

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

---

SECURITIES AND EXCHANGE COMMISSION

*Plaintiff,*

vs.

**RELIEF DEFENDANT'S  
NOTICE OF MOTION TO  
DISMISS**

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,

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

*Defendants, and*

LYNN A. SMITH,

*Relief Defendant.*

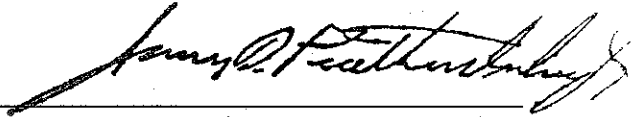
---

PLEASE TAKE NOTICE that upon the affidavit of Lynn A Smith sworn to the 9<sup>th</sup> day of June, 2010, the exhibits annexed thereto, and all the pleadings and proceedings heretofore had herein, the Relief Defendant will move before a term of this Court to be held for the United States District Court for the Northern District of New York 445 Broadway, Albany, New York on the 12<sup>th</sup> day of July, 2010, for an Order pursuant to

FRCP Rules 12(b)(1) and 12(b)(6) dismissing the plaintiff's complaint for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted.

DATED: June 9, 2010

**Featherstonhaugh, Wiley & Clyne, LLP**

By: 

James D. Featherstonhaugh, Esquire  
Bar Roll No. 101616  
Attorneys for Relief Defendant,  
Lynn A. Smith  
99 Pine Street, Suite 207  
Albany, NY 12207  
Tel: (518) 436-0786  
Fax: (518) 427-0452

TO: David Stoelting  
Attorney for Plaintiff  
Securities and Exchange Commission  
3 World Financial Center, Room 400  
New York, NY 10281  
Tel: (212) 336-0174  
Fax: (212) 336-1324

Michael Koenig, Esquire  
Greenberg Traurig LLP  
54 State Street, 6th Floor  
Albany, NY 12207  
Tel: (518) 689-1400  
Fax: (518) 689-1499

Jill A. Dunn  
Attorney for Proposed Intervenor  
The Dunn Law Firm PLLC  
99 Pine Street, Suite 210  
Albany, New York 12207-2776  
Tel: (518) 694-8380

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,

**Civil Action No.: 1:10-CV-457  
(GLS/DRH)**

*Defendants, and*

LYNN A. SMITH,

*Relief Defendant.*

---

**AFFIDAVIT OF RELIEF DEFENDANT LYNN A. SMITH**

**LYNN A. SMITH**, being duly sworn, deposes and says:

1. I respectfully submit this affidavit in support of Relief Defendant's Motion to Dismiss the Complaint (Complaint Doc. 1) filed by the Plaintiff Securities and Exchange Commission ("the Commission"), for lack of subject matter jurisdiction pursuant to F.R.C.P. 12(b)(1).

2. I have been named as a Relief Defendant in the above captioned action by virtue of my nearly 42-year marriage to David L. Smith. As a result, the Commission has frozen all of my independently held personal assets with the ultimate goal of seeking

disgorgement of an undisclosed amount of those assets in the event it is successful in its claims against the named Defendants.

3. I strenuously object to the overreaching, draconian actions of the federal government in attempting to deprive me of my personal life savings, which was started for me by my father more than fifty (50) years ago, based on the conclusory allegations that I have “received and retained ill gotten gains” (Complaint ¶12) and that I was a “recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities” (Complaint ¶141).

4. I was born in Amsterdam, New York in September 1946, and was the only child of Wasil and Frances Laskevich. Both of my parents were the children of immigrants, with my father’s parents having emigrated from Russia and my mother’s parents from Lithuania. My father grew up in Springfield, Vermont as the youngest of six children. My mother was one of three children, and most of her family worked in the knitting mills of Amsterdam.

5. Following their marriage, my mother was a homemaker and my father a skilled laborer in the turbine section of the General Electric Foundry in Schenectady. Throughout my childhood, we lived in one flat of a two-family home in the east end of Amsterdam, with my grandmother occupying the other flat, as was common during that time among the Eastern European population in our community.

6. My parents were not educated people, but my father was very industrious and hard-working, always trying to make a better life for my mother and me. He was also a savvy entrepreneur. We lived modestly and my father used their savings to buy

land north of Amsterdam on Great Sacandaga Lake. On the weekends, he would single-handedly build summer cottages on small parcels of land and then sell the improved property at a profit. He used some of the money he made on these real estate transactions to buy more land and build more cottages. He used the balance of his profits to open an account and make investments with Hayden, Stone & Co., a brokerage house which, decades later, became Shearson/American Express.

7. My father enjoyed investing in the stock market. He had good instincts and was able to grow his investments into a nest egg which he intended to become my inheritance.

8. In approximately 1960, my parents bought their own two-family home in the Market Hill section of Amsterdam. David Smith lived with his parents about four houses down the street from our new home. I had known him in high school prior to our moving to his neighborhood and, a short time later, we began dating.

9. Dave graduated from Amsterdam High School in 1963, a year before me. I enrolled in Russell Sage College in the fall of 1964. We continued dating throughout college, and he returned home to Amsterdam after graduating from college in 1967. That summer, we became engaged, and a few months later, Dave began teaching at the East Main Street School in Amsterdam.

10. In May 1968, I graduated from college with a dual degree in Fine Arts and Elementary Education. A little more than a month after my graduation, my mother lost her seven year battle with breast cancer at the age of 50. My mother's death was a shock to my father, despite the length of her illness. His concern for my future increased

dramatically and prompted him to write and execute a will to provide for me in the event of his death.

11. Later that summer, Dave and I were married and I started teaching in the Amsterdam schools in September 1968. A short time later, he left for basic training with the Air National Guard. When he returned in the spring of 1969, he took a job with Marine Midland Bank in East Rochester. I planned to finish the school year in Amsterdam and then join him in Rochester and seek a new teaching position.

12. In March 1969, following a routine chest x-ray, my father was diagnosed with Brown Lung disease as a result of his many years working in the foundry for GE. He was admitted to the hospital a short time later and succumbed to the disease on July 7, 1969.

13. My father's will created a trust that allowed a portion of the estate to pass to me immediately and a portion to pass to me five years later. My father's estate included my parent's home in Amsterdam, my father's life insurance, his stock account and the property on Great Sacandaga Lake. Having lost both my parents very young, I have always respected the fact that my father, who did not expect to die at the age of 50, provided for my future. The property and stock account my father left me in 1969 was my rightful inheritance, and it is galling that the Commission wants to take that from me.

14. When we moved to Rochester, I used a broker in Rochester to manage my stock account, which remained with Hayden, Stone & Co. At that time, the account had approximately \$60,000 in it.

15. In 1973, we moved back to the Capital Region. We bought a small home in Clifton Park, for which I provided the down payment from my inheritance. I became a teacher at the Tecler School in Amsterdam, and Dave got a job as a stock broker with Bache & Co., a brokerage house, at which time I moved my stock account to Bache, and my husband began managing my account.

16. From the beginning of our marriage, my husband and I maintained a joint checking account, into which we deposited both of our paychecks and from which we paid our household bills. Throughout our marriage and continuing until the Court froze my checking account, I have paid the bills and managed our checking account.

