UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

vs.

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.

Case No.: 1:10-CV-457 (GLS/DRH)

PROPOSED INTERVENOR'S REPLY MEMORANDUM OF LAW IN FURTHER OPPOSITION TO PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

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STATEMENT OF FACTS

David and Lynn Smith formed an *inter vivos* trust for the benefit of their children on August 4, 2004. Urbelis Tr. 10. Thomas J. Urbelis, a lifelong friend and an attorney in Boston, served as the Trustee from the creation of the Trust until his resignation, which took effect May 17, 2010. Urbelis resigned to avoid a conflict or appearance of a conflict between his fiduciary duties to the beneficiaries and his personal interests as an investor of McGinn, Smith & Co., Inc. Id. at 49-51. At that time, the Donors exercised the only power they retain from the Trust Declaration, the power to appoint a successor trustee. They appointed David Wojeski, who is the Intervenor in this preliminary injunction motion and who seeks relief from the asset freeze order.

At his deposition taken on June 1, 2010, Urbelis testified that he believed he had three main duties as trustee: (1) to make sure the Donors' children were taken care of should they need money or assistance, (2) to make sure the taxes were paid, and (3) to preserve the corpus of the trust and keep it relatively liquid so that cash would be available should the beneficiaries need money. Urbelis Tr. p. 11-13. When he accepted the position of Trustee, Urbelis made it clear to the Smiths that he did not want to be responsible for preparing tax returns, so the Smiths arranged for their existing accountant, Ron Simons, of Piaker & Lyon, to prepare the Trust's returns. Id. at 12-14.

To preserve the corpus of the Trust, Mr. Urbelis chose to use the "in-house expert" found in David Smith, the father of the beneficiaries, a stock broker and a creator of the Trust. Id. at 14. Urbelis relied on Smith for his own and his family's investment advice and felt comfortable relying on him for advice relating to the Trust. Id. at 14. Mr. Urbelis viewed his responsibility as preserving the corpus, and not doubling, tripling or quadrupling the amount in the account. Id. at

12. Therefore, he embarked upon a conservative investment strategy and very few investments were undertaken. Mr. Smith had written to Mr. Urbelis at the time the Trust was created to inform him that they could consult on investments but Smith was not eligible to exercise any direct control over the trust or its investments. Urbelis Tr. at 20-21. Mr. Urbelis did not grant David Smith discretionary authority to make investments without the prior approval of Urbelis as the Trustee and account holder. Id. at 22. Urbelis understood that to mean that he could consult with Smith but that he, Urbelis, was the only one who could authorize any transfers, acquisitions or dispositions. Id. at 21. Urbelis contrasted their arrangement with his service on a board of trustees for a charitable organization, where the board's investment advisor buys and sells stock and then provides an annual report. Id. at 21.

The two major investments by the Trust were in Deerfield Triarc and Pine Street Capital Partners. Smith recommended both investments to Urbelis. Urbelis considered the investments for the Trust as he considered investing personally in Pine Street. After discussion with Smith, Urbelis decided to invest Trust money in these two investments and executed routine paperwork provided by McGinn Smith employees. Id. at 25-29. Urbelis invested $400,000 of Trust money in Pine Street Capital Partners LP in January 2005 pursuant to a Subscription Agreement maintained by Pine Street Capital Partners. Welles Tr[1]. Timothy Welles, the Managing Director of Pine Street, recognized Urbelis' name as an investor, and was always available to answer any questions from Urbelis about the Trust's investment. Welles Tr. The Trust's account at Pine Street was held in Urbelis' name as Trustee. Welles Tr. Quarterly interest payments were made back to the Trust's stock account, as were returns of capital. Welles Tr. Pine Street issued three

[1] The deposition of Timothy Welles was taken on June 3, 2010 and an expedited transcript was requested. As of the filing of this Reply Memorandum of Law, the stenographer had not delivered the transcript, so page citations could not be included.

capital cash calls to the Trust in 2006 and the Trust paid all calls from its brokerage account pursuant to the subscription agreement, for a total additional investment of $213,508. Welles Tr. The managers at Pine Street treated the Trust's investment the same as other investors and, at his deposition, Welles reviewed all of the Trust's brokerage account statements which showed a deposit from Pine Street Capital Partners and verified that each such deposit was made in the ordinary course of Pine Street's business, that each amount was due and owing to the Trust, and that Pine Street made the payment to the Trust as part of its ordinary course of business. Welles Tr.

