

**UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK**

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SECURITIES AND EXCHANGE  
COMMISSION,

Plaintiff,

v.

No. 10-CV-457  
(GLS/DRH)

DAVID L. SMITH,

Defendant.

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**APPEARANCES:**

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New York, New York 10281

DREYER BOYAJIAN LLP  
Attorney for Defendant David Smith  
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**DAVID R. HOMER  
U.S. MAGISTRATE JUDGE**

**OF COUNSEL:**

KEVIN McGRATH, ESQ.  
LARA MEHREBAN, ESQ.,  
JOSHUA M. NEWVILLE, ESQ.

WILLIAM J. DREYER, ESQ.

**MEMORANDUM-DECISION AND ORDER**

Defendant David L. Smith previously moved for an order releasing funds from the asset freeze ordered in this case to permit payment of attorney's fees and costs in a related criminal action and, in a decision filed April 4, 2012, the motion was granted in major part. Dkt. No. 478; see also S.E.C. v. McGinn, No. 10-CV-457 (GLS/DRH), 2012 WL 1142516 (N.D.N.Y. Apr. 4, 2012). Presently pending is David Smith's further motion to amend the asset freeze order to permit funds from a life insurance trust to be released for attorney's fees and costs in the criminal case. Dkt. Nos. 484, 489. Plaintiff Securities and Exchange Commission (SEC) opposes the motion. Dkt. No. 487. For the reasons which

follow, the motion is granted.

### I. Background

Familiarity is assumed with the decision filed April 4, 2012 and with the prior decisions and proceedings in this action.

On March 25, 1984, David Smith purchased a whole life insurance policy from Thrivent Financial for Lutherans paying \$350,000 upon David Smith's death to the named beneficiaries. D. Smith Decl. (Dkt. No. 484-2) at ¶ 7 & Ex. A. On January 3, 1989, an irrevocable trust agreement was executed for this policy naming Thomas Urbelis as trustee. Id. at ¶ 8 & Ex. B. The policy is the only asset of the trust. Id. at ¶ 13. This agreement named David Smith's wife, Lynn A. Smith, as the primary beneficiary of the trust and relinquished all rights and interest of David Smith in the trust and policy. Id. at ¶ 9 & Ex. B at 21. Through 2002, the Smiths paid the annual premiums of \$5,350, paying a total of \$96,300 in this period. Id. at ¶ 10. After 2002, the premiums were paid from dividends of the policy in whole or part with the Smiths paying an additional total of approximately \$7,500. Id. at ¶ 11; Stoelting Decl. (Dkt. No. 487-1) at ¶ 4. The policy has a current cash surrender value of approximately \$168,000. D. Smith Decl. at ¶ 13. Urbelis resigned as trustee on July 27, 2010 and a new trustee has not yet been named. Id. at ¶¶ 15, 16. If David Smith's motion is granted, approximately \$7,000 in borrowing costs will be due to Thrivent Financial in 2013. Id. at ¶ 18.

## II. Discussion

The SEC opposes the motion on three grounds. First, the SEC contends that any funds received from the life insurance trust should be frozen or paid to the Receiver in light of Lynn Smith's obligations. Second, it contends that David Smith has relinquished all interest and rights in the life insurance trust and, therefore, cannot now obtain use of those funds. Third, the SEC contends that if this motion is granted, the approximately \$7,500 in premium payments made by David Smith since 2003 should be deducted from the proceeds of the loan and frozen.

### A. Lynn Smith's Obligations

As noted, David Smith relinquished all rights and interest in the life insurance trust and, at present, there is no trustee.<sup>1</sup> Therefore, David Smith proposes that as the primary beneficiary of the policy, Lynn Smith, will apply for a loan against the cash surrender value of the life insurance policy in the total amount of that value, or approximately \$168,000 for use in paying David Smith's legal fees in the related criminal proceeding. Dreyer Decl. (Dkt. No. 484-3) at ¶ 9. However, Lynn Smith is currently under an order of the Court to disgorge \$925,659 to the Receiver and to pay \$51,232 to the SEC. Dkt. Nos. 398, 399. Therefore, if funds from the life insurance trust come into Lynn Smith's care, custody, control, or possession, those funds could be frozen for application against these obligations and may also be subject to attachment under New York law. SEC Mem. of Law (Dkt. No. 487) at 1-2.

