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, GEOFFREY R. SMITH, Individually and as Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04, LAUREN T. SMITH, and NANCY MCGINN,	:	
Defendants,	:	
LYNN A. SMITH, and NANCY MCGINN,	:	
Relief Defendants.	:	

PLAINTIFF'S MEMORANDUM OF LAW
IN OPPOSITION TO TRUST'S MOTION FOR STAY

SECURITIES AND EXCHANGE COMMISSION
3 World Financial Center
New York, NY 10281
(212) 336-0174

October 3, 2011

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Plaintiff Securities and Exchange Commission respectfully submits this memorandum of law in opposition to the motion of defendant/intervenor Geoffrey R. Smith, Trustee of the David L. and Lynn A. Smith Irrevocable Trust, pursuant to Fed. R. Civ. P. 62(c), for an Order staying that portion of the Court's July 20, 2011 Memorandum-Decision and Order ("MDO IV") authorizing the Receiver to either sell or rent the Great Sacandaga Lake property (the "Lake Property") to satisfy Lynn Smith's obligation to repay $944,848.00 to the Trust and pay $51,232.00 in attorneys' fees and costs to the SEC, in the event L. Smith failed to make these payments herself on or before September 1, 2011.

PRELIMINARY STATEMENT

The Trust's motion should be denied because that portion of the order appealed from is not subject to the stay provisions of Rule 62(c), which only applies to orders granting, dissolving or denying an injunction. The Trust also has not sustained its burden of establishing its entitlement to a stay even if one were available. In particular, the Trust has not made a strong showing that it is likely to succeed on the merits, given that: a) the Trust was given actual notice of the SEC's motion for sanctions and had an opportunity to be heard; therefore its due process rights were not violated; and b) the Court's Order does not improperly infringe on the rights of the Trustee or impose a remedy that improperly penalizes a third party. It merely unwinds a transaction that would not have occurred but for L. Smith's fraud and the former Trustee's failure to produce the Annuity Agreement at the center of that fraud.

For the same reasons, the Trust will not be irreparably harmed by the denial of a stay because the Order merely places the Trust back in the same economic position it was in prior to the fraudulent events that lead to its purchase of the Lake Property. Finally, defrauded investors potentially entitled to funds recovered as part of any judgment against the Trust in this case will

be harmed if the Trust has to continue to dissipate funds to continue to maintain the Lake Property and the public interest against permitting parties from benefitting from frauds perpetrated on the Court is better served by unwinding the sale of the Lake Property that occurred only because of L. Smith's fraud.

FACTUAL BACKGROUND

On July 20, 2011, this Court issued MDO IV which, *inter alia,* granted the SEC's motion for sanctions against L. Smith. The Court found that L. Smith acted with subjective bad faith in failing to disclose the existence of an Annuity Agreement in her Statement of Assets filed with the Court (Dkt. No. 34), and in her testimony at her deposition and at the evidentiary hearing held in connection with the SEC's motion for a preliminary injunction, *inter alia*, freezing the assets of the Trust. MDO IV (Dkt No. 342 at 19). The Annuity Agreement required the Trust to make annual payments from the Trust to the Smiths of $489,932.00 beginning in 2015 and continuing until the last of David or Lynn Smith died. (Annuity Agreement; Dkt. No. 103-3). The Court found that "[t]he Annuity Agreement constituted conclusive evidence of David Smith's ongoing interest in the Trust, the issue central to the determination of the SEC's motion for a preliminary injunction as to the Trust and the Trust's cross-motion to lift the TRO." MDO IV (Dkt. No. 342 at 6).

The Court had initially denied the SEC's motion for a preliminary injunction against the Trust and lifted the freeze against its assets. July 7, 2010 MDO ("MDO I"; Dkt. No.86 at 42). The SEC subsequently learned of the Annuity Agreement and moved for reconsideration of that portion of MDO I that denied its motion freezing the Trust's assets. *See* Dkt. 103. On August 3, 2010, the Court temporarily refroze the Trust's assets (Dkt. 104). On November 2, 2010, the Court granted the SEC's motion for reconsideration and entered a preliminary injunction

continuing the freeze of the Trust's assets pending the outcome of this action. (November 22, 2010 MDO; "MDO II"; Dkt. 194).