Each year around April 15, Urbelis would receive a call notifying him of the amount to transfer to pay the Trust's taxes. In April 2005, the first year in which the Trust paid taxes, Dave Smith mailed Urbelis a check for $2300 payable to Urbelis' IOLTA account. Urbelis Tr. at 30-32. The firm cut two checks to the IRS and the NYS Department of Tax and Finance. After that, Urbelis requested that monies not come to his firm because the Trust was not a client of the firm. Id. at 32. Subsequently, the taxes were paid in various ways. On one occasion, Urbelis authorized the brokerage house to issue checks from the Trust's brokerage account. On another occasion, Dave Smith wrote checks to pay the Trust's taxes without being reimbursed and on other occasions, Smith either received the monies in advance or was reimbursed with wire transfers to his account. Wojeski Reply Aff. Ex. C.; Urbelis Tr. 40-41, 52-54. In April 2010, Urbelis authorized the transfer of $95,000 from the Trust account to Lynn Smith's account to pay taxes at the request of Geoffrey Smith, a beneficiary of the Trust. Id. at 53, 61.

POINT I

THE LEGAL FORM OF THE TRUST CANNOT BE PIERCED BECAUSE THE TRUST HAS NOT BEEN USED TO CONCEAL ASSETS OR ENGAGE IN FRAUDULENT CONVEYANCES TO SHIELD ASSETS

A. The Second Circuit has established the applicable legal standard, which is founded in New York law.

Whether a trust can be pierced under an "alter ego" theory is a matter of state law. See, *St. Paul Fire & Marine Ins. Co. v. Pepsico, Inc*., 884 F.2d 688, 700 (2d Cir. 1989). In the most relevant and authoritative case in this jurisdiction, the Second Circuit recognized that "[t]he New York Court of Appeals has never resolved whether courts may 'disregard the form of a trust, when the trust was not formed for an illegal purpose and there is the requisite separation between beneficiary and trustee.'" *Babitt v. Vebeliunas (In re Vebeliunas)*, 332 F.3d 85, 90 (2d Cir. 2003), citing *National Union Fire Ins. Co. of Pittsburgh, PA v. Eagle Equip. Trust*, 221 A.D.2d 212 (1st Dep't 1995). Rather, the Court may only consider the alter ego theory of disregarding a trust form if the Court first finds sufficient proof that either there was fraud in the creation of the trust or that the trust form itself was used to perpetrate a fraud on the plaintiff, and then finds that the beneficial owner and the trustee are indistinguishable. *Id.*

The Intervenor submits that the *Vebeliunas* case is directly on point with the case at bar, both on the law and on the facts, and this Second Circuit decision should control the Court's decision herein. *Id.* Vanda Vebeliunas created and was the sole trustee of an irrevocable trust which owned valuable property, including the family home, on the North Shore of Long Island. *Id.*, at 87-88. Her husband, Vytautas Vebeliunas, who eventually became a debtor in bankruptcy, was alleged to have engaged in various acts of fraud in obtaining millions of dollars in real estate financing by, *inter alia*, purporting to pledge as collateral the title to the real property held in his wife's irrevocable trust. He created fraudulent deeds, false affidavits, made misleading statements, and generally defrauded two major banks by purporting to grant mortgages in the property owned by the irrevocable trust. He was eventually indicted in an unrelated matter for bank fraud, misapplication of credit union funds, criminal conflicts of interest and other charges. Notwithstanding the many and diverse allegations of fraud made against the debtor husband, there were no allegations that the irrevocable trust was used to conceal assets, that the wife's purchase of the real estate or transfer of the property into the trust was part of a fraudulent conveyance, or that the wife made any false representations in furtherance of her husband's fraud. *Id.*, at 91.

Consistent with the Plaintiff's theory here, the trustee in bankruptcy sought to pierce Vanda's irrevocable trust on the theory that the trust was the alter ego of her husband and that he was therefore the equitable owner of the property held in trust. Like the SEC, the bankruptcy trustee argued that the irrevocable trust's assets should be treated as part of the debtor's bankruptcy estate and thus be available to his creditors. And, like Lynn Smith, Vanda Vebeliunas used funds she earned by investing her inheritance to purchase the property she later transferred to the trust. *Id.*, at 92. In both cases, there was insufficient evidence to establish that the consideration the wife paid for the property in trust was inadequate or that the husband actually provided the consideration for his wife's purchase of the property in dispute. See, *Vebeliunas*, 332 F.3d at 91. The facts and the law of the *Vebeliunas* case could not be any more on point with the case at bar.

In a decision by Judge Pooler in *Vebeliunas*, the Second Circuit refused to allow the trust to be pierced. The Court recognized that the debtor husband managed certain ministerial business matters for the trustee wife and paid virtually all of the expenses associated with the irrevocable trust, but nevertheless held that the debtor husband "was neither the equitable owner nor in control of the Irrevocable Vart Trust" because spouses routinely administer each other's assets and conduct business on behalf of each other. *Id.*, at 93. Judge Pooler, recognizing that certain tax benefits flowed to the debtor as a result of his wife's ownership of the trust, reminded the litigants that "New York is not a community property state, and the mere fact that debtor and his wife filed joint tax returns does not indicate that ownership of [the trust property] transferred to the debtor. *Id.*, at 92, citing *Callaway v. Commissioner of Internal Revenue*, 231 F.3d 106, 112 (2d Cir. 2000).

