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,
LYNN A. SMITH, GEOFFREY R. SMITH, Trustee
of the David L. and Lynn A. Smith Irrevocable Trust
U/A 8/04/04, GEOFFREY R. SMITH, LAUREN
T. SMITH, and NANCY McGINN,

Case No.: 1:10-CV-457

(GLS/CFH)

Defendants,

LYNN A. SMITH and NANCY McGINN,

Relief Defendants, and

GEOFFREY R. SMITH, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,

Intervenor.

DEFENDANT DAVID L. SMITH'S RESPONSE TO PLAINTIFF'S STATEMENT OF MATERIAL FACTS AND STATEMENT OF ADDITIONAL FACTS IN OPPOSITION TO PLAINTIFF'S SUMMARY JUDGMENT MOTION

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Dated: August 11, 2014

Defendant, David L. Smith, by and through his attorneys, Dreyer Boyajian LLP, hereby submits this response to Plaintiff's Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Defendant's Statement of Additional Material Facts in Support of His Opposition to Plaintiff's Summary Judgment Motion.

GENERAL OBJECTIONS

1. David L. Smith ("Mr. Smith") objects to the plaintiff's inclusion of numerous irrelevant and immaterial purported "facts" in its Statement of Material Facts ("SMF"). The plaintiff impermissibly seeks this Court to find facts that are irrelevant and immaterial to its Summary Judgment Motion. Therefore, Mr. Smith objects to all of plaintiff's purported "facts" that do not address its motion for summary judgment.

2. Mr. Smith objects to plaintiff's SMF that contradict, mischaracterize, over generalize, or otherwise alter the meaning of sworn testimony given by the Mr. Smith, Timothy M. McGinn, Lynn A. Smith, Geoffrey Smith, Lauren T. Smith, and any other defendants in this action, any third parties, and witnesses in depositions in this action, or otherwise provided testimony at the criminal trial in the parallel criminal proceedings, as well as pleadings and documents in both actions, including plaintiff's selected use of quotes out of context.

3. Where Mr. Smith does not dispute the facts of a particular paragraph, he does so for the purposes that the plaintiff's motion for summary judgment and Mr. Smith reserves all other objections, including but not limited to, the right to object or contest each of plaintiff's assertions of fact at the appropriate time, including the right to challenge each assertion of fact as to admissibility at trial.

4. Mr. Smith objects to plaintiff's submission of unsubstantiated facts that are not supported by a citation of admissible evidence, as required by Federal Rule of Civil Procedure

56.

5. Mr. Smith objects to plaintiff's cited exhibits to the extent that they are not complete, are not characterized as what they purport on their face to be, and otherwise fail as to authenticity, foundation, and admissibility.

6. Mr. Smith's objects to plaintiff's improper insertion of argument, innuendo, opinion, and inferences, throughout its SMF, rather than providing a concise statement of each material fact as which the movant contents there is no genuine issue as required by Rule 56.

7. Mr. Smith makes no admissions as to the evidence set forth by the plaintiff. Any admissions made by Mr. Smith within these responses are made solely for purposes of responding to plaintiff's Motion for Summary Judgment only.

RESPONSES TO PLAINTIFF'S STATEMENT OF MATERIAL FACTS

1. Defendants Timothy M. McGinn ("McGinn"), age 66, and David L. Smith ("Smith"), age 69, founded defendant McGinn, Smith & Co., Inc. ("MS & Co.") in 1980, a registered broker-dealer with its headquarters at 99 Pine Street, Albany, New York. App. Ex. 336.

RESPONSE: Admitted.

2. McGinn also served as CEO of Integrated Alarm Services Group, Inc. ("IASG"), a public company which also had its headquarters at 99 Pine Street in Albany, from July 2003 to May 2006. App. Ex. 332 at 12.

RESPONSE: Admitted.