17. Notwithstanding the fact that we had a joint checking account, the stock account and the real estate on Great Sacandaga, indeed my entire inheritance from my father's estate, have always been my separate property. The account and the real property have always been held in my name and my name alone throughout our entire marriage. Although I have allowed my husband a fair amount of discretion in making investment decisions for my stock account, ultimate decisions on the account were made by me and there has never been any confusion as to the ownership of the account.

18. Over the years, my account grew because of good investment decisions and positive returns on those investments. My husband managed my account with full knowledge that I considered that account to be our nest egg and something I would pass on to our children some day, just as my father had done for me. Under my husband's management, my account grew steadily over the years. By the late 1990's, I had accumulated upwards of \$6,000,000 in my account.

19. Sometime during my husband's employment with Bache, Tim McGinn, an engineer with GE, became a client of the firm. In the mid-1970's, Tim left GE and joined Bache as a stock broker. I met Tim and his wife socially through firm functions. His first wife and I remained close friends while our children were young.

20. My husband left Bache and worked for a few other brokerage houses over the next several years. I had no involvement in his work other than to attend social functions as his wife. I maintained my brokerage account, and my husband moved it with him in his client portfolio each time he moved to a new firm, as he did with his other clients. I received regular account statements from the firm, and we discussed general investment strategy and any transactions which required my specific approval and signature. On occasions, I agreed with his suggestions and on occasions, I disagreed. When I disagreed with the proposed investment, the transaction was not undertaken.

21. In approximately 1980, my husband and Tim McGinn formed McGinn, Smith & Co. in a one-room office in Twin Towers, in Albany, which they refurbished themselves. Four years later, they moved to 99 Pine Street. In both locations, my only role was to assist with decorating the offices. Since the inception of McGinn, Smith & Co., my involvement in the business was as a spouse and as a client. In my role as a spouse, I decorated their offices, sent in gifts and baked goods for the staff on holidays and birthdays, and hosted Christmas parties. In my role as a client, I received account statements and occasionally authorized transactions and investments with the advice of my stock broker/husband.



22. In 1982, with our second child on the way, we built a new home in Clifton Park. I was completely immersed in our children's lives and in managing our household for the next twenty years. Dave was making enough money for us to pay household expenses and support our family without me returning to work. The only times I used my stock account was for the benefit of our children, such as making a down payment on a house, buying a ski condo in the mid-1980's and paying for their college tuition.

23. My husband and I are both from humble beginnings and we have never lived a lavish lifestyle, as the Commission has alleged in its Complaint. Our children attended public schools, each excelling in their own ways, surrounded by a community of friends and parents who looked out for one another. We were involved in our children's activities, their school events and social activities, their sporting events and booster clubs. We have never dined out excessively, nor have we taken extravagant vacations. Our greatest enjoyment and fondest memories have come from our family life and the time we spend together.

24. The Commission has made conclusory allegations that I was the recipient of ill-gotten gains without consideration, but nowhere on the face of the Complaint does the Commission identify or quantify what it believes constitutes ill-gotten gains alleged to have resulted from defendants' purported illegal conduct. Nor does the Commission allege that I lack a legitimate claim to those funds it alleges I received from my husband or from any of the other Defendants. Therefore, it is not clear to me on what basis the Commission believes it has a claim against my assets as a relief defendant.

25. The Commission cites two specific amounts of money which were transferred into my brokerage account in 2009, \$335,000 (See Complaint ¶ 68, 71 and 94) and \$100,000 (Complaint ¶ 94), but does not allege that they were the product of illegal profits resulting from the Defendants alleged fraudulent conduct. In fact, it is alleged that the \$335,000 that was transferred to me came from the same pool of funds which were distributed to other individuals including “an Albany politician” and “investors in other trust companies.” Since I am the only named Relief Defendant in this action, it does not appear on the face of the Complaint that this transfer was intended to support the alleged claim that I am the recipient of ill-gotten gains. To the extent it can be implied that it does, I have a legitimate claim and ownership in those funds.

26. The first payment referenced, \$335,000, in or about June and July of 2009, was actually two separate payments, which are correctly stated in paragraph 26 of the Complaint. Two payments, one for \$160,800 and one for \$175,000 were made to my account from TDMM Cable in repayment of a loan in the amount of \$366,000 which I made to TDMM Cable from my stock account on June 5, 2004. I have annexed hereto and made a part hereof a copy of the note as **Exhibit A**. It is my belief that the original note is in the possession of the United States Government and presumably accessible to the SEC. I have also annexed as **Exhibit B**, the account statements that evidence the withdrawal of the principal amount of that loan and the receipt, in the form of the two deposits, representing partial payment of that loan.

27. The undisputed fact is that a \$366,000 loan was made by me, with my specific consent, to TDMM Cable, and was carried out by my husband. I specifically discussed the loan with him, approved it as an investment from my stock account, and

was entitled to be repaid. In fact, TDMM still owes me approximately \$35,000 in principal plus accrued interest.

28. As to the alleged \$100,000 payment referenced in the Complaint at ¶94, I have no record of such payment or any record of receiving such an amount.

29. The Commission also alleges that I received “many other payments from McGinn Smith Entities” (Complaint ¶ 94), but the Complaint does not indicate those funds allegedly received resulted from ill-gotten gains or that I did not otherwise have a legitimate right to the funds. Nor does the Commission specify the approximate amount of those payments that would justify the freezing of all my personal assets. The statement for my brokerage account as of March 31, 2010, just three weeks before the TRO was granted, showed a balance of \$2,118,511.06 which exceeds the \$435,000 referenced by the Commission by \$1,683,511.06. Nevertheless, the Commission has frozen my entire account, presumably with the intent to seize all the assets and disgorge them in the event it is successful in its claim against the Defendants.

30. I have maintained an independent ownership interest in my accounts for decades. As with hundreds of other investors, my accounts were managed by the McGinn Smith firm and as such I received statements and proceeds pursuant to my personal investments with the firm. The SEC does not plead and cannot establish that I do not have a legitimate claim to my funds as it must do to invoke subject matter jurisdiction and obtain the requested disgorgement remedy from me. Consequently, the Commission’s Complaint, as it pertains to me, should be dismissed.

**WHEREFORE**, I respectfully ask this Court to grant Relief Defendant's Motion to Dismiss on the grounds that the Court lacks subject matter jurisdiction as it pertains to this relief defendant.

  
LYNN A. SMITH

Sworn to before me this  
9<sup>th</sup> day of June, 2010.

  
Notary Public

SCOTT J. ELY  
Notary Public, State of New York  
No. 02EL6134512  
Qualified in Rensselaer County 13  
Commission Expires Oct. 03, 2013

## **Exhibit A**

## PROMISSORY NOTE

June 5, 2009

**\$366,000.00**

Albany, New York

For value received, the undersigned, **TDMM Cable Funding, LLC**, a **Florida** limited liability company (the "Borrower"), promises to pay to the order of **Lynn Smith**, (the "Lender"), the principal amount of **Three Hundred Sixty Six Thousand and 00/100 Dollars (\$366,000.00)** on or July 6, 2009 (the "Maturity Date"), as set forth below, together with interest from the date hereof on the unpaid principal balance from time to time outstanding until paid in full.