The Second Circuit's holding in *Vebeliunas*, and indeed the specific language chosen for the decision by Judge Pooler, takes heed of the caution advised by the New York Court of Appeals in construing trust instruments. In *Matter of Gilbert*, Judge Fuchsberg opined that:

> "In a legal framework, 'rules of legal interpretation are rules of *common-sense'* (Hamilton, Alexander, The Federalist, Modern Library, 539 [emphasis in original]). And, in the narrower context of a trust instrument, the following language is as apt here as it was in the case for which it long ago was written: 'Whatever trust they could create sprang into existence by the instrument which they executed…It was the complete creation of a trust…'"

39 NY2d 663, 669 (1976); citing *Livingston v. New York Life Ins. & Trust Co*., 59 Hun 622, opn in 13 NYS 105, 108, on second app *sub nom*. The Court here must also adhere to established precedent and refrain from piercing the trust in the absence of clear evidence establishing that there was fraud in the creation of the trust or that the beneficiary, or beneficial owner and the trustee were so indistinguishable that the trust was used to perpetrate a fraud by the defendant or to conceal the defendant's assets.

Indeed, consistent with the holding in *Vebeliunas*, Plaintiff has not identified a single New York case in which the courts have preserved the right to pierce a trust where the respective parties were <u>not</u> alleged to have used the trust to conceal assets or to engage in fraudulent conveyances into the trust to shield the defendant's assets from adverse judgments. See, *In re Vebeliunas*, 332 F. 3d at 91; see also, *Pergament v. Meghazeh Family Trust (In re Maghazeh)*, 310 B.R. *5, 8, 2004 Bankr. LEXIS 641, **6 (Bankr. EDNY 2004); compare *Guilder v. Corinth Construction Corporation*, 235 A.D.2d 619, 620 (3rd Dep't 1997) (dominance and control of corporation to extent that individuals are deemed to be equitable owners is insufficient to pierce veil without additional factual finding that individuals abused their power over corporation to commit fraud or wrongdoing to plaintiff's detriment) and *In re Adler, Coleman Clearing Corp. v. Gurian*, 205 Fed. Appx. 256, 2006 U.S. App. LEXIS 21194 (common law alter ego theory requires plaintiff to prove that owner of corporation used its control of corporation to commit a fraud or wrong that resulted in an unjust loss or injury to the plaintiff). Thus, the holding by the Second Circuit in the *Vebeliunas* case must be applied to the facts of the case at bar.

B. The Trust was created for estate planning purposes and Plaintiff has offered no evidence of fraud in the creation of the trust.

In reviewing a trust instrument, the New York Court of Appeals will search for the probable intention of a grantor, especially as evidenced by the trust instrument, and in construing an *inter vivos* trust such as the one at issue here, "effect is to be given to that intention unless it is contrary to public policy or law." *In re Matter of Gilbert*, 39 N.Y.2d 663, 666 (1976). There is no evidence or even an allegation of any fraud in the creation of the David L. and Lynn A. Smith Irrevocable Trust. David and Lynn Smith created this *inter vivos* trust in August 2004 as an estate planning technique to provide for their children. See, Lynn Smith Aff. in Support of Motion to Intervene. By its terms, the Trust was established for the benefit of the Donors' children and was and is irrevocable by the Donors. See Wojeski Aff. dated May 25, 2010, Ex.

A. The only power retained by the Donors was the power to appoint a successor trustee, which power was exercised by David and Lynn Smith upon the resignation of the initial trustee, Thomas Urbelis. Id. at p. 5.

The testimony of Thomas Urbelis, a Boston attorney who holds an MBA and a law degree, corroborated Lynn Smith's testimony concerning her intentions in creating the trust, to pass on her inheritance to her children. Urbelis has served for 20 years as the trustee of a life insurance trust on the life of Dave Smith and has known Dave and Lynn Smith for more than 50 years, and has known the beneficiaries, Geoff and Lauren Smith, since they were born. Urbelis Tr. at 7, 12. Urbelis was asked to serve as "the trustee of the children's trust" and he believed he was selected because he knew the Smith's children, knew their personalities and their needs. See Urbelis Tr. p, 10 – 12. Plaintiff has not offered any evidence to contradict the stated purpose of the trust at the time it was made or to refute the fact that it came into existence upon its declaration. There are sufficient facts to find, as a matter of law, that the Trust was created for estate planning purposes and there was no evidence of fraud in the creation of the trust.

The funding of the Trust did not render Lynn Smith insolvent. Mrs. Smith had more than $6.5 million dollars in her brokerage account when she and her husband decided to create a trust fund for their children. Neither the present claims of fraud by the Plaintiff nor the investigations conducted by FINRA over the last two years were in existence or were known to David or Lynn Smith in August 2004. Thus, the creation of the trust could not have been intended to avoid creditors and, as demonstrated by Lynn Smith's brokerage account statements, funding the trust by transferring this stock did not render her judgment proof. She had $6.5 million in her account when she transferred the stock in 2004, and continued to have $2 million remaining after that transfer. At the time she funded the trust, Lynn Smith was not aware of the claims to be made in this action as the conduct complained of had not even occurred. None of the FINRA investigations had commenced in 2004. Moreover, David Smith did not transfer <u>any</u> of his assets or their joint assets into the trust at any time since its creation. There are sufficient facts not in dispute for the Court to find, as a matter of law, that there was no fraud in the creation of the trust. The Court should give full force and effect to the Trust Declaration and the funding of the Trust by Lynn Smith for the benefit of her children.

