UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	**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,	:	
Defendants, and	:	
LYNN A. SMITH,	:	
Relief Defendant.	:	

PLAINTIFF'S MEMORANDUM OF LAW IN RESPONSE TO:
(1) RELIEF DEFENDANT LYNN A. SMITH'S OPPOSITION TO PLAINTIFF'S MOTION FOR A PRELIMINARY INJUNCTION; AND
(2) INTERVENOR'S ORDER TO SHOW CAUSE

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The investment fraud perpetuated by defendants David Smith and Timothy McGinn robbed hundreds of investors of at least $84 million. Less than $500,000 now remains in the coffers of the companies McGinn and Smith used as vehicles of the fraud. The primary source of funds that could be used to satisfy a judgment and repay the victims is approximately $6 million in several accounts that Smith and McGinn used and controlled but tried to keep separate from their own assets and the entities they controlled (the "MS Entities"). Whether this $6 million should be returned to the defendants and the relief defendant, or whether the status quo should be maintained pending the outcome of the litigation, is the only issue to be resolved.

The parties contesting the SEC's motion for a preliminary injunction are the relief defendant, Lynn Smith (the wife of defendant David Smith), and an Intervenor, the Trustee of the David and Lynn Smith Irrevocable Trust ("Trust"). Their objections are limited to the asset freeze over the following assets: (1) an account in the name of the Trust, which is its only asset, containing approximately $3.5 million (the "Trust Account"); (2) an account in the name of Lynn Smith containing approximately $2.5 million (the "Stock Account"); and (3) joint assets transferred to Lynn's name in 2009: David and Lynn Smith's joint checking account (the "Checking Account") and a home in Vero Beach, Florida.

For the following reasons, the evidence supports maintaining the freeze pending the outcome of the litigation.

First, David Smith exercised beneficial ownership and control over the Trust from its inception in 2004 until the filing of this action. He and Lynn Smith created and funded the Trust. David Smith controlled and selected the Trust's only asset, its investments. David and Lynn considered the Trust account a joint marital asset and they received distributions from the Trust account into their accounts. The Trustee was a figurehead who only signed documents whenever

David Smith told him to sign documents, and the beneficiaries, David and Lynn Smith's adult children, never received any distributions from the Trust account. Accordingly, the Trust account should remain frozen as David Smith's asset.

Second, David Smith and McGinn exercised beneficial ownership and control over the Stock Account for at least fifteen years. Lynn Smith allowed David Smith, McGinn and the MS Entities to draw upon the Stock Account for business and personal needs without restrictions. The Stock Account served as a de facto financing arm for David Smith and McGinn during the period of the fraud. The Stock Account therefore became the functional short-term financing vehicle for the MS Entities and David Smith and McGinn, and it should remain frozen during the litigation. Internal e-mails during the period of the fraud show McGinn Smith employees freely transferring money into and out of the Stock Account.

Third, Lynn Smith received more than $1.8 million from Smith and the MS Entities during the period of the fraud. She claims these were short-term loans; however, the only evidence is one unsigned loan agreement, and Mrs. Smith testified that she never saw this agreement until after this action was filed.

Finally, in 2009, when an investigation by the Financial Regulatory Authority (FINRA) into McGinn Smith commenced, and as David Smith and McGinn that their firm were named as Respondents in a number of FINRA arbitrations filed by investors, David and Lynn Smith began moving assets that had been jointly held into Lynn Smith's name. Similarly, in October 2009, McGinn transferred a home jointly held with his wife into his wife, Nancy McGinn's, name. These assets, including the Checking Account, the Vero Beach home, and McGinn's home, should remain frozen as joint marital property.

THE PROPOSED PRELIMINARY INJUNCTION ORDER

Plaintiff submits with this filing a form of Preliminary Injunction Order that it respectfully requests be entered following the hearing. Declaration of Lara Shalov Mehraban ("Mehraban Decl.") Ex. 1. Defendants David Smith and Timothy McGinn have informed plaintiff, through counsel, they consent to the entry of this Order but have objections to the provisions in Part VIII, dealing with the powers of the Receiver. We continue to have discussions over these provisions and it is hoped that the objections can be resolved by the time of the hearing. The seven entity defendants, through the Receiver, will provide a written consent to the entry of the proposed Preliminary Injunction Order.

