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,

Defendants, and

LYNN A. SMITH,

Relief Defendant.

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

PROPOSED INTERVENOR'S MEMORANDUM OF LAW IN SUPPORT OF MOTION TO INTERVENE AND IN OPPOSITION TO PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

THE DUNN LAW FIRM PLLC
Jill A. Dunn, Esq. (Bar Roll 506942)
Attorneys for Proposed Intervenor
99 Pine Street, Suite 210
Albany, New York 12207
Direct dial: (518) 694-8380
Email: Jdunn708@nycap.rr.com

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POINT I

THE PROPOSED INTERVENOR IS ENTITLED TO INTERVENE AS OF RIGHT PURSUANT TO FEDERAL RULES OF CIVIL PROCEDURE 24

Rule 24 of the Federal Rules of Civil Procedure requires the Court to allow anyone to intervene who "claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest." Fed. R. Civ. Pro. 24 (a). The burden of showing inadequate representation is minimal, and is satisfied if the applicant shows that representation of his interest may be inadequate. *Trbovich v. United Mine Workers*, 404 U.S. 528 (1972). In determining the real party in interest, the trustee of an express trust may sue in his own name without joining the person for whose benefit the action is brought. Fed. R. Civ. P. 17(a).

Here, there can be no dispute that the sole asset of the trust, its brokerage account, has been frozen by the Court's temporary restraining order, and that Plaintiff seeks to continue that restraining order throughout the pendency of this complex securities action by seeking a preliminary injunction. (See Order to Show Cause dated April 20, 2010, Ex. B, p. 5;Wojeski Aff.¶ 4). The effect of the April 20 Order to Show Cause and the proposed preliminary injunction is to render the Trustee powerless to manage this account, make investment decisions or otherwise carry out the terms of the trust. (See Wojeski Aff. ¶ 4, 7). The TRO has, in essence, abandoned this account to the nuances and volatility of the stock market, thus imperiling the sole asset of the trust and depriving the beneficiaries of their rights, under the terms of the trust, to receive disbursements to provide for their education, health, support and maintenance.

(See Wojeski Aff., Ex. A, p. 1). The Trustee has met his burden of demonstrating "an interest relating to the property or transaction that is the subject of this action," particularly an interest that is subject to the preliminary injunction motion hearing. As the duly appointed Trustee of a trust whose account is frozen by this Court's order, David Wojeski clearly has standing to intervene in this action.

It is equally clear that no party to this litigation can adequately protect the interests of the Trustee. The only place this account is mentioned in any of Plaintiff's submissions to the Court is on the last page of Exhibit B of the Order to Show Cause signed on April 20, 2010. Exhibit B purports to be a list of "Known Bank Accounts" -- although there is no explanation as to what the listed bank accounts, and in particular, the irrevocable trust's account, are known for, to whom they are known or to what they purport to relate. This trust account is listed last, dangling alone on the final page, perhaps added by the Plaintiff as a gluttonous afterthought in its thinly veiled effort to make the impact of their TRO as broad and sweeping as possible, even without establishing or even suggesting any connection between this account and any allegation in the Complaint.

Exhibit B is referenced only twice in the 23- page TRO, on page 7 and page 17. Plaintiff does not refer to the irrevocable trust in any manner, directly or indirectly, anywhere in its lengthy Complaint, nor is this irrevocable trust mentioned or even alluded to in any of the Declarations or voluminous exhibits provided to the Court in support of Plaintiff's request for an order freezing all accounts listed in Exhibit B. The concept of good faith and fundamental fairness imposes a duty on a party approaching the Court *ex parte* to seek injunctive relief to present the Court with full and accurate information. Since the Court only had Plaintiff's unchallenged submissions in considering the proposed asset freeze order, submissions which

were voluminous, the Court likely relied in some measure on the presumed good faith of the SEC in submitting its application to freeze 173 different financial accounts and halt business operations by numerous companies. Had anyone pointed out to the Court that there was no reference to or allegation concerning this lone account anywhere in the Plaintiff's voluminous submissions, it is reasonably possible, if not likely, that the Court might have denied at least that one portion of the otherwise far-reaching TRO and asset freeze order.