C. This irrevocable trust has never been used by David Smith to shield assets from his creditors.

Even in applying Plaintiff's theory of piercing the corporate veil, the New York Court of Appeals requires "a showing that (1) the owner exercised complete domination of the corporation with respect to the transaction at issue; and (2) the owner used this domination to commit a fraud or wrong against the plaintiff which resulted in injury to the plaintiff." *Morris v. NYS Department of Taxation & Finance*, 82 N.Y.2d 135 (1993). Even in the unlikely event that Plaintiff convinces the Court that David Smith exercised complete control over the Trust, there has been no allegation or proof that he, or anyone, used this purported control of the Trust to commit a fraud or wrong against the plaintiff or that the trust has been used in any way to shield assets or engage in fraudulent conveyances. *Id.*, at 141. Indeed, despite the numerous allegations of fraud and either assets transfers or fear of asset transfers throughout Plaintiff's Complaint and papers submitted in support of its motion for a Temporary Restraining Order, Plaintiff does not mention the Trust at all, except to ask that its brokerage account be frozen. All of the Trust's account statements were provided to the Plaintiff during discovery, and it is undisputed that the brokerage account is the Trust's only asset. Surely, if there were any evidence whatsoever that

David Smith had transferred any of assets or joint marital assets into the Trust to avoid creditors, there would have been some allegation to that effect.

On the contrary, since the opening of the Trust's brokerage account with the receipt and sale of the Charter One stock in September 2004, the only deposits into the account other than interest earned on the corpus of the trust were interest payments and return of principal as a result of the Trust's investment in Pine Street Capital Partners LP in early 2005. Because of the limited number of transactions in the Trust account, the transactions are easy to track and have been submitted to the Court in a chart attached as an exhibit to the Reply Affidavit of David Wojeski at Exhibit C. There have been no additional transfers into the Trust account by Lynn Smith since September 1, 2004, and there has never been a single transfer of money, securities or investments of any kind into the Trust's brokerage account by David Smith at any point during the life of the Trust. Although David and Lynn Smith wrote the checks to pay the Trust's taxes, they were reimbursed for most of those payments[2]. There are sufficient facts not in dispute for the Court to find as a matter of law that David Smith did not transfer any property into the Trust and therefore cannot be found to have used the Trust or its accounts to shield his assets from creditors.

[2] A comparison of the Trust's reimbursements to David and Lynn Smith for writing the tax checks for the Trust demonstrates that in 2006 and 2007 David Smith wrote checks totaling $105,092 to pay the Trust's estimated state and federal taxes for 2005 and 2006, yet was not reimbursed by the Trust for those payments. Plaintiff points out that in April 2010, $95,000 was transferred from the Trust account to Lynn Smith's checking account to pay taxes and that Lynn Smith believed she paid both the Trust's and her personal taxes with that money. The reconciliation of these transactions would still result in a net positive to the Trust, and does not change the fact that the Trust was never used as a vehicle for shielding assets from creditors, and no amount of money was ever transferred from the Trust to David or Lynn Smith that they were not entitled to as reimbursement for the payment of taxes already paid on behalf of the Trust or in anticipation of writing checks in the future to pay the Trust's estimated or actual tax liabilities.

POINT II

DAVID SMITH IS NOT THE EQUITABLE OWNER OF THIS IRREVOCABLE TRUST OR ITS BROKERAGE ACCOUNT

A. David Smith was neither the equitable owner nor in control of the Trust or its property.

Plaintiff argues that David Smith is the equitable owner of the Trust and therefore the Trust's brokerage account. See Plaintiff's Memo of Law, p. 3. To support its argument, Plaintiff first relies on a lien law case in which the plaintiff failed to update its title search and filed a mechanic's lien against a prior owner without knowledge that the property had been transferred from one LLC to a related LLC. See, *PM Contracting Company, Inc. v. 32 AA Associates LLC*, 4 A.D.3d 198 (1st Dep't 2004). This case is inapposite, as it was based on the court's construction of a state statute, and the decision was based on a finding that transfer of title did not defeat the intended purpose of the Lien Law, which was to give notice of a claim against property. A far higher standard is required here to defeat the form of a trust. See, *Vebeliunas*, 332 F.3d 85.