FACTUAL BACKGROUND

David Smith Exercised Beneficial Ownership and Control Over the Trust Account

David and Lynn Smith created the Trust in August 2004 and funded it with money from Lynn's stock account. Mehraban Decl. Ex. 2, Transcript of Deposition of Lynn Smith ("LSmith Tr.") at 39-40. The beneficiaries have been their children, Lauren and Goeff, who are now 27 and 30 years old. LSmith Tr. at 39. Lynn Smith testified that the reason for creating the Trust was to benefit their children, not themselves, and that she hoped the Trust could help the children "start a business, own a home . . . and reap the rewards of my husband's business." LSmith Tr. at 39-40.

Thomas Urbelis, a childhood friend of David Smith's, was appointed Trustee at the request of David Smith. LSmith Tr. at 38. Urbelis is a lawyer in Boston whose specialty is zoning and land use law. Mehraban Decl. Ex. 11, Transcript of Deposition of Thomas Urbelis ("Urbelis Tr.") at 5. In a letter to Urbelis dated August 4, 2004, Smith thanked Urbelis for agreeing to be Trustee and stated that he and Urbelis "will be able to consult on investments, but

I am not eligible to exercise any direct control over the Trust or its investments." Mehraban Decl. Ex. 12. David Smith selected the Trust's lawyer and accountant. *Id.* The Trust's brokerage account was at McGinn Smith & Co., Inc.

From 2004 until his resignation in 2010, Urbelis signed documents regarding the Trust whenever David Smith asked him to sign documents. Typically, documents would be sent to Urbelis from Smith's office with instructions for him to sign immediately and return to Smith. *E.g.,* Mehraban Decl. Ex. 19. Urbelis did not always understand the documents Smith asked his to sign. Urbelis Tr., at 28-29. He testified that the some of the documents concerning the investments David Smith selected for the Trust were "confusing to me." *Id.* at 32.

Urblelis testified that he had no expertise in investments and depended on David Smith to make all the investment decisions for the Trust. Urbelis Tr., at 10-11. Urbelis admits that he never discussed investments with either of the beneficiaries. Urbelis Tr. at 21, 23. Smith made all investment decisions for the Trust and would have Urbelis execute the necessary documents. Mehraban Decl. Ex. 16.

Although the beneficiaries of the Trust were David and Lynn Smith's adult children, these children never received any distributions from the Trust. Urbelis Tr., at 12. Instead, the only persons to receive distributions were David and Lynn Smith. Urbelis transferred more than $500,000 directly from the Trust account into David and Lynn Smith's personal accounts, on David Smith's instructions. Urbelis testified that he believed that these transfers were to pay the Trust's taxes, but could not explain why the transfers were to David and Lynn's personal accounts.

Urbelis made clear when he became trustee that he would not take responsibility for preparing the tax returns. He testified that when he was appointed "I wanted assurance that I was

not going to be responsible for preparing tax returns . . . I -- make no bones about it . . . I don't understand it." Urbelis Tr., at 10. A McGinn Smith employee would tell Urbelis how much money to transfer and Urbelis would sign an authorization allowing the funds to be transferred from the Trust account to a personal account for David or Lynn Smith. *E.g.,* Mehraban Decl. Ex. 18. Urbelis transferred the funds directly to David or Lynn Smith, and he admitted that he did not know what they did with the funds. Urbelis Tr., at 44. In fact, Urbelis stated that he "didn't care as long as I wasn't getting notices . . . that the taxes weren't getting paid." *Id.*

Urbelis signed documents authorizing transfers out of the Trust account that he believed were going to pay the Trust's taxes. Urbelis Tr. at 14. For example on April 17, 2006, Urbelis signed a wire transfer authorization directing the transfer of $92,105 to David Smith's personal account. Mehraban Decl. Ex. 23; Daniello Decl. Ex. 1. Urbelis's understanding was that these funds were to pay the Trust's taxes; however, this amount is substantially larger than the tax liability for the Trust for the year earlier, which was $2,300. Mehraban Decl. Ex. 18. In 2007, there were no transfers from the Trust account for tax payments. Daniello Decl. Ex. 1. On April 11, 2008, Urbelis authorized the transfer of $110,636 from the Trust account to David Smith's personal account. Mehraban Decl. Ex. 25. Lynn Smith admitted at her deposition that the transfer to her account in 2010 of $95,000 from the Trust Account was in part to pay her personal taxes. LSmith Tr., at 93-94.

