

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION :

Plaintiff,

vs.

Case No. 1:10-CV-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, AND :
DAVID L. 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. and

GEOFFREY R. SMITH, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

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**MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR AN ORDER
APPROVING (I) SALE AND BIDDING PROCEDURES WITH RESPECT TO
THE SALE OF CERTAIN ALARM SYSTEM MONITORING ACCOUNTS AND
RELATED ASSETS OWNED BY CERTAIN RECEIVERSHIP ENTITIES
INCLUDING THE ASSIGNMENT OF CERTAIN AGREEMENTS RELATED
THERE TO, (II) TIME, DATE, PLACE AND MANNER OF NOTICE FOR EACH
OF THE AUCTION AND SALE HEARING, AND (III) THE SALE OF THE
RECEIVER'S INTERESTS FREE AND CLEAR OF LIENS, CLAIMS,
ENCUMBRANCES, AND OTHER INTERESTS**

William J. Brown, as Receiver (“Receiver”) for the entity Defendants in this action and certain other entities, by his counsel, Phillips Lytle LLP, moves (the “Motion”) for an order (i) approving sale and bidding procedures with respect to the sale of certain (i) alarm system

monitoring accounts (“Alarm System Accounts”) owned by McGinn, Smith Firstline Funding, LLC, MSFC Security Holdings, LLC, First Excelsior Income Notes, LLC, First Independent Income Notes, LLC, Third Albany Income Notes, LLC, Pacific Trust 02, McGinn Smith Funding LLC, McGinn Smith Alarm Trading LLC (collectively, “Sellers”), (ii) related interests and assets including used office equipment located at 99 Pine Street, Albany, New York, necessary to the continued operation of the Alarm System Accounts business, (iii) and the assignment of certain agreements related thereto concerning those Alarm System Accounts (collectively, “Assets”), (iv) Time, Date, Place And Manner Of Notice For Each Of The Auction And Sale Hearing, and (v) approving the sale of the Receiver’s interests in the Assets free and clear of liens, claims, encumbrances, and other interests, and in support thereof, represents as follows:

SUMMARY OF MOTION

Each of the Sellers are Receivership entities. In each instance, the Sellers indirectly own or control the remaining Alarm System Accounts currently managed by McGinn Smith Alarm Trading, LLC (“Alarm Traders”) at 99 Pine Street, Albany, New York. The purpose of this Motion is to inform the Court of an offer received by the Receiver for the Assets, to obtain approval for the sale of the Assets to Alarm Services, LLC (“Buyer) pursuant to the Asset Purchase Agreement substantially in the form attached as **Exhibit A** (“APA”), and to establish a bidding process through which the Assets would be sold to the highest and best bidder if another bid was made according to the bidding terms. The proceeds from the sale will be placed in the Receiver’s account and used by the Receiver for the benefit of the estates of the MS Entities including repayment of creditors and investors.

BACKGROUND

A. General Background

1. On April 20, 2010, the Securities and Exchange Commission (“SEC”) filed a Complaint initiating the above-captioned action (the “Complaint”). Also, on April 20, 2010, this Court granted a Temporary Restraining Order which, among other things, froze certain assets of the above-captioned Defendants and Relief Defendants, and appointed the Receiver as temporary receiver with respect to numerous entities controlled or owned by Defendants Timothy M. McGinn and David L. Smith (collectively, the “MS Entities”).

2. On July 22, 2010, the SEC amended the Complaint, and the Preliminary Injunction Order was entered appointing the Receiver as permanent receiver with the consent of defendants Timothy M. McGinn and David L. Smith. The Preliminary Injunction Order authorizes the Receiver to, among other things, “use, lease, sell, and convert into money all assets of the MS Entities, either in public or private sales or other transactions on terms the Receiver reasonably believes based on his own experience and input from his advisors to be most beneficial to the MS Entities and those entitled to the proceeds...” (Preliminary Injunction Order, Para. VIII(m), Docket No. 96).

B. Background Relating to the Sellers

3. The Sellers are MS Entities. Prior to the Receivership, from time to time over a period of years, each of the Sellers at the direction or under the control of David L. Smith and/or Timothy M. McGinn caused the Assets to be purchased in various transactions. Alarm System Accounts are agreements for providing alarm installation, monitoring and service at residential and commercial properties. The Alarm System Accounts which are the subject of this Motion consist of approximately 5,000 residential and light commercial accounts in approximately 40 states throughout the United States.

