

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

10 Civ. 457 (GLS/DRH)

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. MCGINN, DAVID L. SMITH,
LYNN A. SMITH, DAVID M. WOJESKI, Trustee of
the David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04, GEOFFREY R. SMITH,
LAUREN T. SMITH, and NANCY MCGINN,

Defendants,

LYNN A. SMITH, and
NANCY MCGINN,

Relief Defendants, and

DAVID M. WOJESKI, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

**PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION
TO THE MOTION TO DISMISS FILED BY DEFENDANTS
THE DAVID L. AND LYNN A. SMITH IRREVOCABLE TRUST,
GEOFFREY R. SMITH AND LAUREN T. SMITH**

March 25, 2011

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Plaintiff Securities and Exchange Commission respectfully submits this memorandum of law in opposition to the motion to dismiss the Amended Complaint under Federal Rule of Civil Procedure 12(b)(6) filed by defendants the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04/04 (the "Trust"), Geoffrey R. Smith ("G. Smith") and Lauren T. Smith ("L.T. Smith"). Their motion is made "in conjunction with" a pending motion to dismiss filed by Lynn Smith on December 15, 2010 (Dkt. 224), and the Court has assigned both motions to dismiss the same return date.

PRELIMINARY STATEMENT

The motion to dismiss filed by the Trust, G. Smith and L.T. Smith ignores the Court's previous factual findings as well as the admissions of the Trust itself regarding the \$380,000 transferred to G. Smith and L.T. Smith in July 2010. Dkt. 261-6, at 3-7 (Trust's verified accounting showing transfers to G. Smith and L.T. Smith). The fraudulent conveyance claim against the Trust, G. Smith and L.T. Smith arises from these July 2010 transfers as well as from David and Lynn Smith's transfer of \$4.5 million to the Trust in September 2004. As alleged in the Amended Complaint, these transfers are voidable under New York Debtor and Creditor Law ("NYDCL") §§ 276, 278, and the SEC is entitled to a judgment for the amount of the conveyances. Am. Compl. ¶¶ 169-173 (Eighth Claim for Relief).

The extensive evidentiary record in this case establishes that the Trust (ostensibly created to hold assets solely for the benefit of the Smiths' adult children, G. Smith and L.T. Smith) was a sham. Through an Annuity Agreement entered into by the Smiths upon the creation of the Trust, the Trust was obligated to return all its assets over a number of years to the Smiths beginning in 2015. The Smiths created the Trust at a time they had numerous motives to conceal assets; it was not intended to be a benefit to their children but rather a judgment-proof vehicle for the

Smiths to protect their life savings from creditors. The Smiths, the Trust and their lawyers, moreover, sought to conceal the Annuity Agreement to hide the facts that David Smith continued to exercise ownership and over the Trust's assets and that David and Lynn Smith continued to exercise an ownership interest over those assets.

These facts have been established through pre-hearing depositions, two evidentiary hearings, numerous briefs by all relevant parties from May 2010 through the present, and a verified accounting prepared by the Trust showing the July 2010 transfers to G. Smith and L.T. Smith. In addition, the Court has issued three Memorandum-Decision and Orders dated July 7, 2010, Dkt. 86 ("MDO I"), November 22, 2010, Dkt. 194 ("MDO II"), and January 11, 2011, Dkt. 254 ("MDO III"), which make factual findings regarding the Trust and the funding of the Trust. These factual findings, which are now the law of the case, are largely determinative of the issues raised in this motion to dismiss.

The Trust, G.Smith and L.T. Smith do not dispute that the findings in the Court's MDOs are law of the case. They nevertheless misconstrue the allegations in the Amended Complaint, this Court's findings and the relevant law in order to manufacture three arguments for dismissal under Rule 12(b)(6). First, they repeat the arguments previously made in Lynn Smith's pending motion to dismiss, which the SEC thoroughly discredited in its opposition brief. *See* Dkt. 249. Second, they argue that the Trust gave fair consideration for the \$4.5 million transferred to it in 2004. This argument cannot survive in view of this Court's factual findings regarding the intent and knowledge of the Smiths, the Trust and their representatives. Finally, G. Smith and L.T. Smith argue that they are mere beneficiaries of the Trust and they should not be defendants, relying on a single district court case in which beneficiaries of a trust were dismissed as defendants. In that case, however, the beneficiaries were dismissed because they did not receive

any assets directly from that trust. In contrast, G. Smith and L.T. Smith received a total of \$380,000 wired into their personal bank accounts from the Trust.

Accordingly, the motion to dismiss should be denied in its entirety.

ARGUMENT

In considering a motion to dismiss, the court must accept as true all facts alleged in the complaint and must draw all reasonable inferences in favor of the plaintiff. *In re Reserve Fund Sec. and Deriv. Litig.*, ___ F. Supp. 2d. ___, 2010 WL 685013, at *5 (S.D.N.Y. Feb. 24, 2010) (denying motion to dismiss SEC's complaint). Moreover, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).