Between July 7, 2010, when the Trust's assets were unfrozen, and August 3, 2010, when the Trust's assets were frozen again, the Trust was depleted of a total of $944,848.00. *See* Trust Accounting (Dkt. No. 142-2 at 4); Dunn e-mail (Dkt. No. 261-6 at 8). Of that amount, $600,000.00 plus closing costs was distributed to Lynn Smith for the sale of the Great Sacandaga Lake property to the Trust, $101,096.00 was disbursed to Dunn as attorney's fees and costs, and $8,098.50 as fees to Wojeski. Trust Accounting at 4. Accordingly, the Court ordered L. Smith to repay $944,848.00 to the Receiver on behalf of the Trust given that the monies would not have been disbursed but for L. Smith's fraud on the Court. MDO IV, Dkt. No. 342 at 39-41.

The Court further ordered that, if L. Smith failed to pay this amount to the Receiver by September 1, 2011, the Receiver may have judgment against her for any amount which remains unpaid and, if L. Smith fails to return to the Receiver by September 1, 2011 the full amount of the $600,000.00 sale price of the property plus closing costs, the Receiver may proceed in whatever manner he deems economically most feasible to maximize the return on this property, including the sale or rental of the property, or portions thereof, depending on the Receiver's determination of market conditions. *Id.* The Court also ordered L. Smith to pay the SEC $51,232.00 in attorneys' fees and costs. *Id.* at 50.

ARGUMENT

I. The Order Appealed From is Not Subject to the Stay Provisions of Rule 62(c)

The Trustee moves for a stay, pursuant to Fed. R. Civ. P. 62(c), of that portion of MDO IV permitting the Trustee to sell or rent the Lake Property. Trust Br. at 6. (Dkt. 376-1). Fed. R. Civ. P. 62(c), provides in pertinent part that "[w]hile an appeal is pending from an interlocutory

order or final judgment that grants, dissolves, or denies an injunction, the court may suspend, modify, restore, or grant an injunction on terms for bond or other terms that secure the opposing party's rights." Here, the portion of MDO IV that the Trust seeks to stay is not an interlocutory order or final judgment that "grants, dissolves or denies an injunction." Rather, it is an order granting the already appointed Receiver "leave on behalf of the Trust to take whatever action he deems in his judgment to be financially appropriate to obtain the maximum possible return on the Great Sacandaga Lake property, including the sale or rental of that property, in whole or in part..." MDO IV, Dkt. No. 342 at 50-51. Such an order is obviously not an order either granting an injunction, dissolving an injunction or denying an injunction. According, the Trust's application for a stay should be denied because Rule 62(c) does not authorize a stay of the order at issue here.[1]

II. The Trust Has Not Meet Its Burden of Justifying a Stay Even if Rule 62(c) Applies

Even if Rule 62(c) permits a Court to consider entering a stay of an order of the type at issue here, a stay is not warranted. A stay pending appeal under Rule 62(c) "is not a matter of right, even if irreparable injury might result." *Nken v. Holder*, 129 S. Ct. 1749, 1760 (2009) (citation omitted). Rather, such a motion requires "an exercise of judicial discretion, and [t]he propriety of its issue is dependent upon the circumstances of the particular case." Id. (internal quotation marks and citations omitted). "The party requesting a stay bears the burden of showing that the circumstances justify an exercise of that discretion." Id. at 1761 (citations omitted).

The exercise of discretion requires a court to balance four factors:

> (1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured

[1] Query also whether the portion of the Court's Order contested by the Trust is subject to interlocutory appeal given that it is clearly not a final order under 28 U.S.C. §1291, and given that the mere unwinding of the Lake Property's sale may not be appealable under 28 U.S.C. § 1292(a)(1) or (2).

> absent a stay; (3) whether the issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies.

Nken, 129 S. Ct. at 1760 (internal quotation marks and citations omitted). "[T]he degree to which a factor must be present varies with the strength of the other factors, meaning that more of one excuses less of the other." *In re: World Trade Ctr. Disaster Site Litig.*, 503 F.3d 167, 170 (2d Cir. 2007) (internal quotation marks and citations omitted). The first two factors are the "most critical." *Nken*, 129 S. Ct. at 1761. A stay should be granted only "when it is necessary to preserve the status quo pending the appeal." *Kidder, Peabody & Co. v. Maxus Energy Corp.*, 925 F.2d 556, 565 (2d Cir. 1991).

A. The Trust Has Not Made A Strong Showing That It Is Likely to Succeed On the Merits

As to the first factor, the Trust must make a "strong showing that [it] is likely to succeed on the merits." *Nken*, 129 S. Ct. at 1761. This requires a demonstration of more than a mere possibility of prevailing on appeal but less than a likelihood. See *Safeco Ins.Co. of Am. v. M.E.S., Inc.*, No. 09-CV-3312 (ARR)(ALC), 2010 WL 5437208, at *7 (E.D.N.Y. Dec. 17, 2010) (citing cases). "The probability of success that must be demonstrated is inversely proportional to the amount of irreparable injury [the moving party] will suffer absent the stay. Simply stated, more of one excuses less of the other." *Mohammed v. Reno*, 309 F.3d 95, 102 (2d Cir. 2002) (internal quotation marks and citation omitted).