3. MS & Co. was owned by Smith (50%), and McGinn (50%), until January 2004, when Thomas E. Livingston ("Livingston"), a registered representative at MS & Co., acquired a 20% interest. App. Ex. 351.

RESPONSE: Admitted.

4. MS & Co. sold securities to its customers through approximately 35 registered representatives who operated from MS & Co. offices in New York, NY, Clifton Park, NY, and King of Prussia, PA. On December 18, 2009, FINRA informed Smith that MS & Co. was in violation of FINRA's net capital rule and that MS & Co. was required to "cease conducting a securities business." App. Ex. 333. *See also* App Ex. 331 (memorandum to MS & Co. employees dated December 21, 2009 stating "McGinn Smith was ordered by FINRA to cease business as a result of being in violation of its net capital requirement").

RESPONSE: Admitted.

5. FINRA suspended MS & Co.'s membership on August 4, 2010. App. Ex. 336.

RESPONSE: Denied. FINRA suspended MS & CO's membership on June 4, 2010 for failing to file its annual audit report. See Plaintiff's App. Ex. 336.

6. Defendant McGinn, Smith Advisors, LLC ("MS Advisors") is a New York limited liability company formed in September 2003. It was owned by McGinn Smith Holdings, LLC, and was registered with the Commission as an investment advisor from January 3, 2006 to April 24, 2009.

RESPONSE: Admitted.

7. McGinn, Smith Holdings, LLC ("MS Holdings") is a New York limited liability company formed in September 2003, and was owned by Smith (50%), McGinn (30%), and Livingston (20%).

RESPONSE: Admitted.

8. Defendant McGinn, Smith Capital Holdings Corp. ("MS Capital") is a New York corporation formed in January 1989, and was owned by MS Holdings (52%), Smith (24%) and

McGinn (24%).

RESPONSE: Admitted.

9. Defendants First Independent Incomes Notes, LLC ("FIIN"), First Excelsior Income Notes LLC ("FEIN"), Third Albany Income Notes LLC ("TAIN"), and First Advisory Income Notes LLC ("FAIN") (collectively the "Four Funds") were single purpose, New York limited liability companies formed in September 2003, January 2004, November 2004 and October 2005, respectively. App. Ex. 86-89.

RESPONSE: Admitted.

10. MS Advisors was the sole managing member of each of the Four Funds, MS & Co. was their placement agent, and MS Capital was the trustee. *Id.*

RESPONSE: Admitted.

11. The Four Funds each had substantively identical private placement memoranda (PPMs). *Id.* Each offered $20,000,000 worth of notes, except for TAIN, which offered $30 million, which were sold through their placement agent, MS & Co. Each offering had three tranches of notes paying quarterly interest of 5% through 10.25%, and promised a return of principal at maturity, in one, three or five years. *Id.*

RESPONSE: Admitted.

12. Beginning in October 2006, MS & Co. was the sales agent for the following unregistered offerings, which sold trust certificates (the "Trust Offerings"):

a) TDM Cable Trust 06, 7.75%/9.25% ($3,550,000) (11/13/06), App. Ex. 64;

b) TDM Verifier Trust 07, 8.25%/9% ($3,475,000) (2/23/07), App. Ex. 66;

c) Firstline Senior Trust 07, 9.25% ($1,850,000) (5/19/07), App. Ex. 68;

d) Firstline Trust 07, 11% ($1,867,000) (5/19/07), App. Ex. 67;

e) TDM Luxury Cruise Trust 07, 10% ($3,630,000 (7/16/07), App. Ex. 69;

f) Firstline Senior Trust 07 Series B, 9.5% ($1,435,000) (10/19/07), App. Ex. 71;

g) Firstline Trust 07 Series B, 11% ($2,115,000) (10/19/07), App. Ex. 70;

h) TDM Verifier Trust 08, 8.50%/1 0% ($3,850,000) (12/17/07), App. Ex. 72;

i) Cruise Charter Ventures Trust 08, 13% ($3,250,000) (2/14/08), App. Ex. 83;