The absence of any reference to the trust or the trust account in the Plaintiff's Complaint, the TRO or its attorneys' Declarations and exhibits strongly suggests that the Plaintiff was not concerned with the existence of this account when these voluminous pleadings were drafted, other than to tack it on to the end of a long list of accounts and hope that the Court would not question its inclusion. Moreover, neither the account nor the trust was placed under the control of the court-appointed receiver, and there is no legal or factual basis for doing so. See Wojeski Aff. ¶ 6. Lastly, McGinn, Smith & Co., Inc. and David L. Smith had been the broker of record for this account. Since they are now prohibited from engaging in the securities business during the pendency of the TRO, then no one is managing this account. Thus, from every angle, the inescapable conclusion is that the interests of the trustee and the trust beneficiaries are not being protected by any party to this litigation and in fact have been imperiled by the Plaintiff's actions in freezing the account. Thus, the Trustee's motion to intervene for a limited purpose should be granted.

POINT II

THE RESTRAINING ORDER SHOULD BE LIFTED AND THE PRELIMINARY INJUNCTION MOTION SHOULD BE DENIED AS TO THE TRUST ACCOUNT BECAUSE THE PLAINTIFF HAS FAILED TO SUSTAIN ITS BURDEN

Plaintiff commenced this action by filing a Complaint on April 20, 2010. On the same day, Plaintiff sought and obtained, *ex parte*, an Order to Show Cause (Kahn, J.) containing a broad-reaching Temporary Restraining Order and Order Freezing Assets and Granting Other Relief. In support of its application for expedited and injunctive relief, Plaintiff submitted the Declarations of Lara Shalov Mehraban, Roseann Daniello, and Israel Maya, all of which were executed on April 19, 2010. In support of these Declarations, Plaintiff submitted four volumes of exhibits and documentary evidence.

Plaintiff's Complaint is 35 pages long, its Order to Show Cause with Exhibits is another 32 pages, the three Declarations of its attorneys comprise a combined 47 pages, and its entire submission was supplemented with four volumes of exhibits which are about six inches thick. Indeed, to justify the sweeping request made *ex parte* to the Court, one would of course expect Plaintiff to submit voluminous pleadings and affidavits. As is often the case, however, volume does not necessarily portend substance, and a meticulous review of the submission which was before the Court to justify Plaintiff's *ex parte* request to freeze the assets of this account reveals just one lone reference to the David L. and Lynn A. Smith Irrevocable Trust, and that reference is found only in Exhibit B to the Order to Show Cause, which lists the accounts to be frozen by that Order. Despite the explicit requirements of Rule 11(b) of the Federal Rules of Civil Procedure and the fundamental obligations of attorneys practicing before this Court, Plaintiff offered no corresponding allegation, evidence or even a bare supposition, indeed not a scintilla of

factual or legal justification whatsoever was offered to the District Court to justify the inclusion of this account in a sweeping asset freeze order. Astonishingly, Plaintiff instead chose to proceed with some hybrid form of "Trust me, I'm the government" and "just do it because I said so" approach to its *ex parte* application for a temporary restraining order. For the foregoing reasons, the TRO should be lifted immediately and entirely as to this account.

An examination of the merits of Plaintiff's underlying motion[1] for a preliminary injunction should lead the Court to the same conclusion. In his affidavit in support of this motion, the Trustee has submitted the Declaration of Trust which created the trust in August 2004, long before the overwhelming majority of the acts alleged in the Complaint could have occurred. A thorough reading of the Declaration of Trust and the affidavits of the trustee and the Donor of the trust conclusively prove that the source of the assets in the frozen trust accounts is completely unrelated to any of the transactions at issue in the Complaint. Plaintiff has not submitted any evidence, or even alleged, that any of the assets contained in this account came from the defendants or were comprised of any of the alleged "ill-gotten" gains plead in the Complaint and thus is not entitled to freeze the assets in this account.