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<sup>1</sup>David Smith is seeking to have his son, Geoffrey R. Smith, appointed as the trustee. D. Smith Decl. at ¶ 16.

David Smith asserts that the SEC's argument is misplaced because Lynn Smith's interest in the life insurance trust as a beneficiary of the policy does not subject the cash surrender value of that policy to seizure by creditors such as the SEC. D. Smith Reply Mem. of Law (Dkt. No. 489) at 2. However, the SEC does not seek to freeze or seize the life insurance policy for the benefit of investors under the asset freeze order. It asserts only its right, as it has in the past, to seize or freeze funds which come into Lynn Smith's possession from whatever source, whether it be the proceeds of the sale of a primary residence, withdrawals from a retirement account, or, as here, the proceeds of a life insurance policy, all of which are beyond the reach of the SEC until redeemed. See, e.g., Dkt. Nos. 221 at 3-5 (order upholding restraint of David Smith's retirement account under asset freeze order), 478 at 10-11 (finding that certain assets of the Smiths remain in legal limbo beyond the reach of both the Smiths and the SEC pending resolution of this action).

Notwithstanding, the assets in the life insurance trust are similarly situated for purposes of this motion to the assets of David Smith's retirement accounts, which were a subject of the April 4, 2012 decision. See Dkt. No. 478 at 10-13. There, after finding that the retirement account assets were beyond the reach of both the SEC and David Smith until David Smith withdrew them, the Court found that in light of David Smith's demonstrated need for funds with which to pay attorney's fees and costs in the criminal proceeding and the reasonableness of the fees likely to be incurred, principles of equity dictated that the assets in the retirement funds be released from the asset freeze to defray such costs. Id. at 13-16. The same principles of equity, the reasonableness of the fees and costs likely to be incurred by David Smith in defending against the criminal charges, and the fact that the assets are otherwise unavailable to the SEC or allegedly defrauded

investors dictates that the funds in the life insurance trust be released for use to pay attorney's fees and costs in the criminal proceedings unless barred by other legal impediments. See subsections (B) and (C) infra; see also Dkt. No. 478 at 10-16 (stating reasons for releasing David Smith's retirement account assets for use in paying fees and costs incurred in the criminal case, which reasons are incorporated herein by reference).

### **B. David Smith's Relinquishment of Rights and Interest**

The SEC next contends that since David Smith relinquished all rights to and interest in the life insurance trust when it was created, he cannot now seek use of its assets. SEC Mem. of Law at 2. However, the relief sought in this motion is to lift the asset freeze order as to the life insurance trust assets, not an order compelling the trustee to disburse the trust's assets to David Smith. Whether and to what extent the trustee grants the request of David Smith or Lynn Smith to grant a loan of the cash surrender value of the policy for disbursement to David Smith's counsel is committed to the discretion of the trustee by virtue of the life insurance trust agreement. See Trust Agreement (Dkt. No. 484-2, Ex. B) at 8-9 ("The Trustee is hereby vested with all right, title and interest in and to all policies of insurance composing part of the Trust Estate and is authorized and empowered, as absolute owner of such policies, to exercise and enjoy, for the purpose of the Trust herein created all the options, benefits, rights and privileges under the same including the right to borrow upon such policies and to pledge them for a loan or loans.").

Thus, the only question presented here is whether the asset freeze order should be lifted as to the life insurance trust to permit use of the trust's assets to pay David Smith's attorney's fees in the criminal action in the event that the trustee deems such action

appropriate. For the same reasons underlying the decision to lift the asset freeze order as to David Smith's retirement accounts, which are incorporated herein by reference, David Smith's motion is granted and the asset freeze order will be modified to release from its scope the assets of the life insurance trust under the following conditions.

