UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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.

MEMORANDUM OF LAW IN OPPOSITION TO SEC'S MOTION FOR AN EVIDENTIARY HEARING RELATING TO THE CONDUCT OF ATTORNEY JAMES D. FEATHERSTONHAUGH IN REFERENCE TO THE ABOVE-CAPTIONED MATTER

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TABLE OF CONTENTS

STATEMENT OF THE FACTS

This Memorandum of Law is submitted in Opposition to the Securities and Exchange Commission's (the "SEC") Motion requesting permission from this Court to engage in discovery and to hold an evidentiary hearing to determine whether sanctionable facts exist before bringing its formal sanction motion against James D. Featherstonhaugh.

This Motion arises from the Court's findings in its Memorandum-Decision and Orders dealing with the issue as to whether the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04 ("Trust") should be the subject of an asset freeze the SEC was seeking to impose through an application for preliminary injunctive relief. 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.

During this proceeding and all discovery leading up to this proceeding, the Trust, as a separate legal entity, was represented by Jill Dunn. Ms. Dunn intervened on behalf of the Trust on May 28, 2010 (Dkt. 39) and advocated for the release of an existing asset freeze obtained through a temporary restraining order as it related specifically to the Trust. Mr. Featherstonhaugh, on the other hand represented Lynn Smith, who at that time, was only named in the suit as a relief defendant. He advocated for the release of an existing asset freeze obtained through a temporary restraining order as it related to Lynn Smith's personal assets including a stock account, checking account, and other real property that she owned.

On July 7, 2010, the Court issued a Memorandum-Decision and Order ("MDO I") (Dkt. 86) that froze certain assets of Lynn Smith, including her stock account, checking account and her residences in Saratoga, New York and Vero Beach, Florida. The Court

released from the asset freeze the Great Sacandaga Lake camp which Lynn Smith inherited from her father. As to the Trust, the Court determined that the assets of the Trust should not remain frozen since the stock that funded the Trust in 2004 was untainted and severable from the rest of Lynn Smith's stock account or, in the alternative there was no evidence that David Smith had a beneficial ownership in the Trust.

Following the decision of MDO I, the SEC filed an Emergency Motion for Temporary Restraining Order to re-freeze the Trust (Dkt. 103-1) based upon the discovery of an annuity agreement which it apparently obtained from the original Trustee of the Trust ("Annuity Agreement" or "Agreement"). This Agreement entered between the Trust and David and Lynn Smith contractually obligated the Trust to pay Lynn and David annual annuity payments beginning in the year 2015. In an Order dated August 3, 2010 (Dkt. 104), the Court granted the SEC permission to move against the Trust but in the form of a Motion for Reconsideration. As part of its allegations to support its application relating to Lynn Smith, the SEC claimed that Lynn Smith knew of the Agreement but failed to produce it or refer to it in her sworn testimony. (Dkt. 103-1). Although, Lynn Smith did not file an affidavit in opposition to this application, Mr. Featherstonhaugh's Declaration verified that "[Lynn Smith] had no recollection of [the Agreement] prior to my calling it to her attention, and reaffirmed that her intention when creating the Trust was to provide for her children." (Dkt. 133).

Prior to ruling on the SEC's motion, the Court deemed it necessary to hold an evidentiary hearing to hear testimony concerning a telephone call that took place on July 22, 2010 between the Trust attorney and two SEC attorneys wherein it was alleged that Ms. Dunn disclosed the existence of the Agreement – an allegation that Ms. Dunn has denied. The SEC argued that it was this telephone call that led to the discovery of the

Agreement on July 27, 2010 when it was prompted to contact Mr. Urbelis and request the document. Since the Court deemed the issue as to timing and discovery of the Agreement germane to the SEC's pending Motion for Reconsideration, the Court ordered an evidentiary hearing to test the credibility of both parties concerning the substance of this telephone call. (Dkt. 150). That hearing, originally scheduled for November 4, 2010 took place on November 16, 2010.

On November 22, 2010 Your Honor 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 the Annuity Agreement. (Dkt. 194) ("MDO II"). The Court, *sua sponte*[1], also found in the alternative that reconsideration is warranted under Rule 60(b)(3) based on fraud, misrepresentation, or misconduct.

> As described supra, the conduct of those associated with the Trust – principally Urbelis and Lynn Smith – in failing to disclose the Annuity Agreement satisfies the requirements for fraud, misrepresentation, and misconduct. Their failure to disclose the agreement was exacerbated by their statements and testimony that the Trust was created solely to benefit the Smiths' children without disclosing the additional fact that the Trust was also created to pay a substantial annuity in the future to David and Lynn Smith. The SEC's claims under Rule 60(b)(3) are further corroborated by the false assertions of Dunn and Wojeski on this motion as to when and how they learned of the existence of the Annuity Agreement. The SEC has presented substantial evidence of such conduct by the Trust, through Urbelis, and Lynn Smith. Lynn Smith's assertion that she simply forgot the agreement that was to pay her and her husband nearly $500,000 annually in their later years is rejected as incredible.

MDO II, p. 20, n.17.

[1] The Court in MDO II indicates that "the SEC also seeks reconsideration under Rule 60(b)(3) based on fraud." However, because the Court *sua sponte* changed the SEC application seeking a temporary restraining order to a motion for reconsideration, this point was not specifically raised by the SEC prior to MDO II.

As a result of these findings, the Court not only granted the SEC's Motion on Reconsideration but also granted leave to move for sanctions against Lynn Smith, her attorney, James D. Featherstonhaugh, Esq., the Trust attorney, Jill Dunn, Esq., the former trustee Thomas Urbelis, Esq., and the successor trustee, David Wojeski "based on conduct described herein." (MDO II at 24).

On January 31, 2011, the SEC accepted the Court's invitation in MDO II and moved for sanctions against Lynn Smith, Ms. Dunn, Mr. Wojeski and Mr. Urbelis. To support its claims, the SEC not only identified and set forth specific facts for each which it alleges gives rise to sanctionable conduct, but it goes several steps further to allege that the misconduct of each was the result of a diabolical scheme amongst those associated with the Trust, including James Featherstonhaugh. Based on this conspiracy theory, the SEC then moved, without leave of Court, for an evidentiary hearing and discovery to determine what part, if any Mr. Featherstonhaugh played in the "scheme" and, even more, requests that his confidential communications with his client, Lynn Smith, be revealed pursuant to the crime-fraud exception.

For the reasons that follow, the SEC's application to "investigate" the conduct of Mr. Featherstonhaugh while seeking to strip his client of her privileged communications with her attorney during the course of this litigation should be summarily rejected.

POINT I

THE SEC'S APPLICATION FOR AN EVIDENTIARY HEARING TO INVESTIGATE MR. FEATHERSTONHAUGH IS BEYOND THE SCOPE OF THE COURT'S MDO II.

