first-and-sort-out-the-facts-later approach” which is not compatible with the Federal Rules or fundamental fairness. SEC v. Founding Ptnrs. Capital Mgmt. at 1295. The Commission’s Complaint fails to acknowledge that independent from her personal relationship with the Defendant David Smith, the evidence establishes that there has been a longstanding business relationship

with considerable consideration, spanning decades, between the Relief Defendant and the Defendant David Smith with regard to the management of her personal accounts which Mrs. Smith inherited shortly after her marriage when her father passed away.

It is important to take notice of the real-life implications that the Commission's widespread blanket asset freeze has unjustifiably imposed upon the Relief Defendant. For example, when the freeze against the Relief Defendant's assets was first imposed, Mrs. Smith was alone in Florida. No notice of the freeze was provided to the Relief Defendant by the Commission, so that when she went to an ATM, she was in a state of shock to discover that access to her funds was denied. Here was the Relief Defendant, all alone over 1,000 miles from home with no access to return home. Once home, the effects of the freeze rippled through every facet of the Relief Defendant's life. She was unable to purchase groceries, pay her mortgage, or pay her utility bills. Bounced checks were being returned daily, including checks she had sent in good faith to New York State and the Federal Government to pay her taxes. A self-reliant woman, Lynn Smith, who since the untimely death of her father recognized the importance of being self sufficient, was forced to rely on friends and loved ones showing up unannounced at her front door with bags of groceries and home cooked meals. The hardship and humiliation imposed upon the Relief Defendant by the Commission's unwarranted asset freeze is through no personal wrongdoing on her part and is neither supported by the relevant case law nor the thin proof set forth by the Commission in its Complaint.

“The balance struck between necessity and the rights of a non-violator is such that the non-violator cannot be hauled into court unless it is essentially a disinterested stakeholder of money which may ultimately go to the plaintiff.” SEC v. Founding Ptnrs.

Capital Mgmt. at 1294-95. That is not the situation set forth by the Commission in its Complaint or in the submitted evidence.

The Relief Defendant in this matter has maintained an independent ownership interest in her accounts for decades. The Commission offers no substantial justification to refute Mrs. Smith's legitimate claim to her accounts. The Relief Defendant, against whom no wrongdoing has been alleged, maintains her personal ownership interests in and legitimate claims to the proceeds of her accounts that were managed by the McGinn, Smith firm just as hundreds of other investors do. Consequently, Lynn Smith has a legitimate claim of ownership in the accounts sought to be frozen, and as such, is not properly joined as a relief defendant. Moreover, by excluding the hundreds of other investors who have accounts with the Defendants and naming only Lynn Smith - the wife of Defendant David Smith - as a Relief Defendant, the Commission's Complaint seems to imply an anachronistic standard that possession of a marriage certificate is sufficient grounds to freeze a woman's accounts because financial autonomy independent from her husband is necessarily suspect.

The Commission has drafted a Complaint that alleges wrongdoing by nine defendants and makes no allegations of wrongdoing as to Lynn Smith. As the Court declared in SEC v. Founding Ptnrs. Capital Mgmt., it is presumed "that this is the result of the SEC's faithful adherence to §11(b)(3) of the Federal Rules of Civil Procedure which requires that 'factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery.'" The SEC began its investigation several years ago and the evidence supports that separate and distinct from personal relationships, there were

business relationships, spanning many decades between Defendant's Smith and McGinn and Lynn Smith pursuant to written and/or oral agreements. See SEC v. Founding Ptnrs. Capital Mgmt. at 1295. The Commission has failed to meet its burden of showing that Lynn Smith received ill-gotten funds from the Defendant David Smith. Simply asserting that the Relief Defendant has received ill gotten funds and that she does not have a legitimate claim to those funds does not satisfy the SEC's burden necessary to freeze assets in a securities proceeding.

In light of the foregoing, it is respectfully requested that the Commission's request for a Preliminary Injunction to continue the freeze of the Relief Defendant's assets be denied.

POINT II

THE SEC HAS FAILED TO ALLEGE THAT ILLEGAL PROFITS RESULTED FROM THE FRAUDULENT ACTS OF THE DEFENDANTS OR, IN THE ALTERNATIVE, FAILED IN ITS BURDEN TO REASONABLY QUANTIFY THE AMOUNT OF ALLEGED ILL-GOTTEN GAINS PLAINTIFF CLAIMS MUST BE DISGORGED.

In order for the government to succeed in maintaining a freeze on any assets of the Relief Defendant it must demonstrate a probability that it will be successful in proving that the Defendants and McGinn Smith Entities realized an illegal profit as a result of their alleged fraudulent conduct. If it were successful in demonstrating this to the Court, it is then obligated to provide a reasonable approximation of those profits and to further demonstrate that some portion of them has come into the possession of the Relief Defendant, without consideration.

It is well established that the primary purpose of disgorgement is not to compensate investors but rather to force a defendant to give up the amount he was unlawfully enriched. SEC v. Seibald, 1997 WL 605114 (S.D.N.Y. Sept. 30, 1997); SEC v. Blue Bottle Ltd., 2007 U.S. Dist. LEXIS 95992 (S.D.N.Y. 2007), citing, SEC v. Patel, 61 F.3d 137 (2nd Cir. 1995).