The interest rate shall be fixed at twenty-four percent (24.0%) per annum (the "Interest Rate").

Principal and interest shall be payable at 2 Rolling Brook Drive, Saratoga Springs, New York 12866, or at such other place as the Lender may designate in writing, in immediately available funds in lawful money of the United States of America without set-off, deduction or counterclaim. Interest shall be calculated on the basis of actual number of days elapsed in a 360-day year.

There shall be no prepayment premium in the event of any prepayment. In the event of a prepayment the Borrower shall pay interest to the Lender in the amount of one-half of one percent (0.5%) per week for each week, or any part of any week, that this Note remains unpaid.

At the option of the Lender, this Note shall become immediately due and payable without notice or demand upon the occurrence at any time of any of the following events of default (each, an "Event of Default"): (1) default of any liability, obligation or undertaking of the Borrower to the Lender, hereunder or otherwise, including failure to pay in full and when due any installment of principal or interest, or of any endorser or guarantor of any liability, obligation or undertaking, hereunder or otherwise, to the Lender, or default under any other loan document delivered by the Borrower, any endorser or guarantor, or in connection with the loan evidenced by this Note and the continuance thereof for ten (10) days after the due date; (2) failure of the Borrower to maintain aggregate collateral security value satisfactory to the Lender and the Borrower fails to cure such failure within ten (10) days after written notice is given to the Borrower by the Lender; (3) default of any material liability, obligation or undertaking of the Borrower or of any endorser or guarantor hereof to any other party and the Borrower fails to cure such default within ten (10) days after written notice is given to the Borrower by the Lender; (4) if any statement, representation or warranty heretofore, now or hereafter made in connection with the loan evidenced by this Note, or in any supporting financial statement of the Borrower or of any endorser or guarantor hereof shall be determined by the Lender to have been false in any material respect when made; (5) if the Borrower or any endorser or guarantor is a corporation, trust, partnership or limited liability company, the liquidation, termination or dissolution of any such organization, or the merger or consolidation of such organization into another entity, or its ceasing to carry on actively its present business or the appointment of a receiver for its property; (6) the death of the Borrower or of any endorser or guarantor hereof and, if any of the Borrower or any endorser or guarantor hereof is a partnership or limited liability company, the death of any partner or member; (7) the institution by or against the Borrower or any endorser or guarantor hereof of any proceedings under the Bankruptcy Code 11 USC §101 *et seq.* or any other law in which the Borrower or any endorser or guarantor hereof is alleged to be insolvent or unable to pay its debts as they mature, or the making by the Borrower or any endorser or guarantor hereof of an assignment for the benefit of creditors or the granting by the Borrower or any endorser or guarantor hereof of a trust mortgage for the benefit of creditors; (8) the service upon the Lender of a writ in which the Lender is named as trustee of the Borrower or of any endorser or guarantor hereof; (9) a judgment or judgments for the payment of money shall be rendered against the Borrower or any endorser or guarantor hereof, and

any such judgment shall remain unsatisfied and in effect for any period of thirty (30) consecutive days without a stay of execution; (10) any levy, seizure, attachment, execution or similar process shall be issued or levied on any of the property of the Borrower or any endorser or guarantor hereof which shall remain unsatisfied and in effect for any period of ten (10) consecutive days without a stay of execution; (11) the termination of any guaranty hereof; (12) the occurrence of such a material adverse change in the condition or affairs (financial or otherwise) of the Borrower or of any endorser, guarantor or other surety for any obligation of the Borrower to the Lender, or the occurrence of any other event or circumstance, such that the Lender, in its sole discretion, deems that it is insecure or that the prospects for timely or full payment or performance of any obligation of the Borrower or any endorser or guarantor hereof to the Lender has been or may be impaired.

Any payments received by the Lender on account of this Note shall, at the Lender's option, be applied first, to any costs, expenses or charges then owed to the Lender by the Borrower; second, to accrued and unpaid interest; and third, to the unpaid principal balance hereof. Notwithstanding the foregoing, any payments received after the occurrence and during the continuance of an Event of Default shall be applied in such manner as the Lender may determine. The Borrower hereby authorizes the Lender to charge any deposit account which the Borrower may maintain with the Lender for any payment required hereunder without prior notice to the Borrower.

If pursuant to the terms of this Note, the Borrower is at any time obligated to pay interest on the principal balance at a rate in excess of the maximum interest rate permitted by applicable law for the loan evidenced by this Note, the applicable interest rate shall be immediately reduced to such maximum rate and all previous payments in excess of the maximum rate shall be deemed to have been payments in reduction of principal and not on account of the interest due hereunder.

**The Borrower represents to the Lender that the proceeds of this Note will not be used for personal, family or household purposes or for the purpose of purchasing or carrying margin stock or margin securities within the meaning of Regulations U and X of the Board of Governors of the Federal Reserve System, 12 C.F.R. Parts 221 and 224.**

The Borrower and each endorser and guarantor hereof grant to the Lender a continuing lien on and security interest in any and all deposits or other sums at any time credited by or due from the Lender to the Borrower and each endorser or guarantor hereof and any cash, securities, instruments or other property of the Borrower and each endorser and guarantor hereof in the possession of the Lender, whether for safekeeping or otherwise, or in transit to or from the Lender (regardless of the reason the Lender had received the same or whether the Lender has conditionally released the same) as security for the full and punctual payment and performance of all of the liabilities and obligations of the Borrower and any endorser and guarantor hereof to the Lender and such deposits and other sums may be applied or set off against such liabilities and obligations of the Borrower or any endorser or guarantor hereof to the Lender at any time, whether or not such are then due, whether or not demand has been made and whether or not other collateral is then available to the.

No delay or omission on the part of the Lender in exercising any right hereunder shall operate as a waiver of such right or of any other right of the Lender, nor shall any delay, omission or waiver on any one occasion be deemed a bar to or waiver of the same or any other right on any future occasion. The Borrower and every endorser or guarantor of this Note, regardless of the time, order or place of signing, waives presentment, demand, protest, notice of intent to accelerate, notice of acceleration and all other notices of every kind in connection with the delivery, acceptance, performance or enforcement of this Note and assents to any extension or postponement of the time of payment or any other indulgence, to any substitution, exchange or release of collateral, and to the addition or release of any other party or person primarily or secondarily liable and waives all recourse to suretyship and guarantor defenses generally,



including any defense based on impairment of collateral. To the maximum extent permitted by law, the Borrower and each endorser and guarantor of this Note waive and terminate any homestead rights and/or exemptions respecting any premises under the provisions of any applicable homestead laws.

The Borrower and each endorser and guarantor of this Note shall indemnify, defend and hold the Lender and her heirs, administrators, personal representatives, assigns and attorneys harmless against any claim brought or threatened against the Lender by the Borrower, by any endorser or guarantor, or by any other person (as well as from attorneys' reasonable fees and expenses in connection therewith) on account of the Lender's relationship with the Borrower or any endorser or guarantor hereof (each of which may be defended, compromised, settled or pursued by the Lender with counsel of the Lender's selection, but at the expense of the Borrower and any endorser and/or guarantor), except for any claim arising out of the gross negligence or willful misconduct of the Lender.