The Court's November 22, 2010 Order specifically provides:

> 5. The SEC is granted leave to move for sanctions against the Trust, Wojeski, Urbelis, Dunn, Lynn Smith, and Lynn Smith's counsel for the conduct described herein without the necessity of the pre-motion

> conference required by N.D.N.Y.L.R. 7.1(b)(2), and any such motion shall be filed on or before January 31, 2011.

The SEC's motion does in fact seek sanctions, as permitted by the Order as against Wojeski, Urbelis, Dunn and Lynn Smith and identifies under what sources of authority those sanctions are being sought. However, the SEC does not seek sanctions against Mr. Featherstonhaugh but rather seeks the opportunity to further investigate his conduct through additional discovery and fact finding proceedings. While it is evident that this Court has invited the SEC to apply for sanctions against Mr. Featherstonhaugh, there is nothing in the Order that would permit them to seek the unprecedented relief that it now asks of this Court.

Since the SEC has failed to identify any conduct that would warrant sanctions against Mr. Featherstonhaugh in the instant proceeding, its motion for additional proceedings pursuant to the Court's order should be denied.

POINT II

THERE IS NO FACTUAL BASIS THAT SUPPORTS THE SEC'S APPLICATION FOR AN EVIDENTIARY HEARING TO INVESTIGATE WHETHER MR. FEATHERSTONHAUGH'S CONDUCT IS SANCTIONABLE.

While this Court has given the SEC the opportunity to seek sanctions against Mr. Featherstonhaugh, it did not identify, describe or substantiate a single act constituting misconduct on the part of Mr. Featherstonhaugh to warrant such an invitation. Indeed, the only reference made to Mr. Featherstonhaugh [as Lynn Smith's counsel] by this Court is on page 19 of MDO II in the context of whether the SEC exercised reasonable diligence in its efforts to discover the Annuity Agreement. As part of the Court's reasoning in support of its finding that the SEC did demonstrate reasonable diligence, it

evaluated by comparison the diligence of others similarly situtated. As to Mr. Featherstonhaugh, the Court noted:

> Others as well failed to learn of the Annuity Agreement. Lynn Smith's counsel, representing one of the individuals with actual knowledge of the agreement and also unfettered by privilege or adverse interest, also asserts that he failed to discover the existence of the Annuity Agreement until after July 27, 2010 when it was provided by the SEC. [citation omitted] He too presumably exercised due diligence in representing Lynn Smith in her response to the SEC's document demand and during the evidentiary hearing...In short, all those with obligations of diligence at least equal to that of the SEC and without limitations of privilege or adverse interest also failed to discover the existence of the Annuity Agreement further supporting the SEC's contention that it exercised reasonable diligence.

MDO II, p. 19.

This single reference to Mr. Featherstonhaugh does not portray an attorney who has acted in any way contrary to his professional or ethical obligations or even suggests in the slightest that his conduct is in question or sanctionable. While the conduct of other parties have been identified and highly scrutinized by this Court, Mr. Featherstonhaugh has not been provided *any* notice from this Court as to what specific conduct it believes Mr. Featherstonhaugh engaged in that would conceivably subject him to sanctions. Indeed, on this record there is no basis in which this Court could seek sanctions against Mr. Featherstonhaugh whether on its own initiative or by way of motion from an adverse party. See Schalaifer Nance & Co. v. Estate of Warhol, 194 F.3d 323, 334-336 (2nd Cir. 1999). Moreover, the Court did not identify Mr. Featherstonhaugh specifically as someone who was "associated with the Trust" or associated with any wrongdoing.

The SEC's most recent filing explicitly acknowledges that there is no evidence in the record to support an application for sanctions against Mr. Featherstonhaugh. It is uncontested that Mr. Featherstonhaugh did not represent the Trust during the period in question. He did not seek to obtain discovery nor did he have an obligation to respond to

discovery concerning the Trust. He did not file any papers or advocate any position that related to the Trust and he did not solicit any testimony from either his client or any other witness on behalf of the Trust or in furtherance of its interests during any deposition or during the preliminary injunction hearing.

The only documents that Mr. Featherstonhaugh filed on behalf of his client that the SEC has taken issue was a list of assets of Lynn Smith (Dkt. 19), a single affidavit of Lynn Smith, dated May 21, 2010 (Dkt. 23)[2] and his own Declaration dated September 3, 2010 (Dkt. 133). Mr. Featherstonhaugh acknowledged in his Declaration that the discovery of the Annuity Agreement did make the submission of Lynn Smith's list of accounts inaccurate, since at the very least she had a future contingent interest in the form of annuity payments. However, pursuant to that Declaration, he did not become aware of the Annuity Agreement until after the filing of the asset list. The single affidavit of Lynn Smith that Mr. Featherstonhaugh filed contemporaneous with his memorandum of law in opposition to the SEC's motion for a preliminary injunction had nothing to do with the Trust. Rather the focus of the legal arguments and the sworn facts supporting those arguments dealt primarily with Lynn Smith's stock account. The only reference to the Trust account in her affidavit was in paragraph 23, but this was offered to simply verify that her stock account was used to fund its corpus rather to enunciate any particular purpose of the Trust.[3]

Acknowledging that the factual basis for sanctions for conduct by Mr. Featherstonhaugh is non-existent on the record, the SEC attempts to concoct an elaborate

[2] A second affidavit by Lynn Smith was filed by Jill Dunn (Dkt. 34) in support of the Trust's motion to intervene.

[3] A passing reference was made that the Trust was created "to provide security for my children's future." However, even with the existence of the Annuity Agreement, there is nothing false about this statement since her interest and that of her husbands in future annuity payments is merely contingent and that the children are the ultimate beneficiaries to the Trust.

scheme wherein Jill Dunn, Thomas Urbelis, Dave Wojeski and Lynn Smith were all in cahoots in concealing the existence of the Annuity Agreement...and goes even further to suggest that James Featherstonhaugh was the ring leader of it all. Apart from identifying Mr. Featherstonhaugh's relationships between other individuals associated with the Trust, the SEC does not offer a single shred of evidence to support that any conduct on the part of Mr. Featherstonhaugh warrants the type of relief it now seeks in its pending motion.

POINT III

THERE IS NO LEGAL AUTHORITY THAT WOULD PERMIT THIS COURT TO ENABLE THE SEC TO ENGAGE IN DISCOVERY AND AN EVIDENTIARY HEARING TO DETERMINE WHETHER OR NOT SANCTIONABLE FACTS EXIST.