4. The Alarm System Accounts are comprised of three tranches of accounts: the so-called “Firstline” tranche, the so-called “MSFC” tranche, and the so-called “Trust” tranche.

5. The Firstline tranche includes the remaining accounts which were purchased by McGinn, Smith Firstline Funding, LLC from an unrelated entity, Firstline Security, Inc. (“FSI”), out of FSI’s Chapter 11 bankruptcy case at a price based on a multiple of approximately 11.49 times recurring monthly revenue (“RMR”)¹. The annualized attrition rate² for the Firstline tranche over the preceding six-month period is in the 42% range which is considered exceptionally high. Normal annualized attrition for quality alarm system accounts should be in the 8-12% range. The Firstline tranche makes up approximately 48% of the Alarm System Accounts.

6. The MSFC tranche includes the remaining accounts which were purchased by MSFC Security Holdings, LLC from Fortress Credit Corp., and are comprised of accounts originally installed by an unrelated third party, Alarm One, Inc. They were purchased by MSFC for an effective multiple of approximately 12.19 times RMR. The annualized attrition rate for the MSFC tranche over the preceding six-month period is in the 21% range. The MSFC tranche includes primarily contracts that are on month-to-month terms at this juncture, and approximately one-half of the tranche is on non-controlled Alarm Traders telephone lines. The MSFC tranche makes up approximately 27% of the Alarm Systems Accounts.

7. The Trust tranche includes the remaining accounts owned by First Excelsior Income Notes, LLC, First Independent Income Notes, LLC, Third Albany Income Notes, LLC, Pacific Trust 02, McGinn, Smith Funding, LLC, and McGinn, Smith Alarm

¹ RMR is used in the alarm contract industry together with a “multiple” to establish purchase price or value for a portfolio of alarm contracts.

² Attrition rate is the rate at which alarm contract customers do not renew their contracts.

Trading, LLC. These accounts were acquired by those entities at various multiples of RMR and at various times between 2002 and 2008. The accounts were originally installed by more than 40 different alarm dealers. The annualized attrition rate for the Trust tranche over the prior six-month period is in the 14% range. Due to the age of the accounts in the Trust tranche, much of the alarm equipment is outdated and almost the entire tranche is on non-controlled telephone lines. The Trust tranche makes up approximately 25% of the Alarm Systems Accounts.

8. To assist in the evaluation of the Alarm System Accounts, the Receiver engaged R. Anthony Smith of Security Finance Associates, Inc., a nationally recognized consultant and broker in the alarm contract business (“Consultant”) to (a) perform an evaluation of the MS Entities engaged in the alarm contract business including their portfolio of security alarm monitoring accounts, their marketability, and a presently pending offer; (b) identify the best disposition methodologies; and (c) if requested, provide negotiation services and due diligence oversight with respect to a buyer. In addition, the Consultant reviewed the operational procedures at Alarm Traders. He found the Alarm System Accounts as well as all operational areas of the business to be in order. He concluded, however, that the Assets were severely damaged primarily due to the high attrition rates. Additionally, he noted that the geographical spread of the accounts was considered a negative which would limit the pool of buyers. He also found that the lack of control of all of the customer alarm telephone lines, which would permit a buyer to move the alarm customer to the buyer’s own central monitoring station line, to be a serious problem for most buyers. Finally, the excessive attrition rates would seriously affect finding a serious qualified buyer. The Consultant believed it was unlikely that he would find a buyer for all of the Assets in one sale unless the purchase price was severely compromised to a level which the Receiver found to be unacceptable. The other alternative was to break the

portfolio into pieces but without any assurance that sufficient buyers would be found for all of the Assets. The potential transactional costs of multiple sales and the risk of being left with Assets unsold was also unacceptable.

9. The Receiver has used the monthly revenue from all of the MS Entities' Alarm System Accounts to help fund the costs of operating the estates of the MS Entities including the alarm service business and to accumulate monies to eventually distribute to investors of the MS Entities. In the period May 1, 2010 through January 31, 2012, the approximate net revenue generated for investors has been \$2,862,831. These proceeds are deposited in the Receiver's bank account for eventual distribution to creditors and to pay estate expenses.