The Borrower and each endorser and guarantor of this Note agree to pay, upon demand, costs of collection of all amounts under this Note including, without limitation, principal and interest, or in connection with the enforcement of, or realization on, any security for this Note, including, without limitation, to the extent permitted by applicable law, reasonable attorneys' fees and expenses. Upon the occurrence and during the continuance of an Event of Default, interest shall accrue at a rate per annum equal to the aggregate of 4.0% plus the rate provided for herein. If any payment due under this Note is unpaid for 10 days or more, the Borrower shall pay, in addition to any other sums due under this Note (and without limiting the Lender's other remedies on account thereof), a late charge equal to 5.0% of such unpaid amount.

This Note shall be binding upon the Borrower and each endorser and guarantor hereof and upon their respective heirs, successors, assigns and legal representatives, and shall inure to the benefit of the Lender and its successors, endorsees and assigns.

The liabilities of the Borrower and any endorser or guarantor of this Note are joint and several; provided, however, the release by the Lender of the Borrower or any one or more endorsers or guarantors shall not release any other person obligated on account of this Note. Any and all present and future debts of the Borrower to any endorser or guarantor of this Note are subordinated to the full payment and performance of all present and future debts and obligations of the Borrower to the Lender. Each reference in this Note to the Borrower, any endorser, and any guarantor, is to such person individually and also to all such persons jointly. No person obligated on account of this Note may seek contribution from any other person also obligated, unless and until all liabilities, obligations and indebtedness to the Lender of the person from whom contribution is sought have been satisfied in full. The release or compromise by the Lender of any collateral shall not release any person obligated on account of this Note.

The Borrower and each endorser and guarantor hereof each authorizes the Lender to complete this Note if delivered incomplete in any respect. A photographic or other reproduction of this Note may be made by the Lender, and any such reproduction shall be admissible in evidence with the same effect as the original itself in any judicial or administrative proceeding, whether or not the original is in existence.

This Note shall be governed by the laws of the State of New York.

The Borrower and each endorser and guarantor of this Note each irrevocably submits to the nonexclusive jurisdiction of any Federal or state court sitting in New York over any suit, action or proceeding arising out of or relating to this Note. Each of the Borrower and each endorser and guarantor irrevocably waives, to the fullest extent it may effectively do so under applicable law, any objection it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in any such court and any claim that the same has been brought in an inconvenient forum. Each of the Borrower



and each endorser and guarantor hereby consents to any and all process which may be served in any such suit, action or proceeding, (i) by mailing a copy thereof by registered and certified mail, postage prepaid, return receipt requested, to the Borrower's, endorser's or guarantor's address shown below or as notified to the Lender and (ii) by serving the same upon the Borrower(s), endorser(s) or guarantor(s) in any other manner otherwise permitted by law, and agrees that such service shall in every respect be deemed effective service upon the Borrower or such endorser or guarantor.

**THE BORROWER, EACH ENDORSER AND GUARANTOR AND THE LENDER EACH HEREBY KNOWINGLY, VOLUNTARILY AND INTENTIONALLY, AND AFTER AN OPPORTUNITY TO CONSULT WITH LEGAL COUNSEL, (A) WAIVES ANY AND ALL RIGHTS TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING IN CONNECTION WITH THIS NOTE, ANY OF THE OBLIGATIONS OF THE BORROWER, EACH ENDORSER AND GUARANTOR TO THE LENDER, AND ALL MATTERS CONTEMPLATED HEREBY AND DOCUMENTS EXECUTED IN CONNECTION HERewith AND (B) AGREES NOT TO SEEK TO CONSOLIDATE ANY SUCH ACTION WITH ANY OTHER ACTION IN WHICH A JURY TRIAL CAN NOT BE, OR HAS NOT BEEN, WAIVED. THE BORROWER, EACH ENDORSER AND GUARANTOR AND THE LENDER EACH CERTIFIES THAT NEITHER THE LENDER NOR ANY OF ITS REPRESENTATIVES, AGENTS OR COUNSEL HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT THE LENDER WOULD NOT IN THE EVENT OF ANY SUCH PROCEEDING SEEK TO ENFORCE THIS WAIVER OF RIGHT TO TRIAL BY JURY.**

Executed as an instrument under seal on the date first above written.

Witness:

Borrower:

TDMM Cable Funding, LLC

---

By: Timothy M. McGinn

Title: Managing Member

## **Exhibit B**

This is a copy of the customer statement. The original has been mailed to the address of record.

# McGinnSmith & Company, Inc.

Account Number: 916

Account Name: SMITH

Statement Date: 07/01/2009 to 07/31/2009

| Deposits     |              |                      |             | Amount       |
|--------------|--------------|----------------------|-------------|--------------|
| Date         | Account Type | Transaction          | Description | Quantity     |
| 07/30/09     | CASH         | WIRE TRANS FROM BANK | WR38887548  | \$175,000.00 |
| Net Deposits |              |                      |             | \$175,000.00 |

## NET ADDITIONS AND WITHDRAWALS

\$175,000.00

## INCOME AND EXPENSES

### Taxable Income

| Date                     | Account Type | Transaction       | Description                                                                                                                            | Quantity | Amount     |
|--------------------------|--------------|-------------------|----------------------------------------------------------------------------------------------------------------------------------------|----------|------------|
| <b>Taxable Dividends</b> |              |                   |                                                                                                                                        |          |            |
| 07/02/09                 | CASH         | DIVIDEND RECEIVED | MCGINN SMITH & COMPANY CD 1 PFD<br>SER 1987 ADJ RATE PRICE PRICE<br>PROVIDED BY MCGINN SMITH 1987 SE<br>ON MGMT'S MCGINN SMITH 1987 SE |          | \$1,134.38 |
| 07/27/09                 | CASH         | DIVIDEND RECEIVED | GENERAL ELECTRIC CO                                                                                                                    |          | \$480.00   |
| 07/27/09                 | MARGIN       | DIVIDEND RECEIVED | GENERAL ELECTRIC CO                                                                                                                    |          | \$1,000.00 |
| 07/31/09                 | CASH         | DIVIDEND RECEIVED | PRIME FUND CAPITAL RESERVES<br>CLASS DIVIDEND RECEIVED                                                                                 |          | \$4.86     |
| <b>Taxable Interest</b>  |              |                   |                                                                                                                                        |          |            |
| 06/30/09                 | CASH         | INTEREST          | PINE STREET CAPITAL PARTNERS LP<br>FROM NT 9.000% 12/31/2008 BASED<br>ON MGMT'S UNCONFIRMED EST OF NET<br>ASSETS INTEREST              |          | \$8,484.01 |

### Net Taxable Income

\$11,103.25

### Total Income

\$11,103.25

### NET INCOME AND EXPENSES

\$11,103.25

This is a copy of the customer statement. The original has been mailed to the address of record.

