

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION

*Plaintiff,*

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

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

*Defendants,*

LYNN A. SMITH and NANCY McGINN,

*Relief Defendants, and*

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

*Intervenor.*

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**NOTICE OF MOTION**

PLEASE TAKE NOTICE that upon all the pleadings and proceedings heretofore had herein, Defendants Geoffrey R. Smith, successor Trustee of the David L. Smith and Lynn A. Smith Irrevocable Trust U/A 8/04/04 and Geoffrey R. Smith and Lauren T. Smith move before a term of this Court to be held on the 24<sup>th</sup> of March, 2011 at 9:30 a.m., or at any other date convenient to the Court, before the Honorable Gary L. Sharpe,

United States District Judge, United States District Court for the Northern District of New York, 445 Broadway, Albany, New York for an Order pursuant to Fed. R. Civ. P. 12(b)(6) dismissing the Plaintiff's Amended Complaint for failure to state a claim upon which relief can be granted as it relates to the Securities Exchange Commission's allegation that these parties received fraudulently conveyed assets in violation of the New York State Debtor and Creditor Law.

PLEASE TAKE FURTHER NOTICE that pursuant to Local Rule 7.1(b)(2), opposition papers must be filed and served not less than seventeen days prior to the return date.

DATED: February 15, 2011

**Featherstonhaugh, Wiley & Clyne, LLP**

By: \_\_\_\_\_

  
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**MEMORANDUM OF LAW IN SUPPORT OF MOTION TO  
DISMISS ON BEHALF OF DEFENDANTS THE DAVID L.  
SMITH AND LYNN A. SMITH IRREVOCABLE TRUST  
U/A 8/04/04, AND ITS BENEFICIARIES**

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U/A/ 8/04/04 and Defendants Geoffrey R.  
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### **PRELIMINARY STATEMENT**

This application is made in conjunction with a motion to dismiss that was filed by Lynn A. Smith on December 15, 2010 (Doc. 224) specifically as it relates to the Securities Exchange Commission's ("SEC") allegations that (1) the defendant Geoffrey R. Smith, successor Trustee of the David L. Smith and Lynn A. Smith Irrevocable Trust U/A 8/04/04 ("Trust") was the recipient of fraudulently conveyed assets from Lynn and David Smith; and (2) the defendants Geoffrey R. Smith and Lauren T. Smith ("Beneficiaries") were the recipients of funds after July 7, 2010 that had been fraudulently conveyed to the Trust. The SEC has alleged that these transfers were made in violation of Section 276 of the New York Debtor and Creditor Law and, that pursuant to Section 278 of that same law, the SEC is entitled to have the transaction which created the Trust as well as subsequent distributions after July 7, 2010 to the Beneficiaries from the Trust voided and set aside.

In addition to the arguments proffered by Lynn Smith in support of her motion to dismiss, the Trust and Beneficiaries move to dismiss the Amended Complaint based on the following grounds:

(1) The SEC cannot be deemed a legitimate creditor as to the Trust because neither the SEC nor any alleged defrauded investor has ever had a legitimate claim against the assets that originally funded that account. The law of the case is that the monies used to fund the Trust were untainted and severable from the rest of her stock account and was an asset out of reach of her husband's creditors because they could not be construed as being "ill-gotten." Since these funds were free and clear of creditors'

reach at the time of transfer, the Trust cannot be deemed to be in receipt of fraudulently conveyed assets.

(2) The Beneficiaries who received funds after July 7, 2010 can also not be deemed recipients of fraudulently conveyed assets because they arise from the same untainted assets that originated from the transfer of stock that originally funded the Trust.

(3) The SEC's current posture of this case is that the Trust was a purchaser of the stock used to fund its corpus in consideration for the Trust agreeing to be contractually bound to make future payments to David and Lynn Smith pursuant to a separate annuity agreement entered by the Trust and the Smith's. If it is true that the Trust is a purchaser for fair consideration as is now being alleged, then for the SEC to obtain the remedies it seeks pursuant to §278 of the New York State Debtor and Creditor Law, it must prove and affirmatively plead that the Trust, through its Trustee, had knowledge or notice of the fraudulent intent of David and Lynn Smith when they transferred the assets to the Trust in 2004. Such an allegation is absent from the SEC's Amended Complaint making it fatally defective.

(4) The SEC has failed to state a claim upon which relief can be granted as against Geoffrey and Lauren as Beneficiaries of the Trust since it has not alleged that these defendants participated in the actual transfer of assets that is the subject of the SEC's fraudulent conveyance claim.