j) Integrated Excellence Sr. Trust 08, 9% ($900,000) (5/30/08), App. Ex. 74;

k) Integrated Excellence Jr. Trust 08, 10% ($580,000) (5/30/08), App. Ex. 73;

l) Fortress Trust 08, 13% ($3,060,000) (9/24/08), App. Ex. 75;

m) TDM Cable Trust 06, 10% ($1,380,000) (11/17/08), App. Ex. 65;

n) TDM Verifier Trust 09, 10% ($1,300,000) (12/15/08), App. Ex. 76;

o) TDMM Cable Jr Trust 09, 11% ($1,325,000) (1/19/09), App. Ex. 77;

p) TDMM Cable Sr. Trust 09, 9% ($1,550,000) (1/1 9/09), App. Ex. 78;

q) TDM Verifier Trust 07R, 9% ($2,100,000) (2/2/09), App. Ex. 79;

r) TDM Verifier Trust 08R, 9% ($2,005,000) (7/6/09), App. Ex. 80;

s) TDMM Benchmark Trust 09, 8%, 9%, 10%, 11%, 12% ($3,000,000) (8/20/09), App. Ex. 81; and

t) TDM Verifier Trust 11, 9% ($1,550,000) (9/3/09), App. Ex. 82.

RESPONSE: Admitted.

13. The Trust Offerings investors were offered monthly interest payments ranging from 7.75% to 13% per year, and a return of principal at maturity, 15 months to 5 years. App. Ex. 64-83.

RESPONSE: Admitted.

14. McGinn, Smith Transaction Funding Corporation ("MSTF") is a New York

corporation formed in 2008. On April 22, 2008 MSTF offered $10,000,000 worth of notes sold through its sales agent MS & Co. App. Ex. 85 at 1.

RESPONSE: Admitted.

15. Cruise Charter Ventures, LLC ("CCV LLC"), is a Florida limited liability company. On September 25, 2009, CCV LLC, offered $400,000 worth of 12% notes due to mature on May 31, 2010. CCV LLC was to use the net proceeds of the offering to charter a 3 day cruise departing from Miami, Florida on October 29, 2010. According to the PPM, CCV LLC operates in the trade as YOLO Cruises ("YOLO"). "YOLO believes it was the first to charter an entire ship for a "Lifestyle Cruise" in April 2009. App. Ex. 84. Timothy McGinn was the managing member of CCV LLC. App. Ex. 84 at 26.

RESPONSE: Admitted.

16. Defendant and Relief Defendant Lynn A. Smith ("L. Smith"), age 67, is the wife of Smith and is a resident of Saratoga Springs, New York.

RESPONSE: Admitted.

17. Defendant Geoffrey R. Smith ("G. Smith"), age 34, is a resident of Aspen, Colorado. G. Smith is the son of Smith and L. Smith. G. Smith is a beneficiary of the David L. and Lynn A. Smith Irrevocable Trust (the "Smith Trust"). G. Smith became the trustee of the Smith Trust on February 14, 2011, following the resignation of the prior trustee, David M. Wojeski.

RESPONSE: Admitted.

18. Lauren T. Smith ("L.T. Smith"), age 31, is a resident of Aspen, Colorado. Lauren Smith is the daughter of Smith and L. Smith. Lauren Smith is a beneficiary of the Smith Trust.

RESPONSE: Admitted.

19. Nancy McGinn, age 53, is the wife of McGinn and is a resident of Troy, New York.

RESPONSE: Admitted.

20. This Court has jurisdiction over this action pursuant to Sections 20(b) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b) and 77v(a)], Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa], Sections 42 and 44 of the Company Act [15 U.S.C. §§ 80a-41 and 80a-43], and Sections 209 and 214 of the Advisers Act [15 U.S.C. §§ 80b-9 and 80b-14].