Account Number: 916

Account Name: SMITH

Statement Date: 06/01/2009 to 06/30/2009

# McGinnSmith & Company, Inc.

## Core Funds Purchased

| Settlement Date | Account Type | Transaction  | Description                   | Quantity | Amount     |
|-----------------|--------------|--------------|-------------------------------|----------|------------|
| 06/30/09        | CASH         | REINVESTMENT | PRIME FUND - CAPITAL RESERVES | 4.84     | ( \$4.84 ) |
|                 |              |              | CLASS REINVESTED @ \$1.00     |          |            |

## Net Core Funds Purchased

( \$189,386.84 )

## Core Funds Sold

| Settlement Date | Account Type | Transaction | Description                   | Quantity    | Amount       |
|-----------------|--------------|-------------|-------------------------------|-------------|--------------|
| 06/05/09        | CASH         | YOU SOLD    | PRIME FUND - CAPITAL RESERVES | ( 366,030 ) | \$366,030.00 |
|                 |              |             | CLASS @ 1                     |             |              |
| 06/08/09        | CASH         | YOU SOLD    | PRIME FUND - CAPITAL RESERVES | ( 10,015 )  | \$10,015.00  |
|                 |              |             | CLASS @ 1                     |             |              |

## Net Core Funds Sold

\$376,045.00

## NET CORE FUND ACTIVITY

\$206,658.08

## ADDITIONS AND WITHDRAWALS

### Deposits

| Date     | Account Type | Transaction          | Description | Quantity | Amount       |
|----------|--------------|----------------------|-------------|----------|--------------|
| 06/10/09 | CASH         | WIRE TRANS FROM BANK | WR36831831  |          | \$160,800.00 |

### Net Deposits

\$160,800.00

### Other Additions and Withdrawals

| Date     | Account Type | Transaction        | Description | Quantity | Amount           | Total Cost Basis | Realized Gain (Loss) |
|----------|--------------|--------------------|-------------|----------|------------------|------------------|----------------------|
| 06/05/09 | CASH         | WIRE TRANS TO BANK | WD39895092  |          | ( \$50,000.00 )  |                  |                      |
| 06/05/09 | CASH         | WIRE TRANS TO BANK | WD39895099  |          | ( \$318,000.00 ) |                  |                      |
| 06/09/09 | CASH         | WIRE TRANS TO BANK | WD39706733  |          | ( \$10,000.00 )  |                  |                      |

### Net Other Additions and Withdrawals

( \$376,000.00 )

## NET ADDITIONS AND WITHDRAWALS

( \$215,200.00 )

This is a copy of the customer statement. The original has been mailed to the address of record.

Account Number: 0916  
Account Name: SMITH

Statement Date: 06/01/2009 to 06/30/2009

# McGinnSmith & Company, Inc.

## Core Funds Purchased

| Settlement Date | Account Type | Transaction  | Description                                                | Quantity | Amount   |
|-----------------|--------------|--------------|------------------------------------------------------------|----------|----------|
| 06/30/09        | CASH         | REINVESTMENT | PRIME FUND - CAPITAL RESERVES<br>CLASS REINVESTED @ \$1.00 | 4.84     | (\$4.84) |

## Net Core Funds Purchased

( \$169,386.94 )

## Core Funds Sold

| Settlement Date | Account Type | Transaction | Description                                | Quantity    | Amount       |
|-----------------|--------------|-------------|--------------------------------------------|-------------|--------------|
| 06/05/09        | CASH         | YOU SOLD    | PRIME FUND - CAPITAL RESERVES<br>CLASS @ 1 | ( 365.030 ) | \$368,030.00 |
| 06/09/09        | CASH         | YOU SOLD    | PRIME FUND - CAPITAL RESERVES<br>CLASS @ 1 | ( 10,015 )  | \$10,015.00  |

## Net Core Funds Sold

\$376,045.00

## NET CORE FUND ACTIVITY

\$206,658.06

## ADDITIONS AND WITHDRAWALS

### Deposits

| Date     | Account Type | Transaction          | Description | Quantity | Amount       |
|----------|--------------|----------------------|-------------|----------|--------------|
| 06/10/09 | CASH         | WIRE TRANS FROM BANK | WR36831831  |          | \$160,800.00 |

### Net Deposits

\$160,800.00

### Other Additions and Withdrawals

| Date     | Account Type | Transaction        | Description | Quantity | Amount         | Total Cost Basis | Realized Gain (Loss) |
|----------|--------------|--------------------|-------------|----------|----------------|------------------|----------------------|
| 06/05/09 | CASH         | WIRE TRANS TO BANK | WD36865092  |          | (\$50,000.00)  |                  |                      |
| 06/05/09 | CASH         | WIRE TRANS TO BANK | WD36865099  |          | (\$316,000.00) |                  |                      |
| 06/09/09 | CASH         | WIRE TRANS TO BANK | WD39706733  |          | (\$10,000.00)  |                  |                      |

### Net Other Additions and Withdrawals

( \$376,000.00 )

## NET ADDITIONS AND WITHDRAWALS

( \$215,200.00 )

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,

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

*Defendants, and*

LYNN A. SMITH,

*Relief Defendant.*

---

**MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS OF  
RELIEF DEFENDANT LYNN A. SMITH**

Purported "Relief Defendant" Lynn A. Smith moves this Court pursuant to Fed. R. Civ. Proc. 12(b)(1) and 12(b)(6), to dismiss the Complaint for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, based upon this Memorandum of Law and the Affidavit of Lynn Smith with Exhibits sworn to on June 9, 2010.

Lynn Smith is not a proper “relief defendant,” for she is not a mere repository of gratuitous transfers from the Defendants, but rather a person who maintained an independent ownership interest in her accounts for decades. The SEC does not plead and cannot establish that Lynn Smith has no “legitimate claim” to her funds as it must to invoke subject matter jurisdiction and obtain the requested disgorgement remedy from non-culpable third parties, and its complaint should therefore be dismissed.

**I. Introduction**

This securities action is against seven corporate defendants and two individual defendants. Lynn Smith is the sole individual named as a “relief defendant.” The Securities and Exchange Commission (“SEC” or “Commission”) asserts several causes of action alleging securities fraud and other violations against the Defendants in connection with their operation of certain funds and trusts. The SEC’s Complaint (Doc. 1) does not assert any cause of action against Lynn Smith, but only seeks, in its “Seventh Claim for Relief” and in its “Prayer For Relief,” to include Lynn Smith in an order requiring the Relief Defendant to “disgorge her ill-gotten gains.” (SEC Cplt. ¶141 and Cplt. P. 34).

A relief defendant, sometimes referred to as a “nominal defendant,” is a mere custodian of property received gratuitously from the true defendant and to which the relief defendant has no legitimate right. Because such a party is functionally just a repository of the defendant’s assets, it is deemed to fall within the Court’s subject matter jurisdiction over the defendant’s conduct and property and it may be required to disgorge assets that are in truth the defendant’s “ill-gotten” assets. This is not the case here.

## **II. Lynn Smith is Not a Proper Relief Defendant**

The critical inquiry, for both subject matter jurisdiction and the availability of disgorgement from Lynn Smith is whether she is properly named as a relief defendant. This inquiry turns upon the “legitimate claim” test, that is, whether Lynn Smith is a mere custodian of assets received gratuitously from the Defendants or whether she has a legitimate interest of her own in assets that were received for consideration. The SEC’s Complaint neither alleges beyond generalized statements that the funds at issue were received without consideration nor alleges facts showing the absence of a legitimate claim to the funds at issue. Consequently, the SEC fails to meet its burden to establish both a substantive foundation for an ancillary disgorgement remedy and subject matter jurisdiction.