The Trust argues that it is likely to succeed on the merits of an appeal because: "1) the Order is contrary to law in that it violates the Trust's due process rights by compelling the sale or rental of a non-named non-culpable party's property to satisfy a monetary sanction imposed upon an independent third party; 2) the Order is contrary to law in that it usurps the rights and

fiduciary duties of the Trustee; and 3) the Order is contrary to law in that it imposes an improper remedy which in effect penalizes a non-named, non-culpable party." Trust Br. at 7.

1. The Trust's Due Process Rights Were Not Violated

With respect to the first point, the Trust argues that neither the Trustee nor the Trust was a party to the Sanctions Order and neither was subject to sanctions pursuant to Fed. R. Civ. P. Rule 11 or the Court's inherent power. It contends that the July 20 MDO violates the Trust's due process protections in that it effectuates a taking of its real property to satisfy a third party's sanction and disgorgement order without notice and a reasonable opportunity to contest the Order. Trust Br. at 8.

The Trust's argument is based on a number of faulty premises. First, the Trust's claim that it did not have fair notice and an opportunity to contest the order is simply incorrect. The Trust has been a party to this action since it intervened in the spring of 2010. In addition, the Trust, through its attorney Jill Dunn, received notice of the SEC's Motion for Sanctions via the Court's ECF system on January 31, 2011, the very date the motion was filed. Dunn was replaced as the Trust's counsel by James Featherstonhaugh on February 15, 2011 (Dkt. 282). Featherstonhaugh was and is also counsel for L. Smith, one of the named parties to the SEC's sanction motion. Featherstonhaugh, as the attorney for both L. Smith and the Trust, was thus certainly on notice of the SEC's motion. These facts alone distinguish this case from those relied upon by the Trust as discussed below.

The SEC's motion sought to have L. Smith return to the Trust the money she had received from it, including the money from her sale of the Lake Property to the Trust. *See* SEC Motion (Dkt. 261 at 2). Obviously, such a motion raises the question what if anything the Trust will do with the Lake Property if the money it paid for the property is returned to it.

Featherstonhaugh, as attorney for the Trust, on full notice of this issue, had full and fair opportunity to file a motion on behalf of the Trust addressing any aspects of the requested relief and its potential impact on the Trust. He never did so.

In addition, following issuance of MDO IV, the Trust failed to file a motion for reconsideration raising the issues it now claims it was deprived of a full and fair opportunity to address. Thus, even assuming, *arguendo,* the Trust was not on sufficient notice that the Court might order the sale of the Lake Property to satisfy L. Smith's failure to repay the Trust the money she received from it, the Trust could have intervened and filed a motion asking the Court to reconsider the portion of MDO IV authorizing the Receiver to sell or lease the Lake Property. It did not do so. Accordingly, the Trust has waived any argument it might otherwise have that it was deprived of due process. [2]

The cases relied upon by the Trust are unavailing and readily distinguishable. In contrast to the movants in each of those cases, the Trust was not only already a party to the action but it received actual notice of the motion that led to the Order at issue. They are also distinguishable on other grounds. *Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306 (1950), addressed the constitutional sufficiency of notice to beneficiaries on judicial settlements of accounts by the trustee. The judicial settlements were "final and binding decrees." *Id.* at 311. The Court held that what due process requires "in any proceeding which is to be accorded

[2] Moreover, both the original Trustee, Thomas Urbelis, and David Wojeski, the Trustee who replaced Urbelis and who acted as Trustee from May 22, 2010 through January 8, 2011 (July 20 MDO; Dkt. No. 342 at 28) were named as parties to the SEC 's motion for sanctions. The Trust's attorney, Jill Dunn, was also named as a party to the SEC's sanction motion. (Dkt. No. 261). Urbelis, Wojeski and Dunn, the Trust's duly appointed representatives during the period relevant to the sanctions motion, were all also given a full and fair opportunity to raise whatever factual or legal arguments they deemed necessary to defend their actions while acting in their capacities as representatives of the Trust, and they each vigorously and, in varying degrees successfully, did so.

finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." In *Mullane*, due process required more than notice by publication, but not personal service or actual notice to all beneficiaries. *Id.* at 318-319. Here, the Trust was given actual notice of the pendency of the action, through service of the motion on its attorneys Dunn and Featherstonhaugh. The case is also distinguishable in that it does not involve a final, binding judgment or decree.