Plaintiff next cites a case in which its lead counsel here found victory in the courts of New Jersey on an entirely different set of facts. In that case, the New Jersey court found that a defendant who retained trading authority over a trust retained "beneficial ownership" over the trust assets despite disclaiming ownership in Schedule 13D filings. See, *SEC v. Teo*, 2009 WL 1684467, *10 (D.N.J. June 12, 2009). The facts in the *Teo* case are strikingly different from this case, and so too should the result be different. In *Teo*, the very nature of the alleged fraud was a scheme to conceal the defendant's true beneficial ownership of the actual stock that was held in the trust, and to cause materially false and misleading statements and omissions in SEC public filings. *Id*., at *4. Here, plaintiff merely claims that David Smith made investment decisions for the Trust, a claim which was directly refuted by the initial Trustee, Thomas Urbelis.

Unlike the *Teo* case, the actual investments in the Smith Trust's brokerage account are not the assets claimed to have been fraudulently and proactively moved out of the reach of creditors, and there has not been any allegation of misrepresentations by or on behalf of the Trust or the Trustee. In the *Teo* case, the SEC sought to reach the securities in trust in part because the defendant had represented to the SEC that he did not in fact own those securities. Thus, in doing so, the defendant made fraudulent misrepresentations in public filings with the SEC, and the securities at issue were actually the instrumentality of the fraud. *Id*. In contract, our trust's brokerage account was created and funded in 2004 with assets which Lynn Smith acquired in 1992, many, many years prior to the allegedly fraudulent acts and purported attempts to hide assets by other defendants named in the complaint. In this case, Plaintiff has made no allegation that the Trust has been used to hide assets or that the fact or form of the Trust has been an instrumentality of fraud.

The Smith Trust had been managed continuously by a trustee well-known to the donors and the beneficiaries of the trust from its inception until the filing of this lawsuit. The trustee established a prudent investment strategy intended to preserve as much cash as possible to have it available to meet the needs of the beneficiaries. He viewed his duties as providing for the children and preserving the corpus of the Trust, rather than attempting to double or triple the value of the account. He made investment decisions consistent with that conservative investment strategy and in accordance with his own decisions for investing his and his own family's money. He did not hire an outside broker, and instead took advantage of the "in-house" expertise provided by David Smith, the father of the beneficiaries. Plaintiff apparently argues that because

Dave Smith was the stock broker on the account, he somehow gained beneficial ownership of the account. This argument is simply ludicrous, and following it would create even more uncertainty in brokerage accounts than the volatility of the market itself.

Investment decisions were made by the Trustee upon the recommendation of David Smith as the broker on the Trust account and as the Trustee's personal stock broker. While plaintiff takes great pains to disregard substantial portions of the deposition testimony of the initial Trustee, Thomas Urbelis, Mr. Urbelis very clearly testified about his investment strategy for the Trust, including why he chose a conservative approach to investments, instead keeping most of the assets liquid, which was to have money available to meet the needs of the beneficiaries. He authorized very few investments, and one of the two major investments which he authorized was Pine Street Capital Partners, a private placement investment which he considered and ultimately selected for his own and his family's investment funds.

In citing the *Teo* decision and the fact that the defendant in that case had discretionary trading authority over the securities held in trust, Plaintiff suggests that David Smith had discretionary authority over this Trust's stock account. This suggestion, couple with Plaintiff's argument that the Trustee was a "figurehead" flatly ignores the Trustee's explicit testimony that he was well aware that David Smith could not and did not have direct control over or authority to make investments for the Trust. Simply, David Smith did not have the discretionary trading authority that was present in the *Teo* case. In fact, Mr. Urbelis described a very different situation at his deposition. Mr. Urbelis painstakingly explained that the Trust's arrangement with its broker, Dave Smith, was very different from the Trustee's experience sitting on the board of a charitable organization, where the charity's stock broker had complete discretion to buy, sell and trade stock without prior approval. He simply accounted to the board for his investment activities and stock trades in a report at the end of the year.

On the contrary, from the Trust's inception, Tom Urbelis and Dave Smith were both acutely aware that Smith could not control the Trust's investments, as evidenced by Smith's letter to Urbelis on August 4, 2004, their communications and practices, the numerous Letters of Authorization that Urbelis signed to authorize the release of funds from the Trust's account to make investments or to pay taxes, and the sworn testimony of the Trustee himself. Smith and Urbelis discussed investments, both for the Trust and for Urbelis and his family. The staff at McGinn, Smith would follow up by providing the paperwork for Urbelis to sign once he had made his decision. Plaintiff's argument that Urbelis signed anything that was put in front of him ignored his sworn, uncontroverted testimony and various fax cover sheets where he requested that Smith call him to discuss an investment or explain paperwork that he was being asked to sign. Urbelis testified that Smith always called him in those circumstances and answered his question.

All of the tasks performed by David Smith and by staff at McGinn Smith are tasks routinely performed by a stock broker for a client. The absence of such routine interactions with the investing client and the written documentation of transfers of money for investments and taxes would be more worrisome than their presence. Despite the Plaintiff's various attempts to disregard the sworn testimony of Thomas Urbelis and the reams of documentation at McGinn Smith showing approvals and decisions by the Trustee, Plaintiff cannot erase the fact that all of the indicia of control by the Trustee as the investor were present, which conclusively proves that David Smith did not have and did not exercise discretionary authority or beneficial ownership or control over the Trust or its brokerage account.