Urbelis resigned as Trustee days after the SEC's complaint was filed. Mehraban Decl. Ex. 29. Urbelis testified that he resigned because "I and my family were investors [with McGinn Smith], that I could not really fulfill my fiduciary duty with regard to the trust and the kids where the trust was an investor and I also was an investor." Urbelis Tr., at 42.

David Smith Exercised Beneficial Ownership and Control Over Lynn Smith's Stock Account

Lynn Smith testified that the Stock Account was funded initially from her inheritance from her father of $60,000. The Stock Account at one point went down to a low of $10,000 but eventually grew to over $6 million due to the investing skill of her husband. LSmith Tr., at 33-34. David and Lynn Smith routinely used the Stock Account to fund numerous joint marital obligations, including the purchases of multiple houses that were made in both their names, to fund their children's college educations and to ostensibly fund an inheritance for their children. LSmith Tr., at 34-38.

Lynn Smith also allowed the Stock Account to be used for the benefit David Smith and his partner McGinn, including providing bridge loans to various entities affiliated with McGinn Smith. Lynn Smith admitted that the Stock Account was used to loan McGinn $900,000 in 2003 so he could purchase stock in an alarm company and a home. LSmith Tr., at 14. The Stock Account was subsequently used to make a second loan to McGinn of $15,000. *Id.* at 14-15. Lynn Smith testified that she never spoke to McGinn about these loans, and she does not know the purpose of the second loan. *Id.* at 14-16.

In addition, Ms. Smith acknowledges that the Stock Account was used to "provide bridge financing to facilitate the closing of various transactions that McGinn Smith has handled over the course of many years." Lynn Smith's Affidavit in Opposition to Plaintiff's Motion for a Preliminary Injunction, (LSmith Aff."), at 27. For example, according to Lynn Smith, the Stock Account was used to loan $366,000 to TDMM Cable in June 2004. Lynn Smith also stated in her Affidavit that the Stock Account made (a) a $380,000 loan to MS Funding on November 27, 2007, (b) a $20,000 loan to McGinn Smith and Co. in 2006, and (c) an $100,000 loan to TDMM Cable Funding on March 26, 2009. LSmith Aff., at 33.

In support of the statement that the $366,000 transfer to TDMM Cable was a loan, she cited an unsigned loan document (attached as Exhibit A to her Affidavit), which she admitted she did not see before she loaned the funds and, in fact, did not see until after the SEC's Complaint was filed. LSmith Tr. at 45-47. Indeed, when questioned about the 24 percent interest rate on this unsigned loan document, Lynn Smith was unable to provide any explanation for how the interest rate was derived, or whether the interest rates on other loans were higher or lower.

Lynn Smith claimed that loan agreements were executed each time a loan was made from the Stock Account. LSmith Tr., at 40. She was not able to recall how many loans were made, the size of the loans other than those evidenced on documents shown to her, or the interest rates for the loans. *Id.* at 45-47.

Lynn Smith claimed in her Affidavit that "ultimate decisions on the account were made by me and there has never been any confusion as to the ownership of the account" LSmith Aff., at 17. But, she could only recall one time that she claims to have refused to allow David Smith to use the Stock Account to make a loan to a McGinn Smith entity. LSmith Tr., at 48. She testified that in the last year that she refused to allow a loan from the Stock Account of $200,000 to McGinn Smith to meet payroll and other operating needs. She testified that she was concerned with the economy and felt that the other two partners should also contribute. LSmith Tr., at 49- 50.

She also admitted that she did not know whether David Smith invested money from the brokerage account in any McGinn Smith Entities, saying that she left investment decisions to him. LSmith Tr., at 67-68.

Transfers Without Consideration Into Lynn Smith's Accounts

During the period of the fraud, a total of over $1.8 million was transferred into accounts in Lynn Smith's name. LSmith Aff. Exs. B, C and D.