For the purposes of deciding a Rule 12(b)(6) motion to dismiss, the Court may consider "any statements or documents incorporated in [the Complaint] by reference. Even where a document is not incorporated by reference, the court may nevertheless consider it where the complaint relies heavily upon its terms and effect, which renders the document integral to the complaint." *Mangiafico v. Blumnethal*, 471 F.3d 391, 398 (2d Cir. 2006).

I. THE AMENDED COMPLAINT STATES A CLAIM AGAINST THE TRUST

The Trust, G. Smith and L.T. Smith argue that the SEC cannot execute on the assets of the Trust because those assets are "untainted" and because the SEC is not a proper creditor. Both arguments, however, were made in Lynn Smith's motion to dismiss and were thoroughly addressed in the SEC's opposition brief. *See Plaintiff's Opposition to Relief Defendant and Defendant Lynn A. Smith's Motion to Dismiss*, filed Jan. 7, 2011 (Dkt. 249). To summarize, the

Amended Complaint pleads many specific facts detailing the “badges of fraud” and compelling the conclusion that the Trust contained tainted assets, and was created by the Smiths to shield David Smith’s assets from creditors. *Id.*; Am. Compl. ¶¶ 119-133. In addition, the Court found that the Trust is an asset of David Smith’s and should remain frozen so that it can be used to satisfy any judgment entered in this case. MDO II, at 21-22; *see also* Memorandum-Decision and Order filed Feb. 11, 2011 (Dkt. 277) (“the Trust must be viewed as an asset of David Smith”). Finally, the SEC is a creditor within the purview of New York Debtor and Creditor Law. Dkt. 249 at 12-13.

II. THE AMENDED COMPLAINT STATES A CLAIM UNDER NYDCL § 276 AND 278 AGAINST THE TRUST, G. SMITH AND L.T. SMITH

A. The Trust Failed to Provide Consideration and Acted in Bad Faith

The SEC has properly stated a claim against the Trust under Sections 276 and 278 of the NYDCL. The Trust argues that because the Annuity Agreement describes the transfer of the Charter One stock as a “purchase and sale” that fair consideration was provided. New York law, however, provides that “fair consideration” may be found only where property is conveyed “in exchange for such property, or obligation, as a fair equivalent therefore, *and in good faith...*” NYDCL § 272(a) (emphasis added).

David and Lynn Smith did not transfer the Charter One stock to the Trust in good faith, and there was not a bona fide purchase and sale. The Amended Complaint alleges that the Smiths fraudulently created the Trust to shield their assets from creditors. Am. Compl. §§ 130-131. The Court has already found, following the belated disclosure of the Annuity Agreement, that the Smiths formed the Trust “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.” MDO II, at 21. With respect to the Trust, the Court found that the then-

Trustee, Thomas Urbelis, also knew about the Annuity Agreement at the time and therefore knew that the Trust was not what it purported to be. MDO II, at 20 n.17. The lack of good faith means that the transfer was without consideration.

The argument that the Trust acted in good faith and for fair consideration cannot survive these findings, which are now law of the case. The law of the case doctrine “commands that when a court has ruled on an issue, that decision should generally be adhered to by that court in subsequent stages of the same case unless cogent and compelling reasons militate otherwise.” *Johnson v. Holder*, 564 F.3d 95, 99 (2d Cir. 2009). Such reasons include “an intervening change in law, availability of new evidence, or ‘the need to correct a clear error or prevent manifest injustice.’” *Id.* at 99-100 (citation omitted). The Trust, G. Smith and L.T. Smith fail to identify any reason to disregard these findings. In any event, as set forth in the SEC’s opposition to Lynn Smith’s motion to dismiss, the Amended Complaint states facts sufficient to demonstrate bad faith on the part of the Smiths and the Trust.

The Trust’s claim that it received assets from the Smiths in good faith is further discredited by the conduct of the Trustee and Lynn Smith. The Court found that they engaged in “fraud, misrepresentation and misconduct” in misrepresenting the Trust in this action and by concealing the Annuity Agreement. MDO II, at 20.

B. The Claims Against G. Smith and L.T. Smith Are Properly Alleged

The Amended Complaint alleges that G. Smith and L.T. Smith received funds in July 2010 that had been fraudulently conveyed to the Trust. Am. Compl. ¶¶ 138, 172. The relief sought is the return of all assets fraudulently conveyed, or their equivalent value, and for attorney fees pursuant to NYDCL §§ 276, 276-a and 278. Am. Compl. at § IX (Prayer for Relief).