In a weak attempt to bolster its argument that David Smith controlled the Trust, the Plaintiff argued that the Trustee never distributed money to himself to pay the taxes; rather, he transferred money to David or Lynn Smith and they paid the taxes. Mr. Urbelis testified that he did not want to be responsible for preparing tax returns or making sure the taxes got paid. In 2005, the first year for which the Trust filed tax returns, Dave Smith paid estimated taxes for the Trust by sending Urbelis a check for $2,300 payable to Urbelis' law firm. Because Urbelis did not want to run the money through his lawyer's trust account, they handled the taxes differently after that. He did, however, reimburse Dave Smith for the $2,300 he had advanced for the Trust. In future years, Urbelis would receive a call around April 15, once the accounting firm had prepared the tax returns or estimated tax payment forms. Urbelis would sign a letter authorizing either a wire transfer or a check to be paid from NFS to David or Lynn Smith's checking accounts. One of them would then write the checks to the U.S. Treasury or the State Department of Tax and Finance and mail the check with the tax forms to the taxing authority. The mere fact that David Smith assisted the trustee by interacting with the accountant and physically writing and mailing a check, all ministerial acts as an agent of the Trustee, does not divest the Trustee of his equitable ownership of the Trust account. See, *Vebeliunas*, 332 F.3d at 92 (debtor paid virtually all expenses associated with irrevocable trust and routinely administered tasks as agent of trustee).

In addressing the amounts paid for taxes, Plaintiff incredibly argues that payments to the Smiths for taxes were "suspect since the transfers were for amounts that varied substantially. Plaintiff's Memorandum of Law dated June 3, 2010, p. 12. It seems impossible that Plaintiff would be unaware that our state and nation's tax codes are built on the very basic premise that the amount of a taxpayer's liability for any given tax year directly correlates to the amount of taxable income realized by the taxpayer for that year. The Trust does not receive an annual salary in the form of a steady paycheck which does not vary radically from week to week or year to year; rather, the Trust's sole income is based on interest earned and returns on its investments, which vary greatly depending on the trading activities and the success of the investments. In fact, in one year, losses could obviate the need for paying any taxes, while a large return on investment the following year would result in a significant tax liability

For example, Plaintiff compares the payment of $2,300 in April 2005 with the transfer of $92,105 to David Smith for payment of taxes in April 2006. The $2,300 was an estimated payment for 2004, when the Trust was in existence for five months and owned assets and had limited interest income for four months. Between September 2004 and when the Pine Street Capital Partners investment began receiving interest payments in April 2005, the Trust account had no income other than interest earned on the corpus of the trust. In fact, the 2004 tax return demonstrates that the payment of $2,300 represented an overpayment which was applied to the estimated tax liability for 2005.

In late 2004 and early 2005, the Trustee began making investments in the account. As demonstrated by the testimony of Timothy Welles, Pine Street Capital Partners began paying interest to its investors, including the Trust, in 2005. In April 2006, an estimated tax payment was made for 2005 in the amount of $92,105 with the filing of the extension application, and the Trustee authorized the transfer of $92,105 from the Trust account to David Smith to write that check. Urbelis Tr. p. 36-37, Ex. 27, 28. Also in 2006, the Trust began its second round of investment in Pine Street Capital, and the Trust was obligated by its earlier investment in Pine Street to pay the capital cash calls in the amounts of $83,830 and $129,678 during 2006. Welles Tr. It is a basic function of the tax code and the nature of estimated tax payments that the Trust's tax liability necessarily changed throughout 2006 as a result of payment of the cash calls, the acquisition of equity and the receipt of interest payments. In December 2006, Dave Smith made an estimated tax payment for the Trust in the amount of $85,000 and another tax payment of $20,092 on April 15, 2007, neither of which was advanced or reimbursed to him by the Trust. See Wojeski Reply Aff., Ex. C.

Plaintiff suggests that Trustee Urbelis unwittingly made distributions to David and Lynn Smith without caring whether the taxes were paid, alleging that the Smith's used the trust account "like a piggy bank." This argument by Plaintiff is insulting to the trustee, a conscientious individual who possesses both an MBA and a law degree, serves as a lawyer for numerous municipalities in the Commonwealth of Massachusetts and is a longtime partner in a distinguished Boston law firm, Urbelis & Fieldsteel. This argument seems to have been made by Plaintiff without reviewing the Trust's tax returns or reconciling the payments of tax liabilities with the payment transfers from the Trust account, all of which were authorized by the Trustee.[3] The withdrawals from the Trust's brokerage account are clearly shown on the statements, which have been in the possession of Plaintiff for several weeks. Moreover, Urbelis specifically testified that he did not want the Trust's funds to flow through his IOLTA account, as was done in April 2005, a reasonable request, since the trust was not a client of his firm.[4] See Urbelis Tr. p. 31. The Trustee's name was on the tax returns, as he had applied for the taxpayer

[3] Although a portion of the April 2010 transfer of $95,000 may have been used by Lynn Smith to pay her and her husband's personal estimated taxes, the money was authorized by the Trustee at the specific request of a trust beneficiary. This one instance hardly rises to the level of a fraud, since the beneficiary was entitled to seek a distribution of the money for his personal use, and the Trust owed David Smith more than $100,000 for taxes he had previously paid on behalf of the Trust in 2006 and 2007.