Asset Transfers to their Spouses during 2009 by Smith and McGinn

In 2009, David and Lynn Smith transferred the Vero Beach house that they had jointly owns for nine years into Lynn Smith's name. Lynn Smith testified that she "demanded" in 2009 that the house be transferred into her name because "[her] funds were what paid for the house." LSmith Tr., at 72; *see also* LSmith Tr. at 21-22. Also in 2009, David and Lynn Smith also stopped using their jointly-held checking account and Lynn Smith opened her own checking account. She testified that the reason for opening her own account was because "I wanted my own account a year ago" and that she wanted her own account "because I was the only person using it and most couples today have separate checking accounts, and I wanted one." LSmith Tr., at 32.

On October 19, 2009, Tim and Nancy McGinn transferred a house that they had jointly held since 2003 into Nancy McGinn's name.

ARGUMENT

I. THE STANDARD FOR MAINTAINING THE ASSET FREEZE

To continue the Court-ordered asset freeze requires "a lesser showing" is required than that that required to impose preliminary injunctive relief: "the SEC must establish only that it is likely to succeed on the merits" or that an inference can be drawn that the party has violated the federal securities laws."[1] *SEC v. Cavanagh*, 155 F.3d 129, 132 (2d Cir. 1998); *SEC v. Byers*,

[1] The defendants have consented to the Preliminary Injunction Order enjoining violations of the federal securities laws (injunctive relief is not requested as the relief defendant).

2009 U.S. Dist. LEXIS 56989 (S.D.N.Y. Jan. 7, 2009). As the Second Circuit has held, the freeze "merely freezes the status quo[.]" *Cavanagh*, 155 F.3d at 136.

To show likely of success on the merits, the SEC "need not show that success is an absolute certainty. It need only make a showing that the probability of his prevailing is better then fifty percent. There may remain considerable room for doubt." *Byers*, 2009 U.S. Dist. LEXIS at *8 n.4 (quoting *Abdul Wali v. Coughlin*, 754 F.2d 1015, 1025 (2d Cir. 1985)).

Under Second Circuit precedent, a district court has the authority to freeze the assets of a relief defendant where that party "(1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds." *Cavanagh*, 155 F.3d at 136 (2d. Cir. 1998). As the court in *Cavanagh* explained, a contrary rule "would allow almost any defendant to circumvent the SEC's power to recapture fraud proceeds, by the simple procedure of giving stock to friends and relatives, without even their knowledge." *Id.* at 137*; see also SEC v. Unifund SAL*, 910 F.2d 1028, 1035 (2d Cir. 1990); *SEC v. Mgmt. Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975).

II. PLAINTIFF HAS DEMONSTRATED A LIKELIHOOD OF SUCCESS ON THE MERITS

The unchallenged evidence submitted by the SEC in support of its motion for the temporary restraining order on April 20, 2010, is more than sufficient to establish a likelihood of success on the merits. Indeed, no party, including the relief defendant and Intervenor, argues that plaintiff has failed to meet its burden of showing a likelihood of success. *See SEC v. Pittsford Capital Income Partners LLC,* 2007 U.S. Dist. LEXIS 62338, at *53 (W.D.N.Y. Aug. 23, 2007), *aff'd,* 2008 U.S. LEXIS 29909 (2d Cir. Dec. 31, 2008) .

To summarize a portion of the evidence of the fraud, instead of investing in a broad range of investments, the Four Funds invested largely in companies affiliated with McGinn Smith, even though the offering materials did not disclose this. The gap between the Four Funds' equity

and the amount owed to investors laws was large and grew considerably after the initial offering in 2003. Maya Decl. ¶ 23. *See also* Declaration of Roseann Daniello dated April 19, 2010 (showing extensive transfers among Four Funds offerings and Trust offerings); Declaration of Lara Shalov Mehraban filed April 20, 2010; Appendix in Support of Emergency Application filed April 20, 2010.