The SEC has sought sanctions against Dunn, Urbelis, Wojeski and Lynn Smith within the context of three separate legal authorities that permit a Court to sanction a party or an attorney during the course of litigation: Federal Rule of Civil Procedure 11, 28 U.S.C. §1927 (to the extent the statute is applicable only to attorneys), as well as the Court's *inherent authority*. Under each of these authorities, the procedure is that either the moving party or the court must clearly identify and specifically describe the conduct for which sanctions are being sought and provide the target party with an opportunity to be heard and identify the specific legal authority under which they seek the sanction. Schalaifer Nance & Co., *supra* at 194 F.3d 334-336. Rule 11 provides a statutory procedure that incorporates these due process requirements whether a sanction motion is made by a party or whether it is sought by the court upon its own initiative. Fed. R. Civ. P. 11 (c) (1)-(3).

In this case, there is no specific conduct which the SEC can allege that would subject Mr. Featherstonhaugh to sanctions under any legal authority. Indeed, the SEC

has not identified the source of authority for the sanctions that might be considered or the specific conduct for which the sanctions are being sought as required under the law so that a defense can be properly mounted. Id at 334. Rather, the SEC seeks to impose an entirely new and unprecedented procedure that will enable the SEC to undertake ancillary discovery and seek an evidentiary hearing to first determine whether sanctionable facts even exist before bringing its formal motion sanction. Under this unfounded procedural theory, the SEC is not bound to due process procedures which are normally required under established governing law – they do not need to notify what conduct they believe is sanctionable or identify the authority under which they will seek such sanctions. According to the SEC, it need only establish "sufficient red flags"...to justify their request for an evidentiary hearing. (Doc 26, p. 21). Therefore the SEC is not only proposing a fundamentally new procedure where parties can engage in unbridled fact finding expeditions before even bringing a formal application for sanctions, it has constructed the standard by which such procedure can be invoked – the so-called "sufficient red flag" standard.

Not surprisingly, the SEC does not provide a single legal authority that would authorize this Court to permit this kind of fact finding evidentiary hearing or discovery to determine in the first instance whether or not sanctionable facts exist. Neither Rule 11 nor 28 U.S.C. §1927 provides any type of statutory framework that would allow for this kind of procedure and, indeed, one federal district court has found that such a notion "would be a perversion of Rule 11 — it would unnecessarily multiply proceedings — to conduct a trial or extended evidentiary hearing just to determine whether sanctions should be awarded." Tunnell v. Crosby, 2009 U.S. Dist. LEXIS 92437 (N.D.F.L. 2009). Certainly, if Congress had intended that litigants should have some fact-finding ability

for purposes of bringing a future sanction claim, it would have included it in the statutory framework.

Nor is there any case law to support that the Court can order such a hearing based on its inherent authority. The Supreme Court of the United States has recognized the potential for abuse and has cautioned that "[B]ecause of their very potency, inherent powers must be exercised with restraint and discretion." Chambers v. NASCO, Inc., 501 U.S. 32, 44 (1991). The Second Circuit has also expressed concern over the potential for abuse:

> A troublesome aspect of a trial court's power to impose sanctions, either as a result of a finding of contempt, pursuant to the court's inherent power, or under a variety of rules such as Fed. R. Civ. P. 11 and 37, is that the trial court may act as accuser, fact finder and sentencing judge, not subject to restrictions of any procedural code and at times not limited by any rule of law governing the severity of sanctions that may be imposed. The absence of limitations and procedures can lead to unfairness or abuse.

Mackler Prods., Inc. v. Cohen, 146 F.3d 126, 128 (2nd Cir. 1998).

It is submitted that if the Court were to entertain the SEC's request to hold an evidentiary hearing for the purpose of determining whether Mr. Featherstonhaugh's conduct could serve as the basis of a sanction claim before a formal motion is even made is exactly the kind of procedural perversion the Second Circuit has cautioned against. It certainly doesn't take much of an imagination to conjure how this pre-sanction motion, fact finding proceeding could lead to unfathomable abuse. Indeed, if such a procedure were to exist, an attorney could, with little or no evidence (or simple red flags), subject his adversary to tumultuous ancillary litigation which may or may not yield sufficient facts to warrant a sanction motion under the established authority governing sanctions. If the party does eventually identify specific facts that could warrant sanctions, it then must file a motion setting forth the specific conduct identified and the specific authority under

which those sanctions are sought and provide the target party with the opportunity to be heard. To be sure, the multiplication of proceedings would be catastrophic and an insurmountable burden on the judiciary and litigants practicing before the bar in good faith.

The Court need not look any further than the present application to witness the modicum of evidence or so called "red flags" that the SEC is suggesting it needs to allege to pursue its unfettered investigation of Mr. Featherstonhaugh and other members of the bar and parties to any litigation. Here is the list of SEC's red flags: long time relationships, proximity of office space and conversations with other interested parties in the case. Even more disconcerting is a lawyer's ability to craft a red flag when one isn't even there. Take for example, the SEC's total mischaracterization of John D'Aleo's involvement and scope of his testimony concerning the Trust. See Affidavit of John D'Aleo, dated March 21, 2011. Based on these mischaracterizations, the SEC would have the Court believe that Mr. D'Aleo gave false and misleading testimony when this simply was not the case. Couple this with his longtime friendship with Mr. Featherstonhaugh and there you have your "red flag."

Accordingly, this Court should reject the SEC's invitation to establish such an ill-conceived, unfounded, and dangerous legal precedent.

POINT IV

THE APPLICATION OF THE CRIME FRAUD EXCEPTION.

Not only does the SEC seek the permission from this Court to engage in an unprecedented fact-finding evidentiary hearing, including discovery to determine whether or not facts exist that could be used against Mr. Featherstonhaugh in a future application for sanctions, the SEC also seeks to strip Lynn Smith of her privileged communication

with her attorney for such purposes. In the event the Court elects to move forward with the fact-finding investigation against Mr. Featherstonhaugh despite the arguments set forth herein to the contrary, it is premature to determine within this motion whether the crime-fraud exception should apply. If this Court does believe it should apply, then the proceedings contemplated by the SEC against Mr. Featherstonhaugh should be postponed until the end of this litigation in order to ensure Lynn Smith can continue to mount an effective defense in the underlying litigation.

A. A Determination of the Crime-Fraud Exception is Not Ripe.

Whether an evidentiary hearing is found by this Court to be necessary for Mr. Featherstonhaugh, the SEC's motion to invoke a crime/fraud exception to the attorney/client privilege is not ripe. The attorney-client privilege protects against the required disclosure of any confidential information given by a client to his/her attorney during the course of seeking professional legal advice. "Required" implies that for the attorney-client privilege to be invoked, there must be a demand for information by subpoena or other demand sanctioned by the law. A client may not, at least from a technical legal perspective, invoke the attorney-client privilege without first receiving a demand to produce information. Once there is a request for information from an adversary, a client has the privilege to refuse to disclose and/or to prevent another person from disclosing confidential communications between that client and his/her attorney. For the crime-fraud exception to apply, the SEC will have the burden to first demonstrate that there is probable cause to believe that: (1) a fraud or crime has been committed; and (2) the communications *in question* were in furtherance of the fraud or crime. In re Richard Roe, Inc., 168 F.3d 69, 70 (2nd Cir. 1999) (quoting In re Richard Roe, Inc., 68 F.3d 38, 40 (2nd Cir. 1995). (Emphasis added).