[4] New York's own ethical rules prohibit a lawyer from commingling non-client monies with client money in the lawyer's IOLTA account.

identification number. He received a notice when the tax return had been lost by the IRS (but the tax liability of more than $96,000 had been paid). Urbelis Tr. p. 53. He indicated that he did not care which mechanism was used to pay the taxes, i.e., whether they were paid out of Dave Smith's account or a check was delivered to the accountant, as long as the taxes were paid. Urbelis Tr. p. 52. Thus, whether Urbelis wrote a check or transferred money for someone else to write the check, he fulfilled his fiduciary duty of making sure the taxes were paid. Plaintiff's characterization of Mr. Urbelis as a confused, remote figurehead is inappropriate, unfair and without any factual basis.

As evidenced by the tax returns filed by the Trust and the trust account statements, the distributions made to checking accounts held by David or Lynn Smith served to facilitate the drafting of checks to federal and state taxing authorities in the absence of the trust having its own checking account. As the Second Circuit has held, the mere fact that a debtor acts as an agent for a trustee does not divest the trustee of his equitable ownership of the trust property. *Vebeliunas*, 332 F.3d at 93. Similarly, payment of financial obligations of the trust by a third party, such as David Smith's payment of the trust taxes, does not shift beneficial ownership from the trustee to David Smith in the absence of proof that David Smith transferred property to the trust in order to thwart creditors. See *Id.*, at 93 (husband debtor paid "virtually all of the expenses" of the trust); *In re Maghazeh*, 310 B.R. at 18, 2004 Bankr. LEXIS 641, **35 (Bankr. EDNY 2004) (debtor paid the only premiums for life insurance policies which were transferred to trust).

B. The Trust is the record owner of the brokerage account, and therefore the Trustee is the equitable owner.

Plaintiff claims that David Smith held equitable ownership of the Trust and its assets, despite the fact that the Trust was fully funded by Lynn Smith with separate property that she received through inheritance and grew through investments. It is difficult to imagine how a person could obtain equitable ownership of a stock account in the manner suggested by Plaintiff. Dave Smith performed stock broker services, albeit without charging a fee to the Trustee, which benefited the Trust. Urbelis Tr. p. 13–14. The services he performed were consistent with services ordinarily performed by a stock broker. He made investment recommendations, had discussions with Urbelis and answered his questions. Urbelis Tr. p. 25-29. The staff at McGinn, Smith handled the routine paperwork required to facilitate the Trust's investment transactions. The trades were cleared through clearinghouses, first Bear Stearns, then NFS, and account statements were mailed both to the Trustee's home in Boston and to the Smith family home in Saratoga, where they were available for review by the beneficiaries of the Trust. Notably, neither Dave Smith nor McGinn, Smith & Co. dispensed with any of the formalities of the broker/client relationship with respect to written authorizations on investments. To suggest that a stock broker attains beneficial ownership over an account as a result of the client agreeing with and thereby accepting the broker's investment recommendations is simply ludicrous. Urbelis specifically did not give Smith discretionary authority to make trades on the account. Urbelis Tr. p. 22.

Lynn Smith transferred 100,000 shares of Charter One stock to the trust account on September 1, 2004. The Trust immediately sold the stock, resulting in proceeds in the amount of $4,450,000. Actual legal title to the shares changed hands upon that transfer, despite Plaintiff's baseless claim that "the funds in the Trust never effectively belonged to the Trust." The corpus of the Trust vested fully in the Trustee at the moment the stock was transferred from Lynn Smith to the Trust. In arguing that the Trust should be pierced and the assets treated as belonging to David Smith, Plaintiff ignores the fact that Lynn Smith funded the trust and that the source of the funds was her separate property, ignores the Trustee's sworn testimony about his investment decisions and discussions with his broker, ignores the Trustee's sworn testimony about his preferred method for paying taxes, which was to refrain from him writing checks for tax payments, and ignores the fact that all of the Trust's tax liabilities were paid and all returns were filed from tax years 2004 to 2008 and an extension was filed for 2009. There has been no unilateral conduct by David Smith, either alleged or actual, that could have divested the Trust of its record ownership or the Trustee of his equitable ownership of the Trust's brokerage account.

C. Plaintiff does not seek to add the Trust as a Relief Defendant and cannot argue that the Trust should be treated as such.