The David L. and Lynn A. Smith Irrevocable Trust was established by Declaration of Trust on August 2, 2004, pursuant to the New York Estates, Powers and Trusts Law. (See Wojeski Affidavit, Exhibit A). According to Lynn A. Smith, the Donor, this irrevocable trust

[1] Because Plaintiff has not submitted any justification, allegation or evidence to support its inclusion of the trust's brokerage account in the asset freeze order, the task of opposing the motion for a preliminary injunction is challenging in that the proposed intervenor is left to speculate about Plaintiff's reasons, or to point the Court to the fact that no justification has been offered. Since the latter argument has been made by the trustee above in support of his request to lift the temporary restraining order, for purposes of opposing the motion for a preliminary injunction, the Trustee will presume that the trust's brokerage account was included in the asset freeze order on a theory, however, remote, that Defendant David L. Smith or Relief Defendant Lynn A. Smith had an ownership interest in the account and/or that the trust was funded with assets of one of the other defendants. Should Plaintiff assert some other basis, the trustee reserves the right to revisit this issue in his reply papers.

was created specifically to pass assets from Mrs. Smith to her children during her lifetime, in much the same way her father passed assets to her upon his death. (See Smith Aff. ¶ 2-5). By 2004, she had accumulated more than $6,500,000 in her brokerage account and saw no reason to retain these assets until her death, when her children could benefit from them during her lifetime. (See Smith Aff. ¶ 4). The only contribution made to this irrevocable trust was made by Lynn Smith on September 1, 2004 in the form of 100,000 shares of stock in Charter One Financial Corporation. (See Smith Aff. ¶ 3, 4). The origin of this bank stock was Mrs. Smith's initial purchase of Albank stock in 1992 during the IPO of Albany Savings Bank. At that time, she bought 40,000 shares at $10 per share, for a total investment of $400,000. As a result of stock splits, mergers and acquisitions as this local bank evolved from Albank to Albany Savings Bank to Citizens Bank to Charter One, that stock grew in value from her original purchase of 40,000 shares in 1992 to 110,735 shares valued in excess of $4,450,000 at the time they were transferred to the trust in September 2004. (See Smith Aff. ¶ 5; Exhibit B).

Plaintiff has not named the trust as a "relief defendant" and there is no basis for doing so. See *SEC v. Cavanagh*, 155 F.3d 129, 136 (2nd Cir. 1998) (person is not a proper relief defendant where there is an 'ownership interest' or 'legitimate claim' in the funds sought to be frozen). Plaintiff has neither alleged nor can it prove that any defendant transferred any assets to or made any preferential payments or payments without consideration to this trust account for any purpose at any time. Indeed, Lynn Smith was the only individual to fund this trust, and she did so in September 2004 with stock which she had owned continuously since 1992. The consideration she received in funding the trust with this stock was the tax benefit contemplated by paragraph THIRTEENTH of the Declaration of Trust. The Trustee has demonstrated that no beneficial right or ownership interest in this stock was reserved to the Donor, that the stock was

transferred outright from the brokerage account of Lynn Smith to the brokerage account of the trust, and that this stock was the only contribution to the trust. (See Smith Aff. ¶ 3 – 6; Ex. B). The Charter One stock was sold by the trust on the day it was received, realizing $4,450,000, which cash was retained in the brokerage account and invested thereafter. (See Wojeski Aff. Ex. B). There was no other transfer of funds or stock into this trust by the Donors after the initial funding on September 1, 2004, and no transfer of assets into the trust by any other named defendant.

By its terms, the trust is irrevocable and its assets cannot be claimed by the Donors or any creditor of the Donors. (See Wojeski Aff., Ex. A). Paragraph TWELFTH of the Declaration of Trust provides that "This Declaration and the trust(s) created hereunder shall be irrevocable, shall take effect upon acceptance by the Trustee and in all respects shall be construed and regulated by law of the State of New York. (See Wojeski Aff. ¶ 3; Exhibit A). David and Lynn Smith, as the grantors of the trust, did not reserve any power to revoke the trust or to dispose of the property outside the trust during their lifetime. The Smiths formed the trust without any expectation that they had any continuing ownership rights in the trust following its formation. (See Smith Aff. ¶ 6).