It is evident from plaintiff's Complaint and supporting Declarations that the SEC has failed to allege that any of the named Defendants actually "profited" by their alleged fraudulent activities. Instead, the plaintiff's Complaint is confined to allegations that Defendants defrauded investors in violation of the Securities law and other federal statutes where in some cases an illegal profit cannot even be implied based on the nature of the violation. See §7(a) of the Investment Company Act and §5(a) & 5(c) of the

Securities Act. By highlighting the alleged magnitude of the fraud and investor losses, it is apparent that the plaintiff hopes that the Court will assume that any money associated with the alleged fraudulent transactions are in fact “ill-gotten” and grant, on that basis alone, its request to extend its freeze against all of the assets of Relief Defendant.

Such an approach fails for two reasons. First and foremost, the government has the burden to make the causal connection between the offending fraud and any ill-gotten gains received as a result of that fraud. SEC v. First City Financial Corp., 890 F.2d 1215 (D.C. Cir. 1989). Second, the appropriate measure for disgorgement is not the amount of loss suffered by a plaintiff but the benefit unjustly received by the defendant. FTC v. Verity Int., 443 F.3d 48 (2nd Cir. 2006) (emphasis added). Therefore, proof of investor losses resulting from its allegations of fraud cannot be assumed to be the defrauder’s ill-gotten gains.

In reviewing the Complaint, the only effort to make a causal connection between the alleged fraud and ill-gotten gains received are allegations that the Defendants were recipients of “excessive” commissions, transaction fees and other material benefits resulting from defrauded investor offering fees. In each instance, the government does not allege how it determined what it alleges constituted an “excessive” fee or whether it will allege such fees violated any law or industry standard. In paragraph 57 of the Complaint for example, the government alleges that McGinn Smith & Co. “extracted enormous fees from these Trust deals, which were not clearly disclosed in the PPMs... The fees were characterized as trust administration fees, acquisition costs, investment banking fees, legal fees and due diligence fees.” In the very next paragraph, the

Complaint acknowledges “many of these fees were disclosed in the Trust PPMs.” See ¶58 of the Complaint.

In addition to making generalized and unsubstantiated statements as to the exorbitant nature of the fees, the plaintiff also attempts to further discredit the legality of these profits by alleging that the proceeds were received for services not performed including “significant due diligence.” Contrary to this verified statement of which the deponent had no independent knowledge, plaintiff’s counsel admitted in a phone conversation that she was unaware of at least 29 banker boxes that are currently in the custody of the Department of Justice which the Defendants had generated in preparation for its offerings as part of its due diligence efforts.

There is no showing that any fees were undisclosed to the investors and the services alleged by the SEC to be non-existent were in fact actually performed. In addition to alleging that the ill-gotten gains must be causally related to the alleged fraud, the SEC generally must distinguish between legally and illegally obtained profits. SEC v. First City Financial Corp., at 1231. The SEC’s pleadings and supporting Declarations have failed to do so in both regards.

To the extent that the SEC can show that ill-gotten gains were in fact received by the Defendants for its alleged fraudulent activities, it has failed to demonstrate the reasonable and approximate value of such profits or that the Relief Defendant has come into possession of them without consideration. The SEC bears the ultimate burden of persuasion that its ultimate disgorgement figure, if realized, reasonably approximates the amount of unjust enrichment. SEC v. Aimsi Techs., Inc., 650 F. Supp2d 296, 304 (S.D.N.Y. 2007), citing, SEC v. Opulentica, 479 F. Supp2d 319 (S.D.N.Y. 2007). Only

after the SEC has made a reasonable showing of a defendants' illicit profits, does the burden shift to the defendant to show that the disgorgement figure was not a reasonable approximation. SEC v. Aimsi Techs., Inc. at 304.

In a line of cases that plaintiff provided relief defense counsel for the proposition that the SEC is not required to trace ill-gotten funds to individual accounts, it is evident that the courts require a reasonable approximation of the illegal profits gained from alleged fraudulent activity in order to ascertain the scope of the requested asset freeze. See SEC v. Unifund SAL, 910 F.2nd 1028 (2nd Cir. 1990); SEC v. Aragon Capital Mgmt. LLC, 672 F.Supp.2d 421 (S.D.N.Y. 2009); SEC v. Shapiro, 494 F.2d 1301 (2nd Cir. 1974); SEC v. Seibald, *supra.*, SEC v. Glauberman, 1992 WL 175270 (S.D.N.Y. July 16, 1992).

In this case, the SEC has made no effort to ascertain the reasonable value of Defendants' alleged ill-gotten gains nor even to identify what "gains" it will allege were "ill-gotten" but rather has elected to seize all assets including the individual assets of the Relief Defendant. What is even more egregious, apart from the fact that such an unabashed taking contradicts fundamental due process guarantees, is the fact that the request is being made in the form of emergent relief. The procedural history of this case reveals that an investigation of the Defendants has been on-going since 2008. Clearly, the government has had more than enough time to be able to evaluate and quantify the amount of gains it will allege were illicitly received by the Defendants in order to articulate a reasoned request as to the scope of relief it seeks in the form of an asset freeze. Presenting an across-the-board freeze of all assets as if the government has been

forced to hastily seek emergent relief to preserve the status quo is disingenuous and outrageously unfair to the rights of the Relief Defendant.

In light of the fact that the government has failed to allege that illicit profits were gained or to otherwise even attempt to quantify the amount of illicit profits it alleges were gained, the SEC has failed in its burden.

CONCLUSION

BASED ON THE FOREGOING, THE COMMISSION'S APPLICATION FOR A PRELIMINARY INJUNCTION TO FREEZE THE ASSETS OF RELIEF DEFENDANT IN THIS PROCEEDING SHOULD BE DENIED IN ALL RESPECTS.

Dated: May 21, 2010

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