### **A. Plaintiff Has Failed to Establish Subject Matter Jurisdiction Over Lynn Smith**

The plaintiff bears the burden of establishing subject matter jurisdiction. Taylor v. Appleton, 30 F.3d 1365 (11<sup>th</sup> Cir. 1994); see, SEC v. Colello, 139 F.3d 674, 677 (9<sup>th</sup> Cir. 1998) (SEC’s burden to show the test for nominal defendant status is met); United States CFTC v. Sarvey, 2008 U.S. Dist. LEXIS 54566, \*7 (N.D. Ill. 2008) (the party asserting jurisdiction must establish it by competent proof).

Challenges to subject matter jurisdiction under F.R.C.P. Rule 12(b)(1) may be raised “facially” and “factually.” Under a “facial” challenge, if the allegations in the complaint, taken as true, do not allege a sufficient basis for subject matter jurisdiction, then the complaint should be dismissed. Lawrence v. Dunbar, 919 F.2d 1525, 1529 (11<sup>th</sup> Cir. 1990). In a “facial” challenge, the Court is limited to considering the complaint alone. See, Lane v. Halliburton, 546 U.S. 500 (2006). Under a “factual” challenge, the



court may consider evidence outside of the complaint, such as affidavits and other materials to support their position, See, Hamm v. U.S., 483 F.3d 135, 137 (2<sup>nd</sup> Cir. 2007). In such circumstances, the court is not bound to accept the allegations in the complaint as true, but is free to evaluate and make a factual determination with respect to the evidence.

In its Complaint, the SEC does not plead any basis for subject matter jurisdiction over Lynn Smith. In the "Jurisdiction" section of its Complaint, the SEC asserts only that subject matter jurisdiction exists over "this action" generally under several provisions of the Securities Act, the Exchange Act, the Company Act, and the Advisers Act (SEC Cplt. ¶14). Such jurisdictional basis may be true insofar as the action concerns the conduct and assets of the Defendants that allegedly violated provisions of those Acts, but it says nothing at all concerning the Court's exercise of subject matter jurisdiction over the conduct and assets of Relief Defendant Lynn Smith who is not alleged to have violated any such provisions.

A proper relief defendant "has no legitimate claim to the disputed property." SEC v. Ross, 504 F.3d 1130 (9<sup>th</sup> Cir. 2007). Rather, a relief defendant is joined "purely as a means of facilitating collection" of the defendants assets in its custody when the defendant's liability is ultimately established. SEC v. Colello, 139 F.3d 674, 676 (9<sup>th</sup> Cir. 1998). See also, CFTC v. Kimberllynn Creek Ranch, Inc., 276 F.3d 187, 191 (4<sup>th</sup> Cir. 2002) (a nominal defendant is joined as a means of facilitating collection at the resolution of the matter). Since a relief defendant is not accused of any wrongdoing and is joined to aid in the recovery of the defendant's property, it is not necessary to set forth a separate basis for subject matter jurisdiction beyond that over the action involving the defendants' alleged violations. See, Kimberllynn Creek Ranch, Inc., at 191-92.

However, the relief defendant doctrine applies only in limited circumstances in that a federal court may order equitable relief against such a person where that person (1) has received ill-gotten funds, and (2) does not have a legitimate claim to those funds. CFTC v. Walsh, 2009 U.S. Dist. LEXIS 71617 (S.D.N.Y. Aug. 4 2009), citing, SEC v. Cavanagh, 155 F.3d 129, 136 (2<sup>nd</sup> Cir. 1998). It is the SEC's burden to show this test is met, because "the lack of a legitimate claim to the funds is the defining element of a nominal defendant." See, Colello at 677. See also, FTC v. Bronson Partners, LLC 674 F.Supp. 2d 373, 392 (D. Conn. 2008) (the burden rests with the Commission to show that the funds in the possession of [the relief defendant] are ill-gotten).

This analysis also determines subject matter jurisdiction in that if the third party is a proper relief defendant, it falls within the jurisdiction covering the substantive claims against the actual defendants, but if not, then there must be a separate basis for subject matter jurisdiction, and full due process, prior to any final equitable relief being ordered against the relief defendant. SEC v. Cherif, 933 F.2d 403, 413-14 (7<sup>th</sup> Cir. 1991). See also, United States CFTC v. Sarvey, 2008 U.S. Dist. LEXIS 54566 (N.D. Ill. 2008) (complaint dismissed where parties were not proper nominal defendants).

"The paradigmatic example of a nominal defendant is a 'bank or trustee [that] has only a custodial claim on the property'" at issue. Ross at 1141, citing, Colello at 677. A party may also be deemed a relief defendant where it received property from the violator as a gift for which no consideration was given, See, Cavanagh at 137; See also, SEC v. Martino, 255 F.Supp. 2d 268, 288-89 (S.D.N.Y. 2003) (relief defendants had no legitimate claim to yacht that defendant had paid for and placed in relief defendants' name).

However, a third party with an “ownership interest” or “legitimate claim” in the funds sought to be frozen will preclude that person from being a proper relief defendant. See, Janvey v. Adams, 588 F.3d 831 (5<sup>th</sup> Cir. 2009); SEC v. Cavanagh, 155 F.3d 129, 136 (2<sup>nd</sup> Cir. 1998); See also, Bronson Partners, LLC 674 F.Supp. 2d 373, 392 (D. Conn. 2008) (A legitimate claim to funds is established when a relief defendant shows that some services were performed for consideration). Such an ownership interest or legitimate claim “does not require possession of the full bundle of ownership rights that may exist in various types of property.” SEC v. Founding Ptnrs. Capital Mgmt., 639 F.Supp 2d 1291, 1294 (M.D. Fla. 2009). Consequently, a party who gave consideration in exchange for property has a legitimate claim to it, and therefore cannot be treated as a relief defendant. See also, Ross at 1142 (rejecting nominal defendant designation for party who had legitimate claim to compensation for services rendered); CFTC v. Hanover Trading Corp., 34 F.Supp. 2d 203, 205-07 (S.D.N.Y. 1999) (fact that party had received funds as commissions for investor solicitation services suggested legitimate claim to funds); Sarvey at 4-5 (rejecting relief defendant status for party who received funds in exchange for providing a guarantee service). As to such a party with a legitimate claim to the property at issue, equitable remedies may not be obtained unless the SEC can obtain true jurisdiction by asserting a substantive securities claim against that party as a defendant. See, Cherif at 413-415; Ross at 1142; Sarvey at 5.

In this matter, the SEC’s allegations fail to withstand facial scrutiny under F.R.C.P. 12(b)(1). A review of the Complaint shows that the SEC has failed to allege with any degree of specificity that Lynn Smith lacks a legitimate claim to the funds it has alleged she has received from Defendants.

The SEC's 35 page Complaint consists of 142 numbered paragraphs of which only seven directly reference the Relief Defendant. These seven paragraphs set forth only "a formulaic recitation of the elements of a cause of action" necessary to disgorge funds from a relief defendant, Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007), and are consequently insufficient to hold Lynn Smith as a relief defendant. To be sure, the following is the universe of allegations and statements proffered by the Commission against the Relief Defendant excerpted verbatim from its Complaint:

¶ 12. Lynn Smith, as relief defendant, has received and retained ill gotten gains from defendants' fraud.