Currently, there is no demand from the SEC for any confidential communications between Smith and Featherstonhaugh and no privilege has been invoked. In other words, there is no justiciable controversy that warrants the Court's determination on this issue presently. Instead the SEC is merely seeking an advisory opinion from this Court as to whether or not the attorney client privilege should apply...should there be a discovery request or an evidentiary hearing concerning Lynn Smith's communications with her attorney. If there is a need for an evidentiary hearing or document discovery, and at that time, the SEC seeks to illicit confidential communications, only then can Lynn Smith invoke her privilege as to the particular communication being solicited at which time the Court's opinion as to whether the crime-fraud exception applies will be justiciable based upon the particular communication being elicited.

B. If the Crime-Fraud Exception is Applicable, All Further Discovery on this Collateral Issue and any Evidentiary Hearing Should be Postponed Until the End of Trial of the Underlying Matter.

If this Court should presently determine that the crime-fraud exception applies to communications between Lynn Smith and her attorney, Mr. Featherstonhaugh, any subsequent discovery or proceedings contemplated by the SEC against Mr. Featherstonhaugh should be postponed until the end of this litigation in order to ensure Lynn Smith can continue to mount an effective defense in the underlying litigation.

In most cases, the crime-fraud exception is applied during the course of litigation when the protected communication being sought between a defendant and his/her counsel is integrally intertwined with the underlying claims being made by the party seeking to impose the exception. SEC v. Herman, 2004 U.S. Dist. LEXIS 7829 (S.D.N.Y. 2004) (crime-fraud exception applied to attorney-client communication concerning a private offering that was alleged to be used to defraud investors in an underlying claim of fraud

in an SEC action); Sackman v. Liggett Group, 167 F.R.D. 6 (E.D.N.Y. 1996)(crime-fraud exception applies to privileged research documents conducted by cigarette manufacturer that was alleged to be used to mislead the public as to the dangers of smoking). In these cases, the alleged misconduct and the assertion of the privilege are integrally intertwined with the underlying claims of fraud and the evidence derived therefrom can be used in furtherance of those claims.

In the case at bar, the SEC seeks to apply the crime-fraud exception to privileged communications to alleged litigation conduct that is completely unrelated to the SEC's underlying claim for fraud. The distinction is important because the collateral matter the SEC is attempting to litigate for purposes of pursuing sanctions against Mr. Featherstonhaugh does not have to be decided in order for the SEC to continue pursuit of its underlying claims. Thus the SEC will not be prejudiced if the collateral dispute is delayed until the underlying matter is fully litigated and resolved. On the other hand, Lynn Smith's defense of the underlying action could be severely compromised if this Court permits the SEC to proceed in its fact investigation of Mr. Featherstonhaugh on a simultaneous tract. Indeed, it is conceivable that a communication is indisputably a privileged communication as it relates the defense of Lynn Smith in the underlying action but would have to be disclosed pursuant to the crime-fraud exception as to the collateral action against Mr. Featherstonhaugh. In light of the fact that the attorney/client privilege is the most sacred of all confidential communications recognized by common law, Upjohn Co. v. United States, 449 U.S. 383, 389 (1981), this Court should weigh in on the side of the privilege and permit the collateral action to be suspended until the end of this litigation.

CONCLUSION

Wherefore, for all of the foregoing reasons, James D. Featherstonhaugh respectfully requests that the Court deny the SEC's motion in its entirety.

Dated: March 21, 2011

Respectfully submitted,

Featherstonhaugh, Wiley & Clyne, LLP

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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.

AFFIDAVIT OF JOHN D'ALEO

JOHN D'ALEO, being duly sworn, deposes and says:

1. I respectfully submit this affidavit in response to the Securities and Exchange Commission's (the "SEC") Motion for Sanctions against certain attorneys and parties to this litigation and other individuals relating to allegations they conspired to conceal an annuity agreement in order to misrepresent the interests that Lynn and David Smith had in the David L. and Lynn A. Smith Irrevocable Trust U/A 0/04/04 ("Trust").

While it does not appear that the SEC is seeking sanctions against me, my association, engagement and testimony in this matter is certainly negatively implicated and mischaracterized to the degree to which I feel I have an obligation to respond.

2. I am a certified public accountant who was retained by the Trust to review the deposits and transfers in and disbursements from the Trust Brokerage accounts. In other words, I was asked simply to trace the flow of funds going in and coming out of the Trust from its inception to approximately April, 2010. The scope of my engagement with the Trust was limited to a flow of funds analysis as was my testimony in Court as it relates to the Trust. I was not retained nor was I ever asked to analyze or provide an opinion as to the Trust document itself. The Intervenor's Exhibits 10 and 11 attached hereto as Exhibit A and the transcript of my testimony attached as Exhibit B verify the limited scope of my engagement and the testimony I provided in Court.

3. The SEC indicates that I "testified as an expert witness on behalf...of the Trust" and that I "vouched that the Trust was the simple irrevocable Trust that L. Smith, Dunn and Wojeski said it was, and that the Trust paid all of its taxes." As set forth in paragraph 2 of this affidavit, to the extent my testimony can be characterized as expert testimony, it was limited to an analysis of the fund flows of the Trust not as an expert of the Trust itself or the tax consequences relating to its creation. My testimony that the SEC references does not in any way indicate that I "vouched" that the Trust was a simple irrevocable Trust. My testimony states that

> "it was *indicated to me* when we inquired that it was an irrevocable trust, and *if it is an irrevocable trust*, then the assets were transferred into the trust, that those assets are not owned by David or Lynn Smith but, in fact, are owned by the trust."

I also testified that I had seen a copy of the Declaration of Trust, but qualified that statement by stating, "I can't say I looked at every line of it..." lending further credence that my testimony was not to be taken as an opinion about the Trust itself. Based on what I was told and the Trust Declaration that I saw, and, without any other documentation to suggest otherwise, I assumed that the Trust was a standard irrevocable trust.

4. I did testify that all of the Trust taxes were paid but only as *to those taxes that were shown as due on the returns as prepared by the Trust's accountant and that I reviewed as part of my engagement.* I did not determine, evaluate or even consider whether those returns were prepared completely or correctly, including whether any taxes could have been due at the time the Trust was created. I merely identified disbursements from the account, identified them as payments for taxes and confirmed that those taxes were, in fact, paid.