Similarly, *Dusenberry v. United States,* 534 U.S. 161 (2002) merely held that notice sent by certified mail to the prison where the claimant was incarcerated, not actual proof of receipt of notice, was sufficient when pursuing a criminal forfeiture of property, while *Luessenhop v. Clinton County,* 466 F.3d 259, 269 (2d Cir. 2006), which involved local tax authorities foreclosure on properties, merely adopted the *Mullane* requirement of "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." Here, the service of the SEC's motion on the Trust more than satisfied the due process requirements set forth in these cases, all of which were also distinguishable in that they dealt with final orders of forfeiture or foreclosure or termination of rights, not an interim order such as the one at issue here.

Finally, the Trust's argument that it was not provided sufficient notice and a reasonable opportunity to respond in accordance with the provisions of Fed. R. Civ. P. 11(c)(1) is also baseless in that it is not being sanctioned, and thus, was not entitled to notice under that provision. In any event, the Trust was in fact provided sufficient notice and an opportunity to be heard for all of the reasons set forth above.

2. The Order Does Not Improperly Infringe On the Rights and Fiduciary Duties of the Trustee

The Trust argues that the Order is also 'in error" in that it usurps the Trust's rights as vested owner of the Lake Property by granting the Receiver the authority to sell or rent the property. Trust Br. at 10-11. However, the Court has broad equitable powers to impose remedies on parties and their attorneys for conduct undertaken in bad faith. *See, e.g., Chambers v. NASCO, Inc.,* 501 U.S. 32, 42-44 (1991) and cases cited by the Court in MDO IV at pp.11-12. L. Smith's conduct in concealing the Annuity Agreement was "critical to obtaining the release of the Trust from the asset freeze," MDO IV at 16, which resulted in the Trust's expending approximately $1 million, most for the benefit of L. Smith. The Court was thus well within its discretion in ordering the unwinding of that fraud based sale.

In addition, the Court has previously found that David Smith controlled the assets of the Trust for the benefit of himself and his wife in violation of the purported terms of the Trust. *See, e.g.,* November 22 MDO; (Dkt. No. 194 at 21-23). The Smiths' son Geoffrey is the current Trustee. Given the multiple instances of fraudulent conduct engaged in L. Smith, as found by this Court, given David Smith's prior improper control over the Trust, and given the current Trustee's close familial relationship with L. Smith and D. Smith, there is certainly a sufficient basis to look skeptically upon the arm's length nature of any prior or subsequent dealings between and/or impacting the Trust and L. and D. Smith. Accordingly, the Court was well within its discretion in appointing a Receiver to oversee the unwinding of that sale.

Moreover, as discussed below, the Court's order does not sanction or punish the Trust; it simply places it back in the position it was in before L. Smith defrauded the Court, i.e., it is

entitled to full repayment of the purchase price.[3] Thus, the Trust cannot plausibly argue that it is harmed by the Court's order and, in any event, neither L. Smith nor the Trust should benefit from the fraud perpetrated on the Court by L. Smith.

Moreover, as one of the three signatories to the Annuity Agreement, the Trust itself knew of the existence of the Annuity Agreement, and was on notice that the unfreezing of the Trust's assets was obtained through fraud. Accordingly, it had unclean hands when it disbursed Trust assets to the perpetrator of that fraud with knowledge of the fraud. It cannot now complain when that fraud-induced transaction is unwound.

Finally, the Trust's argument that the Receiver owes no duty to the Trust or its beneficiaries is unavailing. MDO IV at 50-51 requires the Receiver to "take whatever action he deems in his judgment to be financially appropriate to obtain the maximum possible return on the Great Sacandaga Lake property, including the sale or rental of that property, in whole or in part…" The Receiver's legal obligations to the Court under this Order are more than sufficient to ensure that fair value is obtained for the Lake Property.

3. The Order Does Not Impose an Inappropriate Remedy

The Trust argues that MDO IV "erroneously imposes the remedy of 'disgorgement' upon L. Smith which in turn imposes final and considerable harm on the Trust." Trust Br. at 11-12. However, the Trust misapprehends the true nature of the remedy ordered by the Court. While the Court does order L. Smith to "disgorge" to the Receiver on behalf of the Trust $944,848.00, that amount is to be held on behalf of the Trust under the freeze order until the end of the case, at which time the money will either be unfrozen and made available to the Trust or disposed of in accordance with any judgment entered against the Trust. The Court's order relating to the

[3] Indeed, to the extent the Trust paid more than fair market value for the Lake Property, that portion of MDO IV directing L. Smith to repay the full purchase price, and permitting entry of a judgment against her for that full amount, puts the Trust in a better position than it is in now.