As such the SEC has failed to state a cause of action under New York law upon which relief may be granted against the Trust or the recipients of Trust funds, namely Geoffrey and Lauren Smith.

### STATEMENT OF THE FACTS

This securities action was originally against seven corporate defendants and two individual defendants, including David L. 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 (“Securities Defendants”). The original complaint was filed on April 20, 2010 naming Lynn Smith, the wife of David Smith, as a “relief defendant”.

Simultaneous with the filing of its original Complaint, the Court issued an Order to Show Cause, Temporary Restraining Order, and Order Freezing Assets and Granting Other Relief that, among other things, froze Lynn Smith’s assets, including a Stock Account (“Stock Account”) that has been individually owned and maintained by Lynn Smith since 1969 when she inherited it upon her father’s passing. Significantly, the freeze also included the David L. Smith and Lynn A. Smith Irrevocable Trust U/A August 4, 2004 (“Trust”). The Trust, as a separate legal entity, was permitted by the Court to intervene in this action on May 28, 2010 (Doc. 39).

Following six weeks of discovery, the Court conducted a hearing on June 9 through June 11, 2010, on the SEC’s Preliminary Injunction Motion to maintain the freeze of both Lynn Smith’s assets and the assets in the Trust. On July 7, 2010, the Court issued a Memorandum-Decision and Order (“Order”) (Doc. 86) that, among other things, granted the Commission’s motion to preliminarily freeze Lynn Smith’s assets based on two alternative theories: (1) that Lynn Smith was a proper relief defendant or, alternatively (2) her husband, Securities Defendant David Smith, was a joint owner of the



Stock Account and her other frozen assets.<sup>1</sup> However, the Court denied the SEC's application as it relates to the Trust and ordered that it be released from the asset freeze. Although, the Trust was neither named as a Relief Defendant nor a Defendant, the Court analyzed the appropriateness of the freeze based on the same two theories it applied to Lynn Smith's assets: (1) whether the Trust was a proper relief defendant or alternatively, (2) whether David Smith exercised sufficient control as to create an equitable ownership interest in that account.

To support his decision, Judge Homer determined that the SEC did not demonstrate a likelihood that it would prove that the Trust was an appropriate relief defendant. His decision was based on the fact that the Trust was not created with ill-gotten gains or that the purchase of the bank stock that was ultimately used to fund the Trust was fraudulent or otherwise illegal. The Judge found that the stock investment used to fund the Trust represented "untainted funds easily identifiable and severable from the stock account as a whole." Since the SEC failed to prove that the Trust received or was created with ill-gotten gains, it did not have a legitimate claim to its corpus based upon a relief defendant analysis.

The Court then analyzed whether the Trust should be subject to the asset freeze based on the theory that David Smith had an equitable ownership interest in the Trust. Based on the evidence presented at the hearing, the Judge maintained that David Smith did not have an interest in the Trust that would warrant it to be frozen based on a joint ownership theory. As a result of this decision, certain assets were purchased by the Trust,

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<sup>1</sup> The portion of the Order that authorized the on-going freeze of Lynn Smith's assets has been appealed to the U.S. Court of Appeals, Second Circuit.

invoices for legal and trustee services were paid and the Beneficiaries, Geoffrey and Lauren Smith, received a disbursement for their respective business and personal use.

Soon after Magistrate Judge Homer issued his July 7, 2010 Order, it was revealed that there was in existence an annuity agreement. The annuity agreement essentially provided Lynn and David Smith with a future contingent contractual interest in the Trust in the form of annual annuity payments beginning in the year 2015 continuing up until their deaths. Based on what the SEC characterized as “new evidence” pursuant to Fed. R. Civ. P. 60(b)(2), it filed a Motion to Reconsider the Court’s decision relating to the Trust based on the theory that the annuity agreement demonstrated that David Smith did have an interest in the Trust corpus and it should therefore remain part of the asset freeze.