5. I was aware that the stock that funded the Trust had appreciated in value above their original cost as indicated by the SEC in its papers but I was never asked and I never evaluated or ever considered what the tax consequences would be if the stocks had been sold rather than gifted to the Trust when it was established. My use of the term "transfer" was not intended to mislead this Court but rather was an accurate term based on the scope of my analysis – identifying the movement of funds from one account source to another (ie. transfer).

6. I never saw nor ever contemplated the existence of another document known as a private annuity agreement and certainly did not evaluate, consider or provide an opinion to my client or this Court as to the tax consequences this may or may not have had when the Trust was created. I have never to this day (apart from this case) had any

experience dealing with private annuity trusts in my over 35 years as a certified public accountant.

7. I am unwilling to accept the SEC's characterization that my testimony was untruthful or that I conspired with others to provide false testimony. Rather I would suggest that it is the SEC who seeks to cleverly mislead this Court by mischaracterizing my testimony and my involvement in this litigation.

JOHN D'ALEO

Sworn to before me this
21st day of March, 2011.

Notary Public – State of New York

MICHELLE M. DUFEL
Notary Public - State of New York
No. 01DU6046997
Qualified in Montgomery County
My Commission Expires August 21, 2014

Exhibit A

P. 6

DAVID & LYNN SMITH IRREVOCABLE TRUST WITHDRAWALS 2004-2010

Date	Amount	Explanation
12/27/2004	$100,000	Purchase 5 year 9% Notes due 12/31/09 of Pine Street Capital Partners, LLP
4/11/2005	$300,000	Same as above
4/18/2005	$2,300	Payment to DLS to reimburse for 2004 trust taxes paid from personal account.
4/18/2006	$92,105	Wired to DLS to reimburse $87,595 for payment of 2005 trust taxes ($71,595) and 2006 trust estimated tax ($16,000) paid from personal account. Difference of $4,510 currently unexplained.
6/30/2006	$83,830	Pine Street Capital Partners, LLP - capital call
12/20/2006	$129,678	Same as above
4/15/2006	$110,636	Wire transfer for payment of 2007 US+NYS trust taxes and 2006 trust estimates.
4/13/2009	$32,967	2008 US final trust tax payment
4/13/2009	$8,570	2008 NYS final trust tax payment (Return shows $8,573 due)
4/15/2010	$95,000	Reimbursement to L. Smith for: Trust 2009 extension payment (US) $16,000 (NYS) $4,000 Personal 2009 tax extensions (US) $66,500 (NYS) $8,500

Updated: June 4, 2010

Intervenor Ex #10 6/10/10 10-CV-457

SMITH IRREVOCABLE TRUST
TAX PAYMENTS 2004-2010

	2004 US	2004 NYS	2005 US	2005 NYS	2006 US	2006 NYS	2007 US	2007 NYS	2008 US	2008 NYS	2009 US	2009 NYS	Totals
Extension Payment													
4/15/2005	$ (1,800)	$ (500)											$ (2,300)
4/15/2008							$ (62,582)	$ (18,054)					$ (80,636)
4/15/2010											$ (16,000)	$ (4,000)	$ (20,000)
Estimated Payments													
4/15/2006					$ (16,000)								$ (16,000)
12/30/2006					$ (85,000)	$ (20,000)							$ (85,000)
4/15/2007							$ (15,019)	$ (5,073)					$ (20,092)
4/14/2008									$ (24,000)	$ (6,000)			$ (30,000)
Overpayment Applied			$ (1,000)	$ (341)			$ (18,834)	$ (227)					
													$ -
Final Tax (+ penalty)	$ 800	$ 159	$ 56,268	$ 16,668	$ 62,166	$ 19,773	$ 96,435	$ 23,354	$ 56,987	$ 14,573			
Overpayment	$ (1,000)	$ (341)			$ (18,834)	$ (227)							
Tax Due							$ -	$ -					
4/15/2006			$ 55,268	$ 16,327									$ (71,595)
4/15/2009									$ 32,987	$ 8,573			$ (41,560)
													$ (367,183)

Summary of Tax Payments				Summary of Tax Payment Related Distributions				
4/15/2005		$ 2,300	[1]	4/18/2005	$ 2,300	[1]	Check payable to DLS	
4/15/2006	$ 16,000			4/18/2006	$ 92,105	[2]	Wire to DLS	
4/15/2006	$ 71,595	$ 87,595	[2]					
12/30/2006		$ 85,000	[3]					
4/15/2007		$ 20,092	[3]	4/15/2008	$ 110,636	[4]	Wire to DLS	
4/15/2008	$ 30,000			4/13/2009 $ 32,987			Payable to US Treasury	
4/15/2008	$ 80,636	$ 110,636	[4]	4/13/2009 $ 8,573	$ 41,560	[5]	Payable to NYS Income Tax	
4/15/2009	$ 32,987			4/15/2010	$ 20,000	[6]	Wire to L. A. Smith	
4/15/2009	$ 8,573	$ 41,560	[5]					
4/15/2010	$ 16,000							
4/15/2010	$ 4,000	$ 20,000						
		$ 367,183			$ 266,601			

Notes:

[1] [4] [5] Total payments agree to distributions

[2] Reimbursement to DLS included difference of $4,510 which is believed to relate to $4,800 4/16/06 NYS estimate for trust paid from DLS account not claimed on return as filed.

[3] Payments made out of DLS funds. No record found of reimbursement from trust to to DLS

[6] Payment included in total of $95,000 wired to account of Lynn A. Smith on 4/15/10.

Updated: June 8, 2010 at 1:00PM

Intervenor Ex # 11 6/10/10 10-CV-457

Exhibit B

THE COURT: Miss Dunn, any questions?

MS. DUNN: Your Honor, Mr. D'Aleo is a summary witness for me as well, but for purposes of clarity, I have no objection to Mr. Stoelting doing his cross-examination of Mr. D'Aleo now, and then I would put on my direct with him, if that would make sense for the record. Or do you want -- I, I, I'm happy to go now if you would like.

THE COURT: Why don't you go now, and then Mr. Stoelting can cross-examine on both.

MS. DUNN: Okay.

MR. STOELTING: Actually, your Honor, it would likely be Mr. McGrath.

THE COURT: I'm sorry. Mr. McGrath.

DIRECT EXAMINATION BY MISS DUNN:

Q. Mr. D'Aleo, did there come a time that an issue came up during -- following your preparation of the asset inventory for Lynn Smith that you were questioned as to why you did not include within that asset inventory an NFS stock account held under the name of the David and Lynn Smith irrevocable trust by its trustee Thomas Urbelis?

A. Yes.

Q. And was there a reason that you -- or what was the reason you didn't include that stock account in Lynn Smith's inventory of assets?

A. Well, it was first indicated to me when we inquired that it was an irrevocable trust, and that if it is an irrevocable trust, then the assets were transferred into the trust, that those assets are not owned by David or Lynn Smith but, in fact, are owned by the trust.