$944,848.00 does not constitute a final judgment of disgorgement as against either L. Smith or the Trust. The order simply unwinds the sale that would not have occurred but for L. Smith's fraudulent conduct and places the Trust and L. Smith back in the position they were in prior to the unfreezing of the Trust.

While MDO IV does not explicitly state that title to the Lake Property would have reverted to L. Smith if she had complied with the Court's order in a timely fashion, applying common sense, that is presumably what would have happened. Indeed, MDO IV does provide that the proceeds from any sale of the Lake Property will constitute an offset of the money L. Smith owes. Thus, read with common sense, the Order does not constitute a final disgorgement order against L. Smith, but rather an Order designed to return L. Smith and the Trust to the same economic position they were in prior to the Trust's distributions to her. Accordingly, MDO IV does not impose an improper remedy upon either L. Smith or the Trust.

It was within the Court's broad equitable authority to unwind the sale of the Lake Property that occurred through the fraud of L. Smith and with the knowledge of the Trust, and place the Trust back in the position it was in prior to the fraud.

Accordingly, the Trust has failed to sustain its burden of making a strong showing that it is likely to succeed on the merits of its appeal.

B. The Trust Will Not Suffer Irreparable Harm Absent the Stay

As to the second factor, the Trust must establish irreparable harm by "an injury that is neither remote nor speculative, but actual and imminent." *Tucker Anthony Realty Corp. v. Schlesinger,* 888 F.2d 969, 975 (2d Cir. 1989) (internal quotation marks and citations omitted). "The injury must be one requiring a remedy of more than mere money damages. A monetary loss

will not suffice unless the movant provides evidence of damage that cannot be rectified by financial compensation." *Id.* (citations omitted).

The Trust argues that it will suffer irreparable harm if the Lake Property is sold in that its ownership right in the property will be eliminated. Trust Br. at 13. It also argues that "because real property by its very nature is unique and exclusive," and because of the Smith's children's "longstanding and memorable history with the property," the sale of that property will impose on the Trust and its beneficiaries an irreparable harm for which a monetary award cannot be adequate. *Id.* However, the Smith children are not the property's owners. Rather, the Trust, not its beneficiaries, is the owner of the Lake Property. It cannot be seriously argued that the Trust has any emotional attachment to the property. Rather, the Lake Property is merely an economic asset of the Trust and converting that asset from real property to its equivalent in cash causes no irreparable harm to the Trust.

The Trust in essence asks this Court to disregard the Trust's separate legal existence and act as if the Smith children own the property, but they do not. Moreover, while there is certainly ample evidence that the Trust is indeed a sham, that has been created solely for the benefit of the David and Lynn Smith, to protect their assets from creditors until they retire, the Smiths and the Trust have vigorously denied this and have attempted to shield the Trust's assets from the SEC. The Trust cannot now reverse course and ask the Court to essentially ignore its separate existence and treat its assets as those of the Smith children before any distribution to them has occurred. In addition, the Lake Property is not only not the property of either of the Trust's beneficiaries, it is also not their residence. Rather, it is at best a vacation home. According, whatever attachment the Smith children may have to the Lake Property has no bearing on whether the Trust will be irreparably harmed by its sale.

C. The Trust Has Not Sustained its Burden as to the Remaining Stay Factors

The Trust also argues that a stay will not harm any other party as it will merely maintain the status quo, Trust Br. at 13-14, and that the public interest supports a stay in order to preserve the status quo and protect property owners from public takings without notice and an opportunity to present their objections. Trust Br. at 14. Given that the Trust has failed to meet its burden of establishing the first two factors required to obtain a stay, the Court need not address these remaining two factors. Nevertheless, as to the third factor, the investors who are the potential beneficiaries of any judgment against the Trust's assets will be harmed if the Trust has to continue to dissipate funds to maintain the Lake Property. As to the final factor, the public interest against permitting parties from benefitting from frauds perpetrated on the Court is better served by unwinding the sale of the Lake Property that occurred only because of L. Smith's fraud.

CONCLUSION

Accordingly, for all of the foregoing reasons, the SEC respectfully requests that the Trust's motion for a stay be denied in its entirety.

Dated: October 3, 2011

Respectfully submitted,

s/ Kevin P. McGrath
Attorney Bar No. 106326
Attorney for Plaintiff
Securities and Exchange Commission
3 World Financial Center, Suite 400
New York, N.Y. 10281
Telephone Number: (212) 336-0533
Fax: (212) 336-1322
E-mail: mcgrathk@sec.gov

Of Counsel

David Stoelting
Joshua Newville