That decision was handed down on November 22, 2010 in which Magistrate Judge Homer granted the SEC’s Motion for Reconsideration and accordingly “re-froze” those Trust assets on the grounds that David Smith possessed an ownership interest in the Trust based on new evidence in the form of an annuity agreement. (Doc. 194). He also found in the alternative that the SEC’s Motion for Reconsideration should be granted pursuant to Fed. R. Civ. P. 60(b)(3) where there is evidence of fraud, misrepresentation, or misconduct, based on the alleged concealment of the annuity agreement. (Doc. 194 at 20, n.17) While Judge Homer held that the Trust should remain frozen based on what it now deemed to be a significant ownership interest in the Trust, *his decision did not change the Magistrate Judge Homer’s findings that the stock originally used to fund the Trust was an untainted asset in the name of Lynn Smith.*

At approximately the same time the SEC filed its Motion for Reconsideration, it also filed an Amended Complaint in which it now names the Trust, Geoffrey Smith and

Lauren Smith as defendants based on allegations that they were recipients of fraudulently conveyed assets in violation of the New York State Debtor and Creditor Law. The assets referred to were the same assets that Judge Homer determined was Lynn Smith's legitimate and untainted asset.

The Trust, Geoffrey Smith and Lauren Smith now tender this Motion to Dismiss the Amended Complaint against them as defendants alleged to have violated the New York State Debtor and Creditor Law.

**POINT I**

**THE ASSETS CONVEYED TO THE TRUST WERE AND REMAIN UNTAINTED FUNDS OVER WHICH NO CREDITOR OF DAVID SMITH WOULD EVER HAVE A RIGHT TO CLAIM.**

It is established precedent that when analyzing an actual fraudulent conveyance claim, it is the intent of the transferor and not the intent of the transferee that is dispositive under §276 of the Debtor and Creditor law. *Sharp Internat'l Corp. v. State Street Bank and Trust Company*, 281 B.R. 506, 522 (E.D.N.Y. 2002). However, to hold the recipient liable, the SEC must first demonstrate the fraudulent intent of the grantor. “To constitute a disposition of property by a debtor with intent to defraud his creditors, the thing disposed of must be of value, *out of which a creditor could have made a portion of his claim*, it must have been transferred by the debtor and this with intent to defraud.” *Gutierrez v. Bernard, et al.*, 865 N.Y.S.2d 212, 213 (1<sup>st</sup> Dep’t 2008) *citing*, *Hoyt v. Godfrey*, 88 N.Y. 669, 670 (1882). (Emphasis added). The term “Claim” is defined as a “demand as one’s own or as one’s right.” Black’s Dictionary, 6<sup>th</sup> Edition, p. 247.

In the case at bar, the SEC fails to establish, based on the law of the case, that the Charter One stock that was conveyed to the Trust was an asset out of which a creditor could have made a portion of his claim. Indeed, in its July 7, 2010 Order, the Court in analyzing the origins of stock that ultimately funded the Trust found:

It is undisputed that the Trust originated from bank stock in the Stock Account purchased in the early 1990s well prior to 2003 when the SEC alleges the scheme began here. In fact, none of the named entities except MS & Co. existed at the time. Thus, there is no proof that fraudulently obtained funds were deposited into the Stock Account prior to the purchase of the bank stock account in the early 1990s. The stock was untouched for the fourteen years it remained in the Stock Account and grew in value from \$400,000 to over \$4 million by market forces alone. No testimony or proof was offered that additional capital was invested into the stock or that the portfolio was otherwise modified since the 1990s.

Accordingly, this stock investment represents *untainted funds easily identifiable and severable from the stock account as a whole...*(citations omitted). (Doc. 86 at 37-38).

There is no evidence that the purchase or sale of the bank stock was fraudulent or otherwise illegal. By all accounts, the stock was purchased for value. Thus, appropriate consideration was provided for the purchase and the Smiths had a legitimate interest in the eventual growth, sale, and proceeds of the bank stock at a time predating the commencement of the scheme alleged herein...Therefore, the SEC has failed to demonstrate a likelihood of success on this ground that the Trust is an appropriate relief defendant as the SEC has failed to prove that the Trust received or was created with ill-gotten gains or that it had no legitimate claim to its corpus. (citations omitted). (Doc. 86 at 38-39).

The Court held that the Trust was not a proper relief defendant because the monies that funded it were not ill-gotten. If that is the law of the case, which has been neither appealed nor altered by subsequent decisions, then it follows that the stock, when conveyed, could not have been deemed subject to a then present or future creditor's claim under the New York Debtor and Creditor law. Accordingly, the SEC cannot establish a fraudulent intent on the part of Lynn Smith, the owner of the untainted stock that funded the Trust over which no one, other than Lynn Smith, has a legitimate claim. Without establishing such intent, the conveyance cannot be deemed fraudulent and the recipient of such funds, including the Trust and the Trust Beneficiaries cannot be held liable under the Debtor and Creditor law. Consequently, the law of the case demands that these allegations be dismissed on their face.