When the Amended Complaint was filed on August 3, 2011, the SEC had not learned the

details of transfers from the Trust after MDO I was issued on July 7. Two weeks after the filing of the Amended Complaint, however, the Trust provided the Court-ordered verified accounting showing that, on July 12 and 16, 2010, G. Smith received two transfers totaling \$295,500 from the Trust and, on July 12, 2010, L.T. Smith received one transfer of \$83,500 from the Trust. These funds were wired directly from the Trust bank account to their personal bank accounts. Dkt. 261-6, at 17. According to the verified accounting, G. Smith and L.T. Smith used these funds to pay for, among other things, personal living expenses, credit cards, health insurance, a new apartment lease, and a down payment on property. *Id.* at 17-18.

Under NYCDL § 278, the transfers from the Trust to G. Smith and L.T. Smith are recoverable unless the transferees provide “fair consideration” and are “without knowledge of the fraud at the time of the purchase.” NYDCL § 272. G. Smith and L.T. Smith do not allege that they provided any consideration for these transfers and the record supports the conclusion that fair consideration was not provided. The transfers are not alleged to be payment for any antecedent debt; indeed, the funds were used to cover personal expenses and to purchase property. Dkt. 261-6, at 6-7. G. Smith and the Trustee have claimed, however, that the \$200,000 transferred to G. Smith’s personal bank account on July 12, 2010 was not a distribution to G. Smith but rather an investment in a business operated by G. Smith. Dkt 148, at 3; Dkt. 147, at 4. This assertion is irrelevant: all of the funds transferred to G. Smith and L.T. Smith in July 2010 were wired into their personal banking account to use at their discretion.

As stated above, the Trust did not act in good faith in transferring funds. Because the SEC has adequately pled actual fraudulent intent on the part of the transferors, the burden shifts to G. Smith and L.T. Smith to demonstrate that they were bona fide purchasers of the assets for value. *See DLJ Mortg. Capital, Inc. v. Kontogiannis*, 594 F.Supp. 2d 308, 331 (E.D.N.Y. 2009)

(citing cases); *Fed. Nat'l Mortg. Ass'n v. Olympia Mort. Corp.*, 04 CV 4971, 2006 WL 2802092, at *8 (E.D.N.Y. Sept. 26, 2006) (“in cases of intra-family transfers, where facts concerning the nature of the consideration are within the exclusive control of the transferee, the burden shifts to the transferee to prove the adequacy of the consideration”). The Amended Complaint adequately pleads G. Smith and L.T. Smith as defendants liable for a Judgment up to amount transferred to them. *See RTC Mortgage Trust v. Sopher*, 171 F. Supp.2d 192, 201 (S.D.N.Y. 2001) (holding that transferee was liable under NYCDL § 278 “to the extent of the value of the assets transferred”).

G. Smith and L.T. Smith’s sole citation in support of their motion to dismiss, *Sullivan v. Kodosi*, 373 F.Supp.2d 302 (S.D.N.Y. 2005), is unavailing because G. Smith and L.T. Smith received direct transfers totaling \$380,000 whereas the beneficiaries in *Sullivan* received no direct transfers. In *Sullivan*, the plaintiff alleged Section 276 claims against the grantor of a \$20 million trust, the trustee and two beneficiaries. The district court granted the motion to dismiss the NYCDL § 276 claim as to the two beneficiaries because there was no evidence of any assets being transferred to them; instead, “plaintiff has merely identified them as beneficiaries.” 373 F.Supp.2d at 309. As the *Sullivan* court stated, dismissal was warranted because “*the assets were not in any way directly transferred into the hands of the Trust beneficiaries[.]*” *Id.* at 310 (emphasis added). Unlike the beneficiaries in *Sullivan*, of course, G. Smith and L.T. Smith received assets directly from the Trust into their bank accounts. As a result, they are properly named as defendants under NYDCL. *See Fed. Nat'l Mortg. Ass'n v. Olympia Mort. Corp.*, 2006 WL 2802092, at *9 (under NYCDL 278, “a money judgment may be entered against the transferee in an amount up to the value of the fraudulently transferred assets”).

CONCLUSION

For the foregoing reasons, the SEC respectfully requests: (1) that the Court deny the motion of the Trust, G. Smith and L.T. Smith under Rule 12(b)(6) to dismiss the Eighth Claim for Relief in the Amended Complaint, and (2) that the SEC be allowed to replead in the event any portion of the motion to dismiss filed by the Trust, G. Smith and L.T. Smith, or Lynn Smith's motion to dismiss, is granted.

Dated: New York, NY
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Respectfully submitted,

s/ David Stoelting
Attorney Bar Number 516163
Attorney for Plaintiff
Securities and Exchange Commission
3 World Financial Center
New York, NY 10281
Telephone: (212) 336-0174
Fax: (212) 336-1324
Email: stoeltingd@sec.gov

Of Counsel

Kevin McGrath
Lara Shalov Mehraban
Haimavathi Varadan Marlier
Joshua Newville