Q. Okay. Did you review the trust declaration?

A. I did. I have seen a copy of it. I can't say I looked at every line of it, but I have seen the declaration of trust.

Q. Did you reach any conclusions regarding it when you reviewed it?

A. It was a relatively standard trust document. And, accordingly, it would meet the criteria of being a trust. A trust is a separate entity, a legal entity. It's a separate taxpayer. The assets that are put into it are -- is funded, are assets owned by that entity, the trust.

Q. And did there come a time that you signed an accounting services agreement with my law firm?

A. Yes, I did.

Q. Do you recall the date that you signed that agreement?

A. I believe it was May 17th.

Q. Of this year?

A. Of 2010. Excuse me.

Q. Okay. I'm going to show you intervenor Exhibits

9, 4, 12, and 2, in that order. I apologize that they are in that order and not in numerical order.

When I asked you to review this trust account for me, did you indicate that you needed certain documents to perform that review?

A. Yes. I thought it would be helpful to get copies of the tax returns since that was would be the annual summary of what happened. And you did supply me with tax returns. And then, since one of the investments, income items that was listed on the tax return was the investment of the trust by Pine Street Capital Partners LP, you also were able to obtain copies of the Form 1065, which is the partnership agreement of the trust -- partnership tax return of the trust, the schedule K-1, which is the amount reported by each individual partner. And you obtained copies of the K-1s for the Lynn and David Smith trust.

In addition, since we were looking at some of the items of various deposits and an analysis of what was paid out of the accounts, some of it obviously related to income taxes, because we looked at the tax returns. And I made an inquiry of you as to whether or not you could have the trustee obtain what is known as an account transcript from the Internal Revenue Service, which you did obtain.

What an account transcript is is basically a summary of that particular taxpayer, showing the amount of

tax, the amount of payments that were made, whether there were estimated payments, extension payments, final payments, if any penalties were imposed, if there was any interest calculated. So you provided me with that information also.

Q. Did there come a time that you asked me to obtained additional information concerning the trust investment in Pine Street Capital Partners?

A. Yes, there is -- there was. And you obtained information with respect to what's reported in these K-1s. And I think you also had some other information you may have gathered based on data that you received in connection with the deposition of Mr. Welles.

Q. All right. And did you also consult with the accountant? Did you consult with anyone related to the trust outside of my law firm?

A. Yes. One of the schedules I prepared was a summary of the taxes that were paid and due for the period in which the trust existed and also the amount of taxes paid or distributions that were made in connection with those taxes.

And in connection with that evaluation, I did speak to a Mr. Ron Simons who's a partner at the Piaker firm who prepared these returns. And prior to the time we actually received the transcripts from the Internal Revenue Service, he was helpful in discerning some of the

information that was on the tax return, specifically relating to when estimated tax payments were made.

Q. Okay. Did Mr. Simons provide you with any information concerning the manner in which the trust taxes were paid?

A. He gave the amounts that were paid. He indicated in a brief conversation I had with him that typically the payments were made, he would fill out the tax returns, he would provide the information to make the payments, and occasionally those payments, as we determined based on looking at the facts, either were paid directly by the trustee, or in other cases may have been paid by David Smith. And then we subsequently were able to trace that in those cases, not in every case, but most of those cases, the amounts that David Smith paid on behalf of the trust were, in fact, reimbursed to David Smith by the trust.

Q. Okay. And did you -- did there come a time that you reviewed the NFS brokerage account statements for the trust?

A. Absolutely. We looked at all -- we looked at every statement that was prepared during the period in which the trust existed.

Q. Okay. I'm giving you intervenor Exhibit Number 5. Are these the account statements which you said you reviewed at my request?

A. I would say without going through every one that these are the statements for the years 2004 through the first several months of 2010.

Q. All right. And can you take me through your analysis of these account statements and describe for the Court what you were doing as you were reviewing the statements?

A. Well, basically, in looking at the statements, I looked at the activity in the account from the period of inception through this time in 2010, with a view to get a better understanding of what happened within the trust. And in doing that, I was able to put together a schedule showing all the deposits to the trust and distributions or transfers out of the trust from the time it was first funded in September of 2005 through the period in March of 2010.

Q. All right. How did you determine how the trust was first funded in September 2004?

A. Okay. I looked at the trust document, found that it was actually formed on, I believe, August 4th of 2004. And then in the tax return for 2004 year, it showed the sale of certain stocks. Obviously, it had been funded by that date. And then in looking at the statements for the trust and also looking at Lynn Smith's personal statements, I was able to determine that the fund -- excuse me -- the trust was funded on September 1, 2005, by a transfer of 100,000

shares of Charter One Financial.

Q. Are you sure it was September 1, 2005?

A. 4. Excuse me.

Q. And how did you get the information to indicate it was funded in that manner?

A. By looking at the statement at the trust level, it showed an incoming transfer of the 100,000 shares on September 1st, and then looking at Lynn Smith's brokerage statement, her individual brokerage stock statement, it showed the transfer out to the account of the trust on that date.

Q. All right. And that account statement for the September 2004 period from Lynn Smith, Lynn Smith's stock account, is that one of the documents you previously testified to under examination by Mr. Featherstonhaugh?

A. Yes, it is.

Q. I'm handing you what I've marked as intervenor Exhibits 3, 10 and 11. Are those the schedules that you prepared at the conclusion of your examination?

A. Yes, they are.

Q. All right. And starting with the Intervenor Exhibit 3.

A. Yes.

Q. The Smith irrevocable trust deposits, 2004 to 2010.

A. Yes.

Q. Can you take the Court through this document, explain how you arrived at these entries?

A. Okay. These are all deposits that went into the account from the period September 1, 2004, up through and including part of April 2010.

Basically, without going on a line by line basis, it shows the initial contribution to the trust of a hundred thousands of Charter One, which was then sold in the trust on September 1, 2004, and the proceeds were 4,000,450. So that was the large portion -- that was the portion in which the trust was funded with.

And these other amounts that were additions were either interest paid on the notes that were issued when they acquired those notes, those two different purchases, one of a hundred thousand, and one of 300,000. So this schedule shows the deposits into the account of the interest. It also shows some return of capital that was received into the trust as a portion of the notes were being redeemed.

I could go through every line, but that's basically what it is.

Q. Okay. So each of these entries listed as a deposit, is that an amount that you obtained from the account statements in Intervenor's Exhibit 5?

A. That's correct. Each of these were taken from and

traced to the particular monthly statement that is indicated on this schedule.

Q. All right. And if you look at the fourth grouping of entries, do you see a date that says 8/21/2006?

A. Yes.

Q. Is there any significance to that?

A. Well, we realized that that was a typo. It's supposed to be 3/31/2006. So --

Q. All right.

A. -- when this was prepared, there was an error.

Q. So that entry actually relates to -- that $9,000 deposit relates to an entry on Exhibit 5, a deposit made on March 21, 2006?