The introduction of the annuity agreement that was the focus of the Court's Order and Memorandum on the SEC's Motion for Reconsideration (Doc. 194) did not alter this aspect of the Court's earlier findings. Indeed, the Judge rested his entire decision to "re-freeze" the Trust on the fact that David Smith, based on the prospect of obtaining annuity

payments in the future from Trust, now appeared to have a joint or equitable interest in that Trust. In analyzing Judge Homer's 23 page decision, it is evident that 20 of those pages were devoted to his findings that the annuity agreement constituted new evidence justifying reconsideration of his July 7, 2011 Order. The remaining three pages related to how the discovery of the annuity agreement impacts on his earlier decision as to unfreezing the assets in the Trust account. His findings are as follows:

The evidence which the Court found insufficient included testimony and documents demonstrating that David Smith had functioned as the investment advisor for the Trust, David Smith had paid approximately \$100,000 in taxes owed by the Trust without reimbursement from the Trust, and Lynn Smith had paid expenses incurred by the Smiths' daughter, a beneficiary of the Trust, which would ordinarily have been paid by the Trust. When the Annuity Agreement is added to the analysis, however, the conclusion is compelled that David Smith possessed an equitable and beneficial interest in the Trust through the Annuity Agreement and that his conduct in controlling investments of Trust assets by the Trustee...was to protect the assets of the Trust to insure their existence when the Annuity Agreement payments were to commence and not simply to protect those assets for the use of his children.

Nowhere in his opinion does Judge Homer address or alter his previous findings that the monies used to fund this Trust were ill-gotten or otherwise tainted as a result of David Smith's alleged fraud. This is significant and dispositive as to this motion because if the Court does grant the relief that the SEC seeks based on its cause of action for fraudulent conveyance, the transaction that established the Trust will be voided and set aside and, by operation of law, the corpus of the Trust will revert back to Lynn Smith. By reason of Judge Homer's findings in his July 7, 2010 decision, neither the SEC nor any other creditor will have a legitimate claim to these funds.

While the SEC has never appealed this aspect of the Court's July 7, 2010 ruling, it certainly has sought to have the Court reconsider its findings as to status of these funds

before they were transferred to the Trust. In its Motion for Reconsideration (Doc. 103), the SEC attempted to persuade the Court to modify its findings when it argued that the shares of stock used to fund the Trust had been used for David Smith's business purposes when they were temporarily journaled into an account of a McGinn Smith Entity. The SEC argued that having used these funds for such purposes contradicts the Court's earlier determination that "the stock was untouched for fourteen years it remained in the stock account..." (Doc. 103 at 14). Unfortunately, as even the SEC concedes in its Memorandum of Law in Support of its Motion, these facts were in evidence during the preliminary hearing (Doc. 103 at 7, n.3). Consequently, the Court opted not to reopen its entire July 7, 2010 decision since the introduction of the annuity agreement, as the "new evidence," limited the scope of the Court's reconsideration of its earlier Order only as to the Trust and not the stock that funded the Trust.

In its opposition to Lynn Smith's Motion to Dismiss the Amended Complaint, the SEC disagrees with her contention that, upon reconsideration of its July 7, 2010 Order, the Court froze the Trust assets based on Mr. Smith's ownership interest alone. Rather, the SEC argues that, "the Court froze the Trust assets, in part based on the SEC's 'substantial evidence of...[fraudulent] conduct by...Lynn Smith' with respect to the Trust." (Doc. 194, at 26, n.17). However, the Court's finding of the likelihood of fraudulent conduct on the part of Lynn Smith was limited to the narrow issue as to whether her alleged concealment of the annuity agreement warranted the Court to reconsider its earlier decision concerning the Trust pursuant to Fed. R. Civ. P. 60(b)(3). Such a finding did not in any way infer that the discovery of the annuity agreement

tainted the stock that she used to originally fund the Trust or that it was conveyed in 2004 with fraudulent intent.