C. Background Relating to the Buyer

10. The Receiver has received an offer from the Buyer to purchase all of the remaining Alarm System Accounts for approximately \$1.75 million (subject to certain agreed upon closing adjustments).

11. The Buyer is a newly formed entity owned by Brian Shea and Douglas Keenholts who each have worked for one or more of the MS Entities prior to the Receivership. Mr. Keenholts has always been primarily involved in the alarm business operated by the MS Entities and Integrated Alarm Services Group, Inc., and not directly involved with the MS Entities' securities businesses. Mr. Shea worked for McGinn, Smith & Co. prior to 2003, then served as the Executive Vice President for Integrated Alarm Services Group until 2007 when he went to work for Alarm Traders. In April 2009, Mr. Shea returned to work for McGinn, Smith & Co., Inc. Since April 21, 2010, Messrs. Shea and Keenholts have continued to work for the Receiver in the operation of the alarm account business at Alarm Traders and have been valuable resources to the Receiver. Mr. Shea has also functioned as the Receiver's controller and has

provided the Receiver with valuable information about the MS Entities from information he has been able to reconstruct and continues to reconstruct from various records including from third party financial institutions. In turn, this has allowed the Receiver to perform his duties and to assist various federal agencies.

MOTION

1. This Motion seeks approval for the sale of the Assets to the Buyer for \$1.75 million (subject to customary closing adjustments) after a bidding process described below. The Receiver considers this to be a market price offer under the circumstances.

2. The Receiver believes the Buyer is in the best position to buy the Assets because its principals already operate them and are in contact with the customers to whom services are provided. The Receiver believes the Buyer is not as affected by the perceived negative attributes of the Alarm System Accounts, while at the same time willing to retain the business in Albany, New York including most of the current employees and providing executive services to the Receiver for up to two years (without compensation) to assist in winding up the estates of the MS Entities.

3. The principal terms of the agreement are as follows:³

a. The purchase price is \$1.75 million (subject to customary closing adjustments);

b. Assets to be sold consist of all personal property, including all business and other assets of every kind, character and description (but expressly not including claims held by the Receiver with the limited exception of claims held against Alarm System Accounts customers in the ordinary course of business) used in or for the benefit of the Alarm System Accounts business at 99 Pine Street, Albany, New York;

³ Reference should be made to the Asset Purchase Agreement for exact terms of sale.

c. The Buyer assumes all obligations and liabilities for the operation of the business as of the closing;

d. The Buyer shall pay a deposit of \$50,000 upon signing the Asset Purchase Agreement which will be held in escrow by counsel for the Receiver, and the Buyer shall pay an additional \$100,000 deposit to be applied against the Purchase Price at closing;

e. The closing shall occur no later than the 15th day after the Order approving the Motion is entered unless waived by the parties;

f. The sale is without recourse, representation or warranty by the Receiver;

g. The purchase price will be paid by the deposits, closing adjustments, and a 36 month Note of approximately \$1.6 million which will be secured by perfected first liens on the Assets and subsequent cash generated pursuant to the form of documents attached as Exhibits C, D and E to attached Exhibit A. It is expected that the Note repayments will be accomplished from income on the Alarm System Accounts and can be prepaid without penalty. The Note bears an annual interest of 7% per annum.

h. There are no brokers associated with the transaction.

4. Despite the belief that the Assets could be of interest to other purchasers, the Receiver has received no material inquiries with respect to the purchase of the Assets.

PROPOSED SALE PROCEDURES

5. Although the Receiver has not received any other offers for the purchase of the Assets, to ensure the maximization of the Sellers for the benefit of the MS Entities and those entitled to the proceeds, the Receiver seeks approval of the following procedures to market and potentially auction the Assets for the highest and best consideration:

a. Upon entry of an Order scheduling a hearing on this Motion, the Receiver shall conspicuously post on the Receiver's website relating to this case