Although Plaintiff loosely argues that the Trust should be treated as a Relief Defendant (Plaintiff's Response Memo of Law at p. 13), Plaintiff seems to do so solely to make an argument that it is not required to trace the proceeds of ill-gotten gains in order to recover from a Relief Defendant. Since there has been absolutely no transfer of money or stock into the Trust account other than the initial funding by Lynn Smith and the payments of interest and return of principal by Pine Street Capital Partners, made in the ordinary course of its business, there is no possible legal theory or set of facts on which Plaintiff can base a claim that the Trust was ever the recipient of ill-gotten gains which could arguably be subject to disgorgement. The Trust cannot be treated as a Relief Defendant, and Plaintiff has not sought leave to name the Trust as a Relief Defendant. See *SEC v. Cavanagh*, 155 F.3d 129 (2d Cir. 1998). There are sufficient facts not in dispute to justify a finding that the Trust is not a proper Relief Defendant. To the extent that the Court considers Plaintiff's argument that the Trust could be treated as a Relief Defendant, the Intervenor hereby adopts and incorporates herein the Memorandum of Law filed by Relief Defendant Lynn Smith and case law cited therein, which addressed the standard of law applicable to claims against relief defendants.

In relation to its vague suggestion that the Trust is a Relief Defendant and its explicit argument that David Smith is the "beneficial owner" of the Trust account and therefore its assets should be considered to be his assets, Plaintiff argues that it should not be required to trace the proceeds of a defendant's ill-gotten funds in order to claim assets of a relief defendant. See Plaintiff's Memo of Law dated June 3, 2010, p. 13. Plaintiff's argument misconstrues both the case law and its application here.

Decisional law which relieves the SEC of tracing the ill-gotten gains merely allows the Plaintiff to recover substitute assets where the original ill-gotten gain has been transferred or lost. The law still requires proof that the defendant or relief defendant in fact profited from some form of ill-gotten gains in the first instance. See *FTC v. Bronson Partners*, LLC 674 F. Supp 2d 373, 392 (D. Conn. 2008), *citing*, *FTC v. Direct Mktg. Concepts*, 569 F. Supp 2d 285 (D. Mass 2008) (the burden rests with the Commission to show that the funds in the possession of a relief defendant are ill-gotten). Defendants who engage in fraudulent activities cannot immunize themselves from having to relinquish the fruits of their fraud by transferring away the assets attained by the fraud. It follows logically that, while a plaintiff may obtain substitute assets from a culpable defendant, there still must be proof of a factual basis for obtaining relief from the so-called relief defendant. The proof required is not that the original ill-gotten gains are still in the hands of the relief defendant, but that the relief defendant, at some point in time, profited in some way from some specified amount of ill-gotten gains.

Therefore, while a plaintiff may not be required to "trace" the assets where the assets have been dissipated, the plaintiff is still required to prove that the gains sought were ill-gotten, which necessarily requires proof of the "source" of those gains. *SEC v. First City Financial Corp.*, 890 F.2d 1215 (D.C. Cir. 1989) (government has burden of making causal connection between the offending fraud and any ill-gotten gains received as a result of that fraud). .All of the cases cited by Plaintiff either explicitly or implicitly acknowledge this line of reasoning. Moreover, the appropriate measure for disgorgement is not the amount of loss suffered by a plaintiff but the benefit unjustly received by the defendant. *FTC v. Verity Int*., 443 F.3d 48 (2nd Cir. 2006) (emphasis added). The SEC bears the ultimate burden of persuasion that its ultimate disgorgement figure, if realized, reasonably approximates the amount of unjust enrichment. *SEC v. Aimsi Techs., Inc.*, 650 F. Supp2d 296, 304 (S.D.N.Y. 2007), *citing*, *SEC v. Opulentica*, 479 F. Supp2d 319 (S.D.N.Y. 2007). Plaintiff's "anti-tracing" argument does not relieve Plaintiff of its obligation to plead and prove that a relief defendant actually received proceeds of a wrong or otherwise received property without adequate giving consideration. See*;Cavanagh*, 155 F.3d 129 (3d Cir. 1998).

Plaintiff has not proven that the Trust has engaged in any wrongdoing, or that the trust form has been used to conceal assets or to perpetrate a fraud upon the Plaintiff, or that it receive any ill-gotten gains from anyone at any time. There is no factual or legal basis for naming the Trust as a Relief Defendant in this action, and Plaintiff has not sought to do so. There are sufficient facts not in dispute on which to base a finding that the Trust cannot be treated as a Relief Defendant.

CONCLUSION

The Plaintiff has failed to sustain its burden of proof in seeking a preliminary injunction to freeze the assets of the Trust. Plaintiff's complaint and motion papers are wholly inadequate and fail to state any claim for relief as against this Trust. The Intervenor respectfully submits that the temporary restraining order should be lifted and the preliminary injunction motion denied as it relates to the Trust account.

Dated: June 8, 2010

s/Jill A. Dunn
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