A. The asset freeze order is lifted as to the life insurance trust assets only upon condition that such assets are transferred directly by the trustee to counsel for David Smith without ever coming into the care, custody, control, or possession of Lynn Smith or anyone else. The asset freeze order remains in full force and effect for any funds which come into the care, custody, control, or possession of Lynn Smith, regardless of the source. Thus, any request to the trustee for a loan of the cash value of the life insurance policy shall be conditioned on the transfer of any such proceeds directly from the trustee to counsel for David Smith, regardless of who requests the loan, without any proceeds passing to or through Lynn Smith or anyone else;<sup>2</sup>

B. On or before **August 1, 2012**, David Smith shall file an accounting under oath in the public docket of this case setting forth the total amounts obtained from the liquidation of each asset released from the preliminary injunction herein, all costs and deductions from that amount, the net amount delivered to their counsel for deposit in counsels' escrow fund, and a certification that (1) none of the funds from these liquidated assets have been used for any purpose other than legal costs billed by counsel, and (2) all proceeds from the liquidation of these assets, after deducting any applicable costs, have

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<sup>2</sup>This procedure adopts a method for disbursement suggested by David Smith. See D. Smith Reply Mem. of Law at 3-4.

been paid to counsel for deposit in counsel's escrow account;<sup>3</sup>

C. Counsel for David Smith shall deposit funds received from the life insurance trust in its escrow account pending further order of the Court;

D. If Thrivent Financial does not deduct the borrowing costs from the loan proceeds before those proceeds are disbursed, counsel for David Smith shall pay those borrowing costs to Thrivent Financial upon receipt of an invoice for such charges;

E. Counsel for David Smith may apply to the undersigned, ex parte and in camera, for the payment of the attorney's fees and costs incurred to that date in accordance with the procedures for the award of such fees and costs under 42 U.S.C. § 1988. Such applications will be filed in the docket of this case under seal although orders ruling on such applications will be filed in the public docket, and the Court will determine those applications under the standards applicable under § 1988;<sup>4</sup> and

F. Further applications may be made thereafter by counsel for David Smith as deemed appropriate.

### **C. Premiums Paid Post-September 2003**

Finally, the SEC contends that if David Smith's motion here is granted, a total of \$7,500 should be forwarded to the receiver for maintenance under the asset freeze order

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<sup>3</sup>The April 4, 2012 decision required David Smith and co-defendant Timothy McGinn to file such accountings by May 1, 2012 for those assets released from the asset freeze order in that decision. Dkt. No. 478 at 15-16. No such accountings have been filed by either David Smith or Timothy McGinn. The deadline for such accountings is hereby extended to August 1, 2012.

<sup>4</sup>See also Dkt. No. 478 at 16 (same).

as the amount of premiums paid by David Smith on the life insurance policy after September 2003. SEC Mem. of Law at 2-3; see also Dkt. No. 478 at 9-13 (finding that funds disbursed by David Smith after September 2003 may be subject to disgorgement). Sufficient evidence has been proffered on this motion to support the SEC's contention that approximately \$7,500 in premiums on the life insurance policy were paid by David Smith on and after September 2003. See Stoelting Decl. at ¶ 4. Accordingly, within fourteen days of receipt of the proceeds of the loan against the cash surrender value of the life insurance policy, counsel for David Smith shall remit to the Receiver the total amount of \$7,500 to be maintained by the Receiver under the asset freeze order for the benefit of allegedly defrauded investors in the event that the SEC prevails in this action.

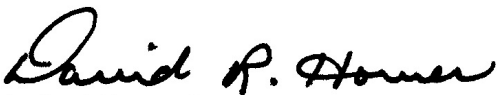
### III. Conclusion

For the reasons stated above, it is hereby

**ORDERED** that Smith's motion for the release of the assets of the life insurance trust from the preliminary injunction to pay attorney's fees and costs in the parallel criminal action (Dkt. No. 484) is **GRANTED** under the conditions set forth above;

**IT IS SO ORDERED.**

DATED: June 20, 2012

  
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David R. Homer  
U.S. Magistrate Judge