Subsequent to the filing on the Complaint, the SEC has learned that McGinn Smith continued to raise funds by coercing investors in prior trusts to invest in a new trust. In a March 25, 2010 letter to investors in four earlier Firstline trusts, McGinn stated that, if the investor did not invest in the new offering at least 15% of the amount of his initial investment, the initial investment would not be protected. Mehraban Decl. Ex. 40. The PPM for this new offering confirmed that the investors who did not invest in the new trust would only be paid out after everyone else is fully redeemed. Mehraban Decl. Ex. 42, at 8-9. Further, in an April 2, 2010 letter, McGinn informed an attorney representing one of the investors that it would be "inadvisable" for the attorney to counsel his client that she would receive any payout if she failed to invest in the new trust. Mehraban Decl. Ex. 41 It appears that investors were so afraid of losing their initial investment that they invested in this new offering, which appears to have raised the full $1.6 million.

III. THE TRUST ACCOUNT SHOULD REMAIN FROZEN PENDING THE OUTCOME OF THE LITIGATION

The amount of ill-gotten gains is at least $83.4 million, representing the amount of funds still owed to investors. This $83.4 million is the amount, plus prejudgment interest, that will be amount sought in disgorgement from the defendants. *See SEC v. Pittsford Capital Income Partners LLC,* 2007 U.S. Dist. LEXIS 62338, at *53 (W.D.N.Y. Aug. 23, 2007), *aff'd,* 2008 U.S.

LEXIS 29909 (2d Cir. Dec. 31, 2008) (disgorgement in investment fraud case was amount raised from investors minutes amount returned from investors) .

Courts have long recognized the importance of requiring securities law violators to disgorge all the proceeds of their fraud. *See SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. Robinson,* 2002 WL 1552049, * 9 (S.D.N.Y. July 16, 2002) (granting SEC's motion for summary judgment and holding in case of fraudulent stock offering "it is appropriate to order disgorgement of the entire (gross) proceeds received in connection with the offering."); *SEC v. Sahley*, 1994 WL 9682, *1 (S.D.N.Y. 1994 Jan. 10, 1994) (granting the SEC's motion for summary judgment and ordering disgorgement of entire $950,000 raised in offering fraud).

The Maya Declaration demonstrates that the amount raised through the relevant offerings is $150 million in principal and that the total amount redeemed is $30 million. TRO App. Tab 31. The total amount of principal owed to investors is approximately $120 million, which is the amount that should be disgorged. TRO App. Tab 91, 99. This is the amount "causally related to the wrongdoing," and is a "reasonable approximation of profits" gained from the violation. *SEC v. First City Financial Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989).

The assets of Smith and McGinn are far below the amount the amount of the expected disgorgement. The Trust account represents a substantial source of funds that could be used to satisfy a judgment. The evidence, moreover, proves that David Smith at all times exercised beneficial ownership over the Trust account. David Smith and his wife created and funded the Trust. David Smith made all the investment decisions and the account was located at McGinn Smith & Co. The Trustee was a figurehead who did signed documents whenever Smith asked him to. The Trustee transferred Trust funds directly to David and Lynn and never to the Trustee.

Although the Trustee testified he thought the funds he transferred were for the Trust's taxes. This is suspect since the transfers were for amounts that varied substantially. In addition, Lynn Smith testified that she used a transfer from the Trust to pay her personal taxes, and that she, and not the Trustee, sometimes paid the Trust's taxes.

David Smith knew he was not supposed to control the Trust because he wrote to the Trustee a letter acknowledging that fact. Mehraban Decl. Ex. 12. Nevertheless, Smith used the Trust account – the Trust's only asset – like a piggy bank and the supposed beneficiaries never received a dime. David and Lynn Smith's own financial records show that they counted the Trust as a cash asset of their own. Mehraban Decl. Exs. 6, 7, and 8.

David Smith's domination and control of the Trust established that the Trust account should be considered his asset and therefore is subject to the asset freeze. *PM Contracting Co. v. 32 AA Assoc. LLC*, 4 A.D.3d 198, 199 (App. Div. 2004) (LLC's "complete control over all aspects of [business] effectively makes it the property's beneficial owner"); *Guilder v. Corinth Const. Corp.*, 235 A.D.2d 619, 619 (App. Div. 1997) (even if individuals were not the defendant's legal owners, "it is apparent that that dominated and controlled the corporation to such an extent that they may be considered its equitable owners").