The significance of the fact that the stock used to fund the Trust was deemed neither ill-gotten nor an asset of David Smith's against which a creditor may have a legitimate claim cannot be overstated. Indeed, even if the SEC can prove by clear and convincing evidence that Lynn Smith had a fraudulent state of mind to defraud her husband's creditors when she conveyed those assets to the Trust, such a finding is meaningless if the asset disposed of cannot be reached by any creditor's claim. This is clearly the case here. Since the SEC never had a legitimate claim to these funds, it cannot be deemed a "creditor" under New York Debtor and Creditor Law and, consequently, this Court cannot hold the Trust or its Beneficiaries liable under that same law under a theory that they are the recipients of fraudulently conveyed assets.



**POINT II**

**IN THE EVENT THIS COURT DEEMS THAT THE SEC HAS A LEGITIMATE CLAIM AS A “CREDITOR” UNDER NEW YORK LAW AGAINST THE ASSETS THAT ORIGINALLY FUNDED THE TRUST, THE COURT SHOULD FIND THAT THE SEC HAS FAILED TO PROPERLY PLEAD A CAUSE OF ACTION BASED ON NEW YORK’S FRAUDULENT CONVEYANCE LAW AS TO THE TRUST AND ITS BENEFICIARIES.**

- A. The SEC has failed to allege that the Trust, through its Trustee, had knowledge or notice of the Smiths’ fraudulent intent in effectuating the conveyance.**

As to its fraudulent conveyance claim, the SEC seeks to have the conveyances voided pursuant to Sections 276 and 278 of the Debtor and Creditor Law and to recover the property conveyed or its equivalent value. (*Amend. Cplt.* ¶19) Section 278 of the Debtor and Creditor Law provides as follows:

1. Where a conveyance or obligation is fraudulent as to a creditor, such creditor, when his claim has matured, may, as against any person *except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase...*(emphasis added)
  - a. Have the conveyance set aside or obligation annulled to the extent necessary to satisfy his claim...

“Fair Consideration” is deemed “given for property, or obligation...[w]hen in exchange for such property, or obligation, as a fair equivalent therefore, and in good faith, property is conveyed...” *Debtor and Creditor Law §272(a)* Where a transferee has given equivalent value in exchange for debtor’s property, the statutory requirement of “good faith” is satisfied if the transferee acted without either actual or constructive knowledge of any fraudulent scheme. *Sharp Internat’l Corp.*, supra at 520.

Section 278 of the Debtor and Creditor Law provides a bona fide purchaser defense for a transferee to avoid a creditor’s ability to set aside a transaction alleged to

have been fraudulently conveyed by the grantor. While this constitutes an affirmative defense, the burden of proof that the transferee had knowledge of the grantor's fraudulent intent is on the party attacking the conveyance:

To enable a creditor to recover in an action claiming that a conveyance was made with intent to hinder, delay and defraud creditors, it is not sufficient that he should prove simply that the conveyance was not founded upon valuable consideration, but, if it was voluntary, he is bound to prove in addition that as matter of fact it was fraudulent and made with fraudulent intent. If, however, it is made to appear that the purchase was for a valuable consideration, then it is necessary for him to prove, not only that the grantor made the conveyance with intent to hinder, delay and defraud her creditors, but that the grantee had previous notice of the fraudulent intent of his grantor. *Weiser v. Kling et al.*, 38 A.D. 266, 268-269 (1<sup>st</sup> Dep't 1899). (Emphasis added).

In its Amended Complaint, the SEC characterizes the transfer of the stock from Lynn Smith's account to the Trust as a sale made in exchange for annuity payments to Lynn and David Smith. Paragraph 120 of the SEC's Amended Complaint summarizes its allegations:

The Smith Trust had no assets when it was created. On August 31, 2004, Smith and L. Smith entered into a "Private Annuity Agreement" with the Smith Trust. Under the agreement, Smith and L. Smith agreed to sell 100,000 shares of Charter One stock to the Smith Trust in exchange for annuity payments from the Smith Trust of \$489,932 per year from September 26, 2015 until the last to die of Smith and L. Smith...

The characterization by the SEC of the transaction as a purchase and sale rather than a gift creates an additional burden on the part of the SEC to prove that the transferee was without notice or knowledge of the grantor's fraud prior to conveyance. In this case, unlike a gratuitous transfer without consideration, the knowledge of the fraud prior to the conveyance on the part transferee is an essential element to the SEC's claim under the Debtor and Creditor Law. Since the scienter of the transferee is an indispensable aspect of its fraudulent conveyance claim to set aside the transaction, it is submitted that the

SEC has not complied with the pleading requirement pursuant to Fed. R. Civ. P. 9(b) by, at the very least, failing to allege in general that the Trust, through its trustee, had knowledge or notice of the fraudulent intent of the Smiths' when the Stock was transferred to the Trust in exchange for future annuity payments. No such allegation is made in the Amended Complaint and therefore it is defective on its face.