¶ 22. Lynn A. Smith, age 64, is the wife of David Smith and a resident of Saratoga Springs, New York.

¶ 68. Not satisfied with the disclosed fees, MS & Co., used a total of at least 54% of the funds raised to: (i) make payments to ... relief defendant Lynn Smith...

¶ 71. McGinn also transferred...more than \$335,000 to Smith's wife, relief defendant Lynn Smith.

¶ 94. MS Capital transferred \$335,000 to accounts in the name of Smith's wife, relief defendant Lynn Smith. Lynn Smith received many other payments from McGinn Smith Entities. On May 4, 2009, for example, Smith directed that a \$100,000 check be issued to his wife's account at National Financial Services. Smith also testified that his salary was generally paid to his wife, Lynn.

¶ 141. Relief Defendant Lynn A. Smith was a recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities alleged above. The Relief Defendant profited from such receipt or from the fraudulent and illegal sales of securities alleged above by obtaining illegal proceeds under circumstances in which it is not just, equitable, or conscionable for her to retain the illegal proceeds. Consequently, Lynn Smith has been named as a Relief Defendant for the amount of proceeds by which she has been unjustly enriched as a result of the fraudulent scheme or illegal sales transaction.

142. By reason of the foregoing, Lynn Smith should disgorge her ill-gotten gains, plus prejudgment interest.

When these conclusory allegations are viewed in conjunction with the two-part relief defendant test set forth in Cavanagh, it is clear that the SEC's allegations fail to withstand scrutiny in that the Commission has both failed to sufficiently substantiate that Lynn Smith has received ill-gotten funds and that she has not made a sufficient showing that she has a legitimate claim to her funds. Consequently, Lynn Smith is not properly named as a relief defendant and the Court is precluded from ordering equitable relief against Lynn Smith.

Going beyond its defective recitation of the necessary elements, Paragraph 68 of the SEC's Complaint affirmatively undermines its basis for naming Lynn Smith as the sole relief defendant. Specifically, Paragraph 68 of the SEC's Complaint states:

Not satisfied with the disclosed fees, MS & Co. used a total of at least 54% of the funds raised to: (i) make payments to McGinn, McGinn's son, Smith, relief defendant Lynn Smith, MS Partner 4 and an Albany politician; (ii) to cover MS & Co.'s payroll between January and April 2009; and (iii) to pay investors in other Trust entities. The following is a summary of McGinn's misuse of TDMM Cable 09 investor funds:

By the SEC's own words, Paragraph 68 of the Complaint groups Lynn Smith in with "McGinn's son," "an Albany politician," and "investors in other Trust entities" who are alleged to have received funds from Defendant MS & Co. Neither "McGinn's son," the "Albany politician" nor the "investors in other Trust entities" are named as relief defendants in the SEC's Complaint. In light of the fact that Lynn Smith is the only named relief defendant in the SEC's action, it would appear on the face of the Complaint that this transfer was not proffered to support an allegation that Lynn Smith is a recipient of ill-gotten gains, especially since the SEC's Complaint does not substantiate in a sufficient manner that the funds referenced in Paragraph 68 are indeed "ill-gotten" or

were received by Lynn Smith without consideration. While Lynn Smith may be the wife of one of the Defendants, her possession of a marriage certificate in no way trumps her independent ownership interests in her accounts and does not serve as a basis for subject matter jurisdiction.

Here, the SEC has not pleaded with sufficiency that either the funds are ill-gotten or that Lynn Smith lacks a "legitimate claim" to the funds at issue. Consequently, the SEC has failed to meet its burden pursuant to a facial challenge under F.R.C.P 12(b)(1) by showing that Lynn Smith received ill-gotten funds from Defendants and that she lacks a legitimate claim to the funds at issue. Since that showing is the "defining element" of proper relief defendant status, see, Colello at 677, without it the SEC has no basis to bring Lynn Smith within the Court's subject matter jurisdiction over the Defendants or ultimately obtain the equitable disgorgement remedy it seeks against Lynn Smith as a non-culpable party.

With regard to a F.R.C.P. 12(b)(1) factual challenge, the Complaint, the attached Affidavit of Lynn Smith and the attached Exhibits show that the SEC has failed to meet its burden in substantiating its allegations against the Relief Defendant as set forth in Paragraphs 12, 68, 71, 94 and 141 of the Commission's Complaint.

The Commission's Complaint implicates Lynn Smith as a relief defendant based upon broad and unsubstantiated allegations that she has "received ill-gotten gains" (SEC Cplt. ¶12) and was "a recipient, without consideration, of proceeds of the fraudulent and illegal sales of securities." (SEC Cplt. ¶141) To support its very general allegations against Lynn Smith, the Commission cites two specific amounts of money that were transferred into Mrs. Smith's brokerage account in 2009: \$335,000 (See, SEC Cplt. ¶¶68,

71 and 94) and \$100,000 (SEC Cplt. ¶94). The first payment referenced, \$335,000, in or about June and July of 2009 was actually two separate payments which are correctly stated in Paragraph 26 of the Complaint. Two payments, one for \$160,800 and one for \$175,000 were made to Mrs. Smith's account from TDMM Cable in repayment of a short-term loan in the amount of \$366,000 which she made to TDMM Cable from her stock account on June 5, 2009 (Lynn Smith Affidavit Exhibit B). Lynn Smith has no record of the \$100,000 payment referenced in SEC's Complaint at Paragraph 94 and has no record of ever receiving such amount.

In light of Lynn Smith's arm's-length transactions, and even assuming the truth of its allegations (which the Court need not do on a 12(b)(1) subject matter jurisdiction motion), the SEC has not pleaded and cannot show that Lynn Smith lacks a "legitimate claim" to the funds at issue and therefore the Court lacks subject matter jurisdiction.

**B. Plaintiff Fails to Allege a Valid Basis for a Disgorgement Remedy Against Lynn Smith**

Under Rule 12(b)(6), a complaint should be dismissed for failure to state a claim if the allegations in the complaint, taken as true, do not constitute a valid claim. Mills v. Foremost Ins. Co., 511 F.3d 1300, 1303 (11<sup>th</sup> Cir. 2008). "[A] plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" Teamsters Allied Benefit Funds v. McGraw-Hill Companies, Inc., 2010 U.S. Dist. LEXIS 23052 (S.D.N.Y. Mar. 10, 2010), citing, Ashcroft v. Iqbal, 129 S.

Ct. 1937, 1949 (2009). The SEC here fails to state a valid basis for the ancillary disgorgement remedy it seeks against Lynn Smith as an alleged holder of the Defendants' assets, for the same reasons that it fails to establish subject matter jurisdiction: it does not plead a proper basis for treatment as a relief defendant. Also, the SEC does not state any substantive claim of securities violation by Lynn Smith that could give rise to a disgorgement remedy based upon her own conduct.

