

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

McGINN, SMITH & CO., INC., et al.,

Defendants.

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PLAINTIFF’S MEMORANDUM OF LAW IN OPPOSITION TO DAVID L. SMITH’S MOTION TO MODIFY THE ASSET FREEZE TO PERMIT THE RELEASE OF THE IRREVOCABLE LIFE INSURANCE TRUST

Defendant David Smith asks that, in order to fund his defense in the parallel criminal case, the Court allow his wife, defendant Lynn Smith, to apply for a loan from the trustee of an irrevocable trust after the trustee has obtained a loan from an insurance company. *See* Smith Br. at 3; Declaration of David L. Smith dated Apr. 25, 2012, ¶ 17; Declaration of William J. Dreyer dated Apr. 26, 2012, ¶ 9.

For the following reasons, the motion should be denied.

First, Lynn Smith should not be allowed to borrow funds and then transfer those funds to D. Smith because she is subject to two Court-ordered obligations to pay any funds in her possession to the Receiver and to the SEC. The Court’s *Order Directing Payment of Money to Receiver* entered October 6, 2011 (the “Order”) provides that “L. Smith is liable for disgorgement of \$925,659 . . . [and that] L. Smith shall satisfy this obligation by paying \$925,659 to the Receiver.” Dkt. 398. A separate *Judgment* entered the same day (the “Judgment”) states that “L. Smith is liable [to the SEC] for attorney’s

fees and costs in the amount of \$51,232.” Dkt. 399. Lynn Smith has not made any payments to satisfy either the Order or the Judgment.

Any funds Lynn Smith receives from the trustee pursuant to the proposed loan transaction should be used to satisfy her payment obligations. Once the trust disburses funds to Lynn Smith, those funds should be either paid to the Receiver or frozen by this Court. Any funds received by Lynn Smith, equal to the amount of the Judgment for \$51,232, are also are subject to attachment under New York law. *See* Dkt. 221, at 5 n.1 (Court’s finding that funds in David Smith’s 401(k) plan are not protected after they reach the beneficiary). As a result, L. Smith should not be permitted to evade her payment obligations by directing funds borrowed from the trust toward her husband’s criminal defense.

Second, when David Smith created this irrevocable trust he surrendered his rights to the trust assets. Having Lynn Smith act as the functional equivalent of a pass-through for the benefit of D. Smith violates the express terms of the trust agreement, which provides that D. Smith has irrevocably transferred “all of his right, title and interest in the insurance polic[y]” to the Trustee. *See* D. Smith Decl., Ex. B, at 2. David Smith’s motion seeks to use this irrevocable trust to benefit himself rather than to provide for the beneficiaries as the trust agreement requires.

Finally, D. Smith concedes that any insurance premiums paid after September 2003, when the fraud is alleged to have begun, should be deducted from any funds that are released. *See* Smith Br. at 3 (“this amount is minimal and may easily be identified and severable from the principal of the insurance trust”). According to Smith and premium notices available to the SEC, a total of \$7,500 was paid as premium during the period of

the fraud. *See* Declaration of David Stoelting dated May 9, 2012, ¶¶ 3-4, Ex. A; Smith Decl. ¶ 11. As a result, if the Court were to grant any portion of D. Smith's motion, then \$7,500 of any loan proceeds should be paid to the Receiver or frozen by the Court.

WHEREFORE, plaintiff respectfully requests: (1) that D. Smith's motion be denied in its entirety; (2) to the extent that any loan proceeds are distributed to L. Smith, that they be frozen pursuant to the Order and the Judgment; and (3) to the extent that not all loan proceeds are frozen, that \$51,232 of any such proceeds be transferred to the Receiver in satisfaction of the Judgment; and that \$7,500 of any loan proceeds, representing the amount of premiums paid during the period of the fraud, be paid to the Receiver or frozen by the Court

Dated: New York, NY
May 9, 2012

Respectfully submitted,

s/ David Stoelting
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