**B. The SEC fails to state a cause of action against Geoffrey and Lauren Smith as beneficiaries of the Trust.**

In the SEC's Amended Complaint, Geoffrey and Lauren Smith are named in their individual capacities as defendants based on the single allegation that they, as beneficiaries to the Trust, received fraudulently conveyed assets. (*Amend. Cplt.* ¶172). However, in a similar case as to the one at bar, the United States District Court for the Southern District of New York has held that absence of any allegations that beneficiaries of a family trust participated in allegedly fraudulent conveyances of the debtor's assets to the trust precluded their liability under the New York fraudulent conveyance statute. *Sullivan v. Kodosi et al.*, 373 F. Supp. 2d 302 (S.D.N.Y. 2005).

In *Sullivan*, the plaintiff creditor claimed that his business partner who he sued for breach of contract transferred his corporate assets to a family trust with the intent to hinder, delay or defraud his creditors. The plaintiff creditor also brought a fraudulent transfer claim against the family trust itself as well as the trustee in his individual capacity and the beneficiaries of the trust. The partner, trust, trustee and beneficiaries moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). The Court found that the plaintiff creditor plead with particularity the allegations to substantiate his claim of fraud as against the partner and the trust, who was the immediate and gratuitous recipient of the alleged fraudulently conveyed funds. However, as to the beneficiaries, the Court found

the plaintiff failed to sufficiently plead facts that allege the beneficiaries in any way participated or had knowledge of the circumstances surrounding that transfer. The Court held:

Plaintiff's sole allegation against [the beneficiaries] is contained in P33 of the Complaint, and makes no reference to their participation in the transfers, stating merely that "on information and belief, each of the Trust's beneficiaries have received or are entitled to receive the benefits of the assets fraudulently conveyed to the Trust." Although plaintiff asserts in his briefing that "it is fair to conclude" and "safe to assume" that [partner's] wife and mother knew of various litigation pending against [partner] at the time transfers were made, even had these conclusory statements been included in the Complaint, they would have stopped short of alleging assistance in the transfers themselves, given that the assets were not in any way directly transferred into the hands of the Trust's beneficiaries, and do not speak at all to the knowledge on the part of the beneficiaries of the exact alleged circumstances of the transfers and/or [partner's] finances at the time of transfers.

*Id.* at 310 (references omitted)

In *Sullivan*, the beneficiaries, as subsequent transferees, received the property at issue passively via the trust as a result of the actions of the transferor and the original trustee. The Court observed that, "[w]hile ordinarily it might be difficult for a transferee or beneficiary to be distinguished by definition from a participant in the transfer, the particular relationship of these defendants to the transferred assets creates just such a distinction." *Id.* at 309. In so holding, the Court found that the plaintiff creditor failed to state a cause of action upon which relief could be granted pursuant to Fed. R. Civ. P. 12(b)(6) as to the beneficiaries of this trust.

In this case, the SEC's sole allegation against Geoffrey and Lauren is that they "received funds after July 7, 2010 that had been fraudulently conveyed to the Smith Trust." (*Amend. Cplt.* ¶ 172). The SEC does not allege that they, in any way, participated in the transfer of funds to the Trust or were the direct recipients of the fraudulently

conveyed funds from the Grantor. Nor is it alleged that either Beneficiary had knowledge of the exact circumstances of the transfers or Dave Smith's finances at the time of transfer. In fact, Geoffrey and Lauren are mirror images of the beneficiaries in *Sullivan*. Consequently, the SEC has failed to properly allege sufficient facts to entitle it the relief that it seeks under the Debtor and Creditor Law as it relates to these two defendants.

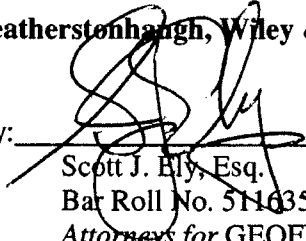
**CONCLUSION**

For the foregoing reasons, the SEC's Amended Complaint should be dismissed against the Trust and Geoffrey and Lauren as Beneficiaries for failure to state a claim on which relief can be granted under the New York State Debtor and Creditor law.

DATED: February 15, 2011

**Featherstonhagh, Wiley & Clyne, LLP**

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