"The notion of a 'beneficial' or 'equitable owner' is usually found in the areas of trusts or corporate law. Black's law Dictionary 1130 (7th ed. 1999). A 'beneficial owner' may generally be defined as 'one recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else…" *In re Worldcom, Inc.*, 34 B.R. 430, 439 (Bankr. S.D.N.Y. 2006). *See also SEC v. Teo*, 2009 WL 1684467, *10 (D.N.J. June 12, 2009) ((defendant who retained trading authority over trust retained beneficial ownership over the trust assets despite disclaiming beneficial ownership in Schedule 13D filing).

In addition, the funds in the Trust never effectively belonged to the Trust because David and Lynn treated those funds as their own. Smith disregarded the formalities of the Trust and treated it like his own asset, which justifies making the Trust subject to the freeze. *See SEC v. Ballesteros*, 252 F. Supp. 2d 720, 729 (S.D.N.Y. 2007) (trust can be liable for conduct of person who dominated and controlled trust; "where an individual so dominates or controls the activities of some entity such as the trust, the entity may also be held responsible."); *SEC v. Blackwell*, 477 F. Supp. 2d 891, 916 (S.D. Ohio 2007) (ordering disgorgement of profits that "never legally belonged to the Trust .... The Court finds no justification for allowing the Trust [to] profit from the illegal conduct of its fiduciaries when it was never entitled to the funds in question.").

The Trustee argues that the funds in the Trust cannot be traced to the proceeds of the fraud. However, courts do not require the SEC to trace the proceeds of a defendant's ill-gotten funds. In *SEC v. Aragon Capital Mgmt. LLC*, for example, the court explicitly rejected tracing, stating "there is no basis for the suggestion of [a defendant] and the Relief Defendants that the SEC must trace the proceeds of [a defendant's] insider trading to their individual accounts." 672 F.Supp.2d 421, 443 (S.D.N.Y. 2009). The court continued: "to the extent that the proceeds of [the fraud] are no longer in the [defendant's] account, the SEC is entitled to pursue the return of an amount equal to the amount that [the defendants] illegally obtained." *See also SEC v. Shapiro*, 494 F.2d 1301 (2d Cir. 1974) (defendant who traded unlawfully on the basis of inside information was required to disgorge all of his profits even though some of them had been subsequently lost through additional trades).

Similarly, in *SEC v. Byers*, 2009 WL 33434, at *3 (S.D.N.Y. Jan. 7, 2009), Judge Chin granted a freeze of assets, including a home occupied by the brother and sister-in law of the defendant that was given to them by the defendant. The brother and sister-in-law sought to lift

the freeze, arguing that there was no showing that it was specifically defendant's ill-gotten gains that were used to purchase the property. The court denied this application, holding that it was improper to allow relief defendants to profit from someone else's illegal activities: "in the sense that money is fungible, [] it would be difficult, if not impossible, to trace specific [defendant] funds to specific mortgage payments – 'a freeze order need not be limited only to funds that can be traced to defendant's illegal activity.'" *Id.* (*quoting SEC v. Sekhri*, 2000 WL 1036295, at *1 (S.D.N.Y. July 26, 2000)); *see also SEC v. Seibald*, 1997 WL 605114 (S.D.N.Y. Sept. 30, 1997) ("[T]he SEC does not need to show exactly where the profits went to have relief defendants disgorge the benefits 'that they derived from the violations by the culpable defendants.'" (*quoting SEC v. Egan*, 856 F. Supp. 401, 402 (N.D. Ill. 1993)); *SEC v. Grossman*, 887 F. Supp. 649, 661 (S.D.N.Y. 1995) ("It is irrelevant whether the funds affected by the Asset Freeze are traceable to the illegal activity."), *aff'd*, 101 F.3d 109 (2nd Cir. 1996); *SEC v. Glauberman*, 1992 WL 175270, at *2 (S.D.N.Y. July 16, 1992) (upholding disgorgement of assets that had been transferred to relief defendants, and rejecting argument that disgorgement is not appropriate because "the challenged transfers cannot be traced dollar for dollar to profits from insider trading").

IV. THE STOCK ACCOUNT SHOULD REMAIN FROZEN

Lynn Smith testified in her deposition and in her Affidavit that the Stock Account was a source of funding for David Smith's business during the period of the fraud and for years before. Exhibit 2 to the Daniello declaration demonstrates the flow of funds being transferred between the Stock Account and her husband and business affiliated with the MS Entities. Employees of McGinn Smith freely transferred funds in and out of the Stock Account as if it were part of David Smith and McGinn's business. Mehraban Dec. Ex. 9 (e-mails directing transfers).