A. Exhibit 3?

Q. I'm sorry. Exhibit 5. The account statements.

A. Oh, yes. Yes.

Q. All right.

A. Each of these that are delineated here on the schedule all relate to deposits or additions to the accounts on the dates that are indicated, except for that one, there was a typo.

Q. Okay. And you prepared this document?

A. Yes, I did.

Q. Do you have a pen with you, Mr. D'Aleo?

A. I do.

Q. I'm going to ask you to correct that typographical error on the exhibit since it has not yet been entered into evidence?

A. Okay. I've done that.

Q. With that correction, is this document -- does it accurately reflect all the deposits made into the Lynn and David Smith irrevocable trust brokerage account from September 2004 through April 16, 2010?

A. That's correct, it does.

Q. All right. Can you explain the bottom section of that document, other contributions to trust?

A. Yes. What this shows, there was a period in which the brokerage statements wouldn't show amounts related to private placements. They just simply couldn't. Since they couldn't value it, the clearing agent would not show that asset. So what the bottom line -- bottom four lines are, is it actually came back into the statement when it changed the clearing agent. I believe it was on October 9, 2009. So it then showed back on the statement.

Similarly, on September -- excuse me -- July 2, 2009, the partnership units, which also were not in the statement because they wouldn't show private placements, came back into the statement. So there really wasn't technically a deposit. It was just a reintroduction of the partnership units into the statement because they were never

there before.

Q. Okay. And what is the reason you chose to include it in this document?

A. Just for clarity and to be complete based on increases in the values of that account in that time period.

Q. All right. Turning to Intervenor's Exhibit 10, which is entitled David and Lynn Smith irrevocable trust withdrawals 2004 to 2010, can you explain who you created this statement and the source of the information is?

A. The source of the information was basically the same, was looking at the various account statements and seeing the amounts that came out. And they were, in fact, limited as one, two, three, four ...

MR. McGRATH: I'm sorry. Do you have an extra copy?

A. Okay. So to continue, these amounts were also determined by looking at the individual statements for the time period and that's reflected on this particular chart.

Q. Okay. Can you explain the first two entries, the 100,000 and the 300,000?

A. Yes. The 100,000 was taken out on December 27, 2004. The 300,000 was taken out on April 11, 2005. These both were a subscription to the $400,000 in nine percent notes that the trust actually purchased in Pine Street Capital Partners LP.

Q. Okay. And the entry for April 18, 2005, can you explain that entry --

A. Yes.

Q. -- and how you arrived at it?

A. Okay. On April 18, 2005, there was a withdrawal of $2,300. And determined that was a repayment to David Smith to reimburse him for the 2004 trust taxes that were actually paid from his personal account.

The way we got to that is we saw that the distribution comes out in the amount of $2,300 in another exhibit which I assume we're going to get to, which is a summary of all the tax returns. That is the amount, cumulative amount of taxes paid in 2005 for both U.S. and New York State.

Q. Did there come a time that you saw a -- any checks written by David Smith representing his payment of that $2,300?

A. I think I made a request of you to try to get those checks. And, yes, we did see those checks. One for $1,800 and one for -- 1800 and $500, yes.

Q. And was there a package of documents that I obtained from Thomas Urbelis at your request and provided to you?

A. Yes, you did.

Q. And was the copy of David Smith's check in that

package?

A. I believe it was.

Q. The next entry, April 18, 2006, in the amount of $92,105, does that indicate that amount was withdrawn from the trust account on that date?

A. Yes, it does.

Q. Can you amplify on your explanation in this box and explain how you arrived at this explanation?

A. Okay. This also was a total amount of 92,105 wired into the account of David Smith, again reimbursing him for taxes. It was made up of two pieces. It actually is made up of three pieces, excuse me.

The 2005 trust taxes equal the total 71,595, and the first payment of the 2006 estimated taxes was $16,000, both of which were paid from David Smith's personal account. There's a difference between that total and the 92,105, of $4510.

And further determination, I think what we found was that, in fact, David Smith made an estimated tax payment in the amount of $4600 to New York State. And I believe we saw a check for that. I do have to say, however, that since we were unable to get the transcripts from New York State because they were going to take four to six weeks, as opposed to the IRS that gave it to us in two days, we have not been able to document that. But the returns as filed

did not show that additional $4600 payment being made, but we do have a check that I've seen in the amount of $4600 that was made payable to New York State income tax that had a reference for --

Q. Okay.

A. -- the trust payment.

Q. All right. Now you prepared this chart or last updated it on June 4, 2010, is that correct?

A. That's correct.

Q. And if you could look at the documents I gave you, Intervenors' Exhibit 2 is in front of you in that pile. They are copies of four pages, copies of cancelled checks?

A. Yes.

Q. Can you take that out?

A. I have that.

Q. All right. Since you last updated this chart, have -- did I provide you with those copies of cancelled checks?

A. Yes, you did.

Q. Did you review the cancelled checks?

A. Yes, I did.

Q. And could you tell me if you drew any conclusions as a result of your review of the cancelled checks consecutively numbered 1742, 1743, 1744, and 1745?

A. These were payments all drawn on the M & T bank

account of David Smith, and they were amounts that paid the U.S. Treasury on 4/17/06, in the amount of $16,000.

Q. Is that the first check written?

A. That's the first check.

Q. Is there any notation on that check that you could tie to the trust tax return, such as a taxpayer ID number?

A. Yes. In the stamp on the back that shows where it was being charged to or deposited, it has the trust federal ID number starting with the series 55, which, in fact, is the taxpayer identification number of the trust.

Q. And the next page, check number 1743?

A. That's made payable to New York State income tax in the amount of $4600. This is the check I just referenced that we found out about that came out of the account of David L. Smith payable to New York State income tax. And that also was in connection with the trust. This is the particular check that we've not been able to determine, in fact, that the return included that amount. And since we've not received the transcripts from New York State, we don't know whether or not the state credited it. But it appears, based on what's on this check, it is a payment in connection with the New York State income tax.

Q. Okay. And the next two checks?

A. Okay. The next check is check number 1744. It's dated April 17, '06, again drawn on the M & T bank account

of David Smith, in the amount of 55,000... I'll have to read this. I think it's 55,268.

Q. Okay. And the final check in that series?

A. Final check is check number 1745, also on April 17, '06, in the amount of $16,327, payable to New York State income tax.

Q. All right. Mr. D'Aleo, if you add those four checks together, what's the total amount that they represent?

A. If you add these together, it comes to $92,195, I believe.

Q. And those checks were written on what date?

A. These were written on 4/17/06.

Q. And you determined from your review of the trust account statements that the next day $92,105 was wired from the trust account to David Smith's account, is that correct?