As a matter of law, this trust was and remains, irrevocable. Neither David Smith nor Lynn Smith has any beneficial interest in or control over the trust or its assets, and neither of them have any power to revoke the trust. By its terms, the trust exists for the benefit of their children, Geoffrey Smith and Lauren Smith and their children's issue. In the absence of any allegation or proof to the contrary, there is simply no factual or legal basis for imposing an Order, temporarily, preliminarily or permanently, which restrains or affects the trust's brokerage

account. The mere fact that the trust was named after its Donors does not provide a substitute for the proof required for Plaintiff to sustain a claim to the assets of this trust.

The only reference to the David L. and Lynn A. Smith Irrevocable Trust relates solely to a stock account owned by the irrevocable trust and held at NFS/Fidelity, which account has been managed by McGinn, Smith & Co., Inc. since its inception. (See Plaintiff's Order to Show Cause, Ex. B, p. 5). Plaintiff's own reference to the name on this account indicates that Plaintiff was aware that the Trust was irrevocable at the time it ought the asset freeze and was aware of the identity of the trustee. (See Plaintiff's Order to Show Cause, Exhibit B, p. 5). Plaintiff's reference to the account states: "[Redacted Name] TTEE David L. Smith & Lynn A. Smith, Irrev Tr U/A [Redacted date] 04). Indeed, this reference in Plaintiff's papers is a tacit acknowledgement that Plaintiff was aware that the account being frozen (a) belonged to the named Trustee ("TTEE") of the David L. Smith & Lynn A. Smith Irrevocable Trust, (b) that the trust was irrevocable ("Irrev Tr"), and (c) that it was formed under agreement ("U/A [Redacted date] 04") dated in August 2004.

Based upon Plaintiff's own notation on page 5 of Exhibit B, Plaintiff was on notice that the trust is irrevocable and should have undertaken further investigation before proceeding *ex parte* to freeze the account. Plaintiff was aware of the identity of the trustee and should have served him with notice of this proceeding. As indicated by the absence in the Order to Show Cause of any provision for serving the trustee, and the absence of any certificate of service on the Court's Docket, Plaintiff never served the then-trustee with the Order to Show Cause, thus creating significant jurisdictional issues. Lastly, Plaintiff was aware that the trust was formed under agreement dated in August 2004, well before the majority of the transactions alleged in the Complaint could have occurred. Thus, even a speculative theory for Plaintiff's reasons for

including the trust in the asset freeze order is belied by the notation to the trust in the very document created by Plaintiff.

Plaintiff's own inclusion of this account in Exhibit B of the TRO Exhibit B demonstrates that Plaintiff was aware that this account is not owned by any defendant or the relief defendant, and that the account should not have been included in the seemingly limitless "catch-all" provision of the TRO, which allowed Plaintiff to restrain any "assets, funds or other property of the Defendants and Relief Defendant" (See Plaintiff's Order to Show Cause dated April 20, 2010, p. 7) and prohibiting the "withdrawal, removal, transfer or other disposal of any such assets, funds or the properties including but not limited to, all assets, funds, or other properties held in the accounts listed in Exhibit B." See, Id. at p. 17. Plaintiff has not submitted any basis for restraining this account, whereas the trustee as proposed intervenor has conclusively demonstrated that the trust account should not be restrained. Plaintiff's motion for a preliminary injunction should be denied.

CONCLUSION

The proposed intervenor has demonstrated an interest in an account affected by Plaintiff's motion for a preliminary injunction and the failure of any party to the litigation to be able to protect the trustee's interests in the outcome. The Plaintiff has failed to plead or prove any entitlement to the relief requested as against the Trustee or the assets of the David L. and Lynn A. Smith Irrevocable Trust brokerage account with NFS/Fidelity. It is respectfully submitted that the temporary restraining order should be lifted and the preliminary injunction motion denied as it relates to this account.

Dated: May 26, 2010

s/Jill A. Dunn
Jill A. Dunn (Bar Roll No. 506942)
Attorney for Proposed Intervenor
THE DUNN LAW FIRM PLLC
99 Pine Street, Suite 210
Albany, New York 12207-2776
Telephone (518) 694-8380
Fax (518) 935-9353
Email: JDunn708@nycap.rr.com