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March 31, 2011

Hon. Gary L. Sharpe
U.S. District Court Judge
James T. Foley U.S. Courthouse
445 Broadway, Rm. 441
Albany, NY 12207

Re: Securities and Exchange Commission v. McGinn, Smith & Co., Inc. et al.
Case No: 1:10-CV-457

Dear Judge Sharpe:

Kindly accept this letter brief in lieu of a more formal submission in reply to the Securities and Exchange Commission's 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.

Notably absent from its opposition papers is a single acknowledgement that there remains an undisputed holding in this case rendered by Magistrate Judge Homer in its July 7, 2010 Memorandum Decision and Order that the stock that was used to fund the Trust in 2004 was severable from the rest of Lynn Smith's stock account and that it could not be construed as being tainted for purposes of a future disgorgement claim. It would appear the SEC would rather ignore this aspect of Judge Homer's various decisions, even though it remains the law of the case, because it does not fit so neatly into its allegations that these assets were fraudulently conveyed by Lynn Smith to the Trust.

The SEC instead has attempted to argue that the assets that funded the Trust were tainted along with the rest of Lynn Smith's Stock Account based on Judge Homer's alternative holding that David Smith was a beneficial owner of that account. However, Judge Homer was clear in his finding that the stock used to fund the Trust represented "untainted funds easily identifiable and severable from the stock account as a whole." (Dkt. 86, p. 38). The two alternative holdings are clearly reconcilable and without conflict and therefore the SEC cannot argue that the stock asset used to fund the Trust was tainted and subject to then-present or future creditor claims.

Although the introduction of the annuity agreement may have resulted in Judge Homer re-evaluating his decision as to David Smith's interest in the Trust, the agreement does not implicate the legitimacy of the funds that now represent the corpus of the Trust. Granted, the SEC is correct that the Magistrate Judge elected to include in the asset freeze the corpus of the Trust upon reconsideration. However, we disagree that the corpus can be used to satisfy any judgment entered in this case. In fact, Lynn Smith has appealed that aspect of Judge Homer's decision to freeze the entire Trust because the annuity agreement simply does not give David Smith an equitable interest in the corpus of the Trust. (Appeal No: 11-916). Rather it provides Mr. Smith with a contingent future interest in the form of annual annuity payments. It is the annual annuity payments rather than the entire corpus of the Trust that should have been the subject of Judge Homer's asset freeze – a point that will be raised with the Second Circuit.

However, this issue need not deter this Court from dismissing the Amended Complaint as to Lynn Smith and the Trust (and inevitably the beneficiaries) since the law of the case continues to be that the corpus of the Trust constitutes untainted funds because they originated from untainted and severable funds from Lynn Smith's Stock Account. With those funds securely out of the grasp of present and future creditors, the SEC's repeated arguments that it specifically pled actual fraud on the part of Lynn Smith and the Trust is unavailing to its fraudulent conveyance claim simply because even if the allegations are taken as true, you can't defraud a creditor of a claim over property to which he is not entitled. See *Gutierrez v. Bernard, et al.*, 865 N.Y.S.2d 212, 213 (1st Dep't 2008) *citing, Hoyt v. Godfrey*, 88 N.Y. 669, 670 (1882).

The SEC further argues that the claims against Geoffrey and Lauren Smith are properly alleged. We disagree. It would appear from its opposition papers that the SEC is now arguing that the Trust itself, fraudulently conveyed Trust assets after July 7, 2010 to Lauren and Geoffrey. In its Memorandum of Law in opposition to this motion, the SEC argues:

> As stated above [in reference to its previous arguments in its memorandum of law], the Trust did not act in good faith in transferring funds. Because the SEC 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 Plaintiff's Opposition to Motion to Dismiss filed by the Trust, Geoffrey and Lauren Smith. (Dkt. 313, p. 6).*

However, the single allegation in its Amended Complaint that seeks to hold Geoffrey and Lauren liable under the New York State Fraudulent Conveyance statute is that they had "received funds after July 7, 2010 that had been fraudulently conveyed to the Smith Trust." (Dkt. 100 ¶ 172). While the SEC may argue that it has pled sufficient facts to substantiate a fraudulent conveyance claim from Lynn Smith to the Trust, nowhere in the Amended Complaint can the SEC represent that it pled with particularity the necessary facts to establish actual fraud perpetrated by the *Trust* as the transferor of the assets to the beneficiaries as required pursuant to *Fed. R. Civ. P. 9(b).* Rather the SEC relies on statements made in its Memorandum of Law to allege such fraud.

In the case of *Sullivan v. Kodsi*, 373 F. Supp. 2d 302 (S.D.N.Y. 2005), the transferor was the individual who funded the trust and the court found that the plaintiff had pled facts sufficient to establish actual fraud in order to survive a motion to dismiss. Consequently, the plaintiff was found to have stated a cause of action as it relates to the transferor and the Trust, as a recipient of the alleged fraudulently conveyed assets. However, the court held that it could not hold the beneficiaries of the trust liable under the fraudulent conveyance statute unless there were sufficient facts pled that the beneficiaries participated in the transfer that was the subject of the fraud.[1] Id. at 309-310.

Here, the SEC merely alleges that that Lauren and Geoffrey are the recipients of funds that had fraudulently been transferred to the Trust in 2004. In order to hold each of them liable under the Debtor and Creditor law, the SEC would have to plead additional facts that demonstrate Lauren and Geoffrey participated or otherwise had knowledge of the alleged circumstances of the transfer from Lynn Smith to the Trust. No such allegations are made, and therefore a claim under the fraudulent conveyance statute against Lauren and Geoffrey simply cannot stand. While the SEC belittles the fact that only a single case from the United States District Court of the Southern District of New York is relied upon for such a proposition, it offers not a single case to the contrary.

If the SEC is now arguing that the beneficiaries are the direct recipients of assets fraudulently conveyed by the Trust, the SEC is required to plead such allegations with particularity in order to survive a motion to dismiss. Clearly, the SEC has failed to do so in its Amended Complaint.

Based on the submissions to date, we respectfully request that the Court find that the SEC has failed to state a cause of action to hold the Trust and its beneficiaries liable under the New York State Debtor and Creditor law.

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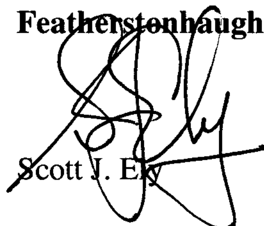
[1] The SEC attempts to distinguish *Sullivan* because the beneficiaries in that case were not alleged to have received transfers of the assets fraudulently conveyed. However, this distinction is without substance because "New York law permits money damages to be recovered only "against parties who participate in the fraudulent transfer..." *RTC Mortgage Trust v. Sopher* 171 F. Supp.2d 192 (S.D.N.Y. 2001).

Respectfully Submitted,

Featherstonhaugh, Wiley & Clyne, LLP



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