Normally, disgorgement is obtained from a culpable defendant, its primary purpose being "to ensure that those guilty of securities fraud do not profit from their ill-gotten gains." SEC v. One Wall Street, Inc., 2008 U.S. Dist. LEXIS 97387, \*3 (E.D.N.Y. Nov. 26, 2008) (quoting SEC v. Wang, 944 F.2d 80, 81 (2d Cir. 1991)). It is imposed upon those who commit violations "for the purpose of depriving the wrongdoer of his ill-gotten gains and deterring violations of the law." CFTC v. American Metals Exchange Corp., 991 F.2d 71 (3d Cir. 1993); SEC v. Better Life Club of Am., Inc., 995 F.Supp. 167, 179 (D.D.C. 1998). See also, SEC v. ETS Payphones, Inc., 408 F.3d 727, 735 (11<sup>th</sup> Cir. 2005) (the "power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing").

Here, it is evident from the Commission's Complaint that the SEC has failed to allege that any of the named Defendants actually "profited" by their alleged fraudulent activities making the Commission's demand for disgorgement on these parties as suspect as its demand for the same equitable relief on Lynn Smith. A review of the Complaint reflects the Commission's effort to advance its theories of fraud and misrepresentation perpetrated by the Defendants in violation of the federal statutes cited. However, the Complaint is silent as to how the Defendants' illegally profited by these alleged



fraudulent activities. For example, paragraphs 24 - 52 outline the alleged fraudulent scheme behind the Four Funds. The allegations are essentially summarized in paragraph 2 of the Complaint:

McGinn, Smith, MS & Co., MS Advisors and MS Capital deceived investors in the Four Funds. They told investors that their hard-earned money would be invested and that the profits would depend on the spread between the cost of the investment and the rate of return. Instead, the Defendants secretly funneled investor money to entities they owned or controlled, even though this was not permitted by offering materials. Defendants concealed from investors the truth about the Four Funds, including the fact that investor money was being routed to in-house entities controlled by Smith and McGinn and to other non-public and illiquid investments, and that these actions were having a disastrous impact on the investors.

Of those 38 paragraphs only one paragraph alleges that certain fees and commissions were received as part of those offerings but significantly does not characterize or otherwise allege that those fees constituted ill-gotten gains.

The same holds true for the Trust Offerings. Unlike the allegations set forth relating to the Four Funds, the Commission does in fact allege that the Defendants were the recipients of “excessive” commissions, transaction fees and other material benefits resulting from these Trust offerings. (SEC Cplt. ¶¶57, 63, 71, 82, 89, 90 and 91). However, the Commission never alleges that these “excessive fees” and other material benefits translate to “ill-gotten gains.”

As for Lynn Smith, she is not a defendant. The only possible basis for disgorgement against her would be if she met the two-part “ill-gotten gains” and “no legitimate claim” test articulated in Cavanagh. The Complaint fails to allege facts that satisfy either prong of this test.

First, as with the case of the Defendants, there are no allegations that support the supposition that ill-gotten gains resulted from the Defendants' alleged conduct and certainly no allegations that Lynn Smith was the recipient of such funds. Granted, several allegations relating to Lynn Smith make reference to "ill-gotten gains" (SEC Cplt. ¶12) and "proceeds of fraudulent and illegal sales of securities." (SEC Cplt. ¶141) However, when those phrases are referenced and alleged in the Complaint they are done so in a conclusory manner that is legally insufficient to withstand the scrutiny of a 12(b)(6) motion. To the extent that the allegations depict the Relief Defendant as a recipient of money from the Defendants, such as in paragraphs 71 and 94, the Complaint fails to allege that such monies were causally related to the Defendants' alleged fraudulent conduct. In fact apart from paragraphs 12, 141 and 142, all conclusory in form, there is no further allegation in the entire Complaint that even utilizes the terms "ill-gotten gains" or "illegal profits" let alone tie such gains to the fraudulent conduct being alleged or that the Relief Defendant was in fact the recipient of such funds.

To the extent that the SEC can show that ill-gotten gains were in fact received by the Defendants from its alleged fraudulent activities which it has failed to do in its complaint, it has failed to further demonstrate the reasonable and approximate value of such gains or that the Relief Defendant has come into possession of them without consideration. 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.Supp. 2d 296, 304 (S.D.N.Y. 2007), citing, SEC v. Opulentica, 479 F.Supp. 2d 319 (S.D.N.Y. 2007). Only after the SEC has made a reasonable showing of defendants' illicit profits, does the burden shift to the defendant to

show that the disgorgement figure was not a reasonable approximation. SEC v. Aimsi Techs., Inc. at 304.

In this case, the SEC has made no effort to allege the reasonable value of Defendants' alleged ill-gotten gains or even to identify what "gains" it will allege were "ill-gotten" but rather has elected to seek disgorgement of all Defendants' assets including the individual assets of the Relief Defendant. The allegations in the Complaint against Lynn Smith are limited to \$435,000. There is no record that the payment to Lynn Smith in the amount of \$100,000 ever occurred. For the remaining \$335,000, Lynn Smith has demonstrated a legitimate interest in those funds. What remains left is the general allegations that Relief Defendant received "many other payments" and, as David Smith's wife, the recipient of his salary payments. However, the Commission never alleges the estimated amount of these payments nor provides any evidence that the payments can be traced to ill-gotten gains. Here, the SEC seeks disgorgement on all the assets individually held by Lynn Smith and seeking to do so without alleging a single fact that any monies she did receive were derived from ill-gotten gains.

Further, the Commission again fails to state a claim for which relief can be granted for the same reason the Commission cannot withstand a facial challenge to subject matter jurisdiction. In short, the Complaint fails to allege with any degree of specificity that Lynn Smith lacks any legitimate claim to the funds that are alleged to have been received from the Defendants. To the extent the Commission does make the allegation, it is conclusory in nature.

Because the SEC has failed to plead facts sufficient to support its claim that Lynn Smith was the recipient of ill-gotten gains and that she lacks a legitimate claim to the

funds, both of which are defining elements of valid nominal defendant status, the Commission's Complaint seeking a disgorgement remedy on a nominal defendant theory must be dismissed.

### CONCLUSION

The SEC has no valid basis to name Lynn Smith as a relief defendant, and thereby attempt to obtain equitable disgorgement relief from Lynn Smith as though she is a mere appendage of the Defendants. The Complaint should be dismissed as against Lynn Smith, for both lack of subject matter jurisdiction and failure to state a claim on which relief can be granted.

DATED: June 9, 2010

**Featherstonhaugh, Wiley & Clyne, LLP**

By: 

James D. Featherstonhaugh, Esq.  
Bar Roll No. 101616  
Attorneys for Relief Defendant,  
Lynn A. Smith  
99 Pine Street, Suite 207  
Albany, NY 12207  
Tel: (518) 436-0786  
Fax: (518) 427-0452

TO: David Stoelting  
Attorney for Plaintiff  
Securities and Exchange Commission  
3 World Financial Center, Room 400  
New York, NY 10281  
Tel: (212) 336-0174  
Fax: (212) 336-1324

Michael Koenig, Esquire  
Greenberg Traurig LLP  
54 State Street, 6th Floor  
Albany, NY 12207

Tel: (518) 689-1400  
Fax: (518) 689-1499

Jill A. Dunn  
Attorney for Proposed Intervenor  
The Dunn Law Firm PLLC  
99 Pine Street, Suite 210  
Albany, New York 12207-2776  
Tel: (518) 694-8380