(<http://mcginnsmithreceiver.com>) general details of the proposed sale of the Assets along with the deadline for submissions of competing bids for the Assets;

b. The Receiver will promptly distribute to the Consultant and David Roman of Safe Home Security as well as any other individuals who have expressed, or who, in response to the Receiver's publication of the sale, express, interest in the Assets with any available due diligence package, subject to the signing by such individual of a confidentiality agreement;

c. Any competing offers for the Purchase of the Assets must be on substantially the same terms as set forth in the Purchase Agreement;

d. To the extent that the Receiver receives one or more bona-fide offers to purchase the Assets in accordance with these procedures, an auction will be held at the offices of Phillips Lytle LLP, Omni Plaza, 30 South Pearl Street, Albany, New York 12207 two business days prior to the date and time set by the Court for this Motion;

e. There is a break-up fee of \$60,000 if the Buyer is not the highest and best bidder at the auction. Any alternative offer must result in a net higher economic value to the Sellers of not less than \$150,000 based upon all consideration paid by Buyer, which is a partial estimate of the value for the services to be provided by Messrs. Shea and Keenholts to the Receiver as part of the Executive Services Section of the APA as described in paragraph 5 of the APA;

f. The sale of the Assets to the Buyer or, alternatively, the winning bidder at the auction, will be approved by this Court;

g. The Receiver, in his reasonable discretion, may take such other actions as necessary to ensure that the marketing, auction and sale procedures are in accordance with his duty to maximize the value of the Assets for the benefit of the MS Entities and those entitled to the proceeds.

6. Timing is of the essence in completing the sale of the Assets. The Buyer has agreed to the Purchase Agreement on the condition that the sale is approved on or before March 19, 2012. This expedited timetable is necessary because an important component of the consideration for the sale is further investment by the Buyer in the assets to improve their condition and performance and obtaining the portfolio while the revenue makes operating it of interest.

BASIS FOR RELIEF

7. The relief requested herein is authorized by the Preliminary Injunction Order and applicable law, and additionally is appropriate because it preserves the value of the Sellers for the benefit of the MS Entities and those entitled to the proceeds.

8. This court clearly has the authority to freeze assets and to permit sales of such assets. That authority authorizes a court in cases such as this to exercise “broad equitable discretion.” S.E.C. v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997); see also SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1103 (2d Cir. 1972) (explaining the equitable powers granted to the district court and holding that when there is “a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy.”).

9. The Preliminary Injunction Order mandates that the assets be maintained without dissipation of their value. (Preliminary Injunction Order at page 5). Therefore, if the value of an asset is at risk of dissipation so that funds available to investors could be diminished in the event the SEC ultimately obtains a judgment, the Court may act to prevent such

dissipation. S.E.C. v. Am. Bd. of Trade, Inc., 830 F.2d 431, 436 (2d Cir. 1987). In addition, the Court also has the power to enter the proposed Order under § 21(d)(5) of the Securities Exchange Act of 1934, which provides that in SEC actions, “the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.” See also S.E.C. v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980) (“federal courts have inherent equitable authority to issue a variety of ‘ancillary relief’ measures in actions brought by the SEC to enforce the federal securities laws”) (citations omitted).

10. In this case, the proposed sale is likely to maximize the value of the Sellers, and, additionally to mitigate the risk that the value of the Assets further diminish to the detriment of the MS Entities and those entitled to the proceeds. The rights to Alarm System Accounts decline over time as individual accounts expire and are not renewed. The proposed sale would monetize the value of the Sellers, and the procedures set forth herein provide for higher and better offers to better ensure that the Assets is sold for the greatest consideration.

MEMORANDUM OF LAW

11. Since the basis for the relief requested herein under the Permanent Injunction Order and applicable law is set forth herein, the Receiver requests that any requirement for a separate memorandum of law be waived.

CONCLUSION

12. As such, for the reasons set forth herein, the Receiver requests entry of an Order (i) approving the procedures set forth herein for the marketing and auction of the Assets pursuant to the terms set forth herein, (ii) approving such procedures on an expedited basis to allow the Receiver to begin as soon as possible such marketing procedures, (iii) setting a hearing date for approval of the sale of the Assets to the Buyer or the highest and best bidder at the

auction, as the case may be, consistent with a hearing to occur on or before March 19, 2012, and
(iv) providing such other relief as is necessary and proper.

Dated: March 1, 2012

PHILLIPS LYTTLE LLP

By /s/ William J. Brown

William J. Brown (Bar Roll #601330)

Todd A. Ritschdorff (Bar Roll #512601)

Attorneys for Receiver

Omni Plaza

30 South Pearl Street

Albany, New York 12207

Telephone No. (518) 472-1224

and

3400 HSBC Center

Buffalo, New York 14203

Telephone No.: (716) 847-8400

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