A. That's correct. I think it's two days later. Oh, some of them the 17th and some of them the 16th. Oh, they're all dated the same date.

Q. Okay.

A. Excuse me, it is one day.

Q. Okay. Now, the next entry in your trust withdrawal chart, June 30, 2006, can you explain that entry?

A. That is the amount of $83,830.

Q. And let's take that with the following entry for

$129,678.

A. That is on December 20th of 2006.

Q. What do those two amounts of withdrawals represent?

A. We were able to determine that all both of these were capital calls for the Pine Street Capital Partners LP.

Q. How did you make that determination?

A. We made an inquiry -- I made an inquiry through you. We were able to determine, I believe, based on the deposition that was given by Mr. Welles, that, in fact, these were amounts relating to capital calls.

Q. All right. Were you also able to tie those amounts in any way to the K-1 -- the schedule K-1s issued by Capital Street Partners to the trust?

A. Yes, I believe I was. They were shown as withdrawals from the capital section of the tax returns.

Q. And that would be in 2006? The K-1s are in Intervenor Exhibit 4.

A. I'm looking at that.

Q. Would the aggregate of those two amounts, $83,830, and $129,678, would they show on the K-1 statement issued by Pine Street Capital Partners to the trust?

A. Yes.

Q. In the tax year 2006? (crosstalk.)

A. If you look at the 2006 schedule K-1, which is a

portion of the partnership return that goes to the individual investor, the aggregate of those two amounts are reported as capital contributed during the year, for a total of 213,508.

Q. Okay. Is that box N of the K-1 for 2006?

A. It's box N, and it's the second line. It's entitled capital contributed during the year.

Q. Okay. And the next line on your schedule, April 15th 2008, can you explain that entry in your explanation?

A. Okay. That's in the amount of 110,636. And when we prepared the schedule summarizing the amounts that were required to cover the taxes for 2007 for New York State and for the U.S. for the trust, it totalled 110,636.

Q. Okay. And you drew those amounts from the tax returns and from the account statements?

A. That's correct.

Q. All right.

A. And some of it was also duplicative work with respect to New York -- the U.S. payment because it was reported on the transcripts.

Q. Okay. And the next entry, April 15th, 2009?

A. That was April 15th. Oh, April 13th, 2009?

Q. The next entry on the trust of withdrawal document.

A. I have April 13th, 2009. 32,987? That is the balance that was due for the 2008 federal taxes, 32,987. And there was a check drawn from the trust in that amount. Also on that date, there was a check for $8,570, which is the amount of the New York State final trust payment. And I indicated on my schedule that even though the check was drawn for 8570, the return shows 8573 as being due.

Q. Okay. And those two amounts, you reviewed documentation of checks having been issued directly from the NFS trust account to pay these taxes?

A. Yes.

Q. All right. And then the final entry on that chart, can you explain what that is?

A. The final entry in the book chart is April 15, of2010 for $95,000, which was the amount that was drawn and deposited in the account of Lynn Smith. We were able to determine two things. First, the total of $20,000, which is made up of a U.S. payment of 16,000 and a New York State payment of 4,000, related to the extension payments for the trust, for a total of 20,000.

And the additional amounts, the difference, the $75,000, we were able to determine was amounts that were deposited in Lynn Smith's accounts for which they made personal extension payments of sixty-six-five for the United States and $8,500 for New York State.

Q. All right. Turning to the final exhibit in front of you, Intervenor's Exhibit 11.

THE COURT: Do you have much longer, Miss Dunn?

MS. DUNN: Very close.

THE COURT: Close?

MS. DUNN: Yes.

A. Yes.

Q. Can you explain this document, how you prepared it and what it shows?

A. What this document shows is based on information that was accumulated from the tax returns, from conversations with Ron Simons at Piaker with respect to estimated tax payments, and also with respect to reviewing the account transcripts from the Internal Revenue Service.

Now, what this shows in some level of detail are the tax payments, whether they were in connection with estimated payments or final payments or carryovers from extra payments in a prior year, and it tracks on a year by year basis the tax liabilities and the payments made against those liabilities. That's the top one-half of the schedule.

On the bottom, we summarize on the left-hand side the payments that were made that relate to particular periods and summarized by year. Those total 367,183, which agrees to the total amount of the payments that were made

for all the years, 367,183.

The bottom half on the right-hand side is a summary of distributions that were made from the trust to pay the taxes whether they were made in the form of direct payments, by check to the tax authorities or by wires or by payments made either by wire or by check to the account of David Smith or Lynn Smith to pay the taxes that we just discussed. That totals 266,601.

Q. All right. And based upon your review of all of the documentation we've discussed and your preparation of these charts and in your consultation with Ron Simons, the accountant for the trust, were you able to reach a conclusion as to whether or not all of the trust tax liabilities were paid --

A. Yes.

Q. -- for all of the preceding years, dating back to the taxable Year 2004.

A. Well, yeah, I think I would make one caveat. All the payments for the years 2008 were made and the extension payments were made for 2009. We don't know yet what the final taxes are yet for 2009 because the returns haven't been prepared.

Q. And with the exception of the two payments you testified to that were made on April 15th, in the amount of $66,500 and $8,500 to pay Lynn and David Smith's personal

taxes, with the exception of those two amounts, were you able to account for all of the money that has gone out of the trust account since its inception?

A. Yes. I accounted for all the monies that went out. The -- my analysis here determines that the actual amounts of tax payments that were made out of the trust were actually less than were made because the distributions in certain cases David Smith was not reimbursed in total for the amounts that he had paid personally.

Q. Okay. And do you -- can you tell us the amount of money over the years that David Smith was not reimbursed for?

A. Well, the total taxes equal 367,183. And the amount of reimbursements were 266,601. So a difference of, let's say, a hundred thousand dollars roughly.

Q. All right. Very good. Thank you.

THE COURT: We're going to take our evening recess at this time. It appears we'll be back together again tomorrow. I would propose 10:15, since I have another matter on at 9:30. SEC have any thoughts on the subject?

MR. STOELTING: I think 10:15 is acceptable to us.

THE COURT: Mr. Featherstonhaugh?

MR. FEATHERSTONHAUGH: 10:15 is fine with me, your Honor.

THE COURT: And Miss Dunn?

MS. DUNN: Is there -- do we have any play with that to maybe start a little bit later? I have a commitment tomorrow from 10 to 11. I was not anticipating this hearing going this long.

THE COURT: I don't think any of us were.

MS. DUNN: If not, that's fine, I can make adjustments.

THE COURT: I think you'll have to make adjustments.

MS. DUNN: Okay. Thank you.

THE COURT: 10:15 tomorrow to the conclusion or the death, whichever comes first. (laughter.) All right?

We'll stand in recess.

(Court adjourned at 5:15 PM.)

* * * * *