The evidence shows that the Stock Account was used primarily as a financing tool of David Smith and McGinn's fraudulent scheme. It should remain frozen.

V. LYNN SMITH RECEIVED FUNDS WITHOUT CONSIDERATION

Lynn Smith concedes that more than $1.8 million was transferred into the Stock Account, the Checking Account and her IRA account from David Smith and the MS Entities during the period of the fraud. LSmith Aff. Exs. B, C and D. Mrs. Smith claims that these were loans; however, the only loan agreement is unsigned and Mrs. Smith admits not only that she never saw this loan agreement before transferring the funds but that the first time she saw it was in her lawyer's office after this case was filed.

The evidence does not show any consideration for the funds transferred to Lynn Smith. Moreover, these transfers were fraudulent conveyances because David Smith and McGinn knew of the fraud at the time of the transfers and knew that there would not be enough money to pay back investors in these entities.

In addition, Lynn Smith received from far more than the $1.8 million directly transferred into her accounts. She had no source of income other than David Smith's ill-gotten gains during the period of the fraud. By paying their joint bills from a joint checking account, Lynn Smith could maintain her Stock Account as a financing tool for David Smith's business.

Lynn Smith cites to a number of cases in support of her argument that "the decisional law only requires an 'ownership interest' or 'legitimate claim' in the funds sought to be frozen to preclude a person from being a proper relief defendant." Lynn Smith Brief at 5. However, the cited cases in which a freeze of relief defendant assets were denied are distinguishable. *See, e.g., Janvey v. Adams*, 588 F. 3d 831 (5th Cir. 2009) (relief defendants were investors who had purchased CDs from defendants); *SEC v. Funding Ptnrs. Capital Mgmt.*, 639 F. Supp. 2d 1291

(M.D. Fla. 2009)(third party lender with legitimate written loan documents); *FTC v. Bronson Partners, LLC,* 674 F. Supp. 2d 373, 392 (D. Conn. 2008)(employee with legitimate wage claim). None of these cases presented the circumstances here, where the relief defendant's accounts contained proceeds from the fraud and were controlled and used by the defendant-spouse in furtherance of the fraud. Moreover, the alleged transfers for consideration are not corroborated by any loan documents, and fraudulent loan documents have already been submitted to investigatory authorities by the defendants. *See* Mehraban Decl. (April 19, 2010), at ¶ 52 (citing App. Ex. 24, at 171-180).

VI. THE 2009 FRAUDULENT TRANSFERS

In January 2009, David Smith acknowledged in an e-mail to McGinn that "Lynn and I have to shift money around between us." In 2009, David and Lynn Smith transferred the Vero Beach home into Lynn Smith's name, and Lynn Smith opened her own Checking Account. Similarly, McGinn and his wife, Nancy, transferred their home into Nancy McGinn's name. These transfers took place after the FINRA investigation began, after a number of investor arbitrations were filed and after Smith and McGinn had admitted to investors that the Funds were insolvent. Accordingly, these were fraudulent transfers. *See, e.g., Palermo Mason Const., Inc. v. Aark Holding Corp.*, 752 N.Y.S.2d 99 (2d Dept. 2002) (fraudulent conveyance is a "transfer made without fair consideration by debtor when he or she is insolvent or which renders him or her insolvent, or by defendant in action for money damages who is unable to satisfy judgment that plaintiff finally obtains"); *In re Teligent, Inc.*, 325 B.R. 81 (S.D.N.Y. Bankr. 2005) ("party asserting constructive fraudulent transfer must prove three elements: (1) a transfer of debtor's property, (2) while debtor was insolvent or which rendered debtor insolvent, (3) for less than

reasonably equivalent value (under bankruptcy law and the Uniform Fraudulent Transfer Act) or fair consideration (under the Uniform Fraudulent Conveyance Act)").

CONCLUSION

For the foregoing reasons, and as further set forth in its prior submissions, the Commission respectfully requests that its motion for a preliminary injunction be granted.

Dated: New York, NY
June 3, 2010

Respectfully submitted,

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