RESPONSE: Objection. This paragraph improperly states a legal conclusion outside of the scope and requirements of a Statement of Material Facts pursuant to Federal Rule of Civil Procedure 56 and Local Rule 7.1(a)(3). It is therefore denied.

21. This Court has jurisdiction over the fraudulent conveyance claim – the Eighth Claim for Relief – pursuant to 28 U.S.C. § 1345 and the Court's ancillary and/or supplemental jurisdiction.

RESPONSE: Objection. This paragraph improperly states a legal conclusion outside of the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

22. Venue lies in the Northern District of New York pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], Section 27 of the Exchange Act [15 U.S.C. § 78aa], Section 44 of the Company Act [15 U.S.C. § 80a-43], and Section 214 of the Advisers Act [15 U.S.C. § 80b-14].

RESPONSE: Objection. This paragraph improperly states a legal conclusion outside of the scope and requirements of a Statement of Material Facts pursuant to Local

Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

23. On April 20, 2010, in order to halt the ongoing fraud, maintain the status quo and preserve assets for injured investors, the SEC filed a Complaint and Order to Show Cause seeking emergency relief. Dkt.[1] 1-4. Later that day, the Court granted the Commission's application and entered an Order temporarily freezing assets of the defendants and the relief defendant, L. Smith. Dkt. 5.

RESPONSE: Objection. This paragraph improperly contains legal argument, opinion, and conclusory statements outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

24. Following a hearing the Court entered the Preliminary Injunction Order on July 22, 2010. Among other things, the Preliminary Injunction Order confirmed the appointment as Receiver of William J. Brown, Esq., who had been appointed temporarily on April 20, 2010,

[1] "Dkt." refers to docket entry numbers in *SEC v. McGinn, Smith & Co., Inc. et al.*, 10- cv-457 (N.D.N.Y.), pending the final disposition of this action, over the assets of approximately 80 entities that Smith and McGinn controlled, including MS & Co., MS Advisors, MS Holdings, and MS Capital, and the Four Funds. Dkt. 96 at 5-9, Ex. A.

RESPONSE: Admitted.

25. The Court entered a Scheduling Order on September 7, 2010, Dkt. 136, and the parties conducted deposition and document discovery through December 2011.

RESPONSE: Admitted.

26. On February 13, 2012, the Court set a schedule for the filing of dispositive motions. Dkt. 442. On March 27, 2012, however, upon a motion filed by the US Attorney's

Office for the Northern District of New York, the Court stayed all dispositive motions and the trial pending completion of the parallel criminal proceedings. Dkt. 474.

RESPONSE: Admitted.

27. On September 5, 2013, the Court lifted the stay, and further ordered that a briefing schedule on dispositive motions would be "reserved until the SEC is informed of when it can expect a copy of the transcript from the criminal proceedings." Dkt. 589. On January 23, 2014, the Court ordered that dispositive motions shall be filed by July 1, 2014. Dkt. 672. *See also* Dkt. 695 (adjusting briefing schedule).

RESPONSE: Admitted.

28. L. Smith opposed the entry of the Preliminary Injunction, and moved to vacate the Court's freeze over certain assets held in her name: a checking account, a brokerage account (the "Stock Account"), the Sacandaga Lake property, and a vacation home in Vero Beach, FL.

RESPONSE: Admitted.

29. On May 26, 2010, the Trustee for the David L. and Lynn A. Smith Irrevocable Trust U/A dated August 4, 2004 (the "Smith Trust") intervened in order to challenge the freeze over its only asset: a brokerage account. Dkt. 31-35.

RESPONSE: Admitted.

30. Following a three-day evidentiary hearing on June 8, 9 and 10, 2010, the Court ruled that the Stock Account should remain frozen because "the SEC has shown a substantial likelihood of success in proving that [the] . . . Stock Account includes ill-gotten gains to which [Lynn Smith] has no legitimate claim of ownership"; and "David Smith had complete access to and control over the account and that such access and control were maintained for decades." Dkt. 86 at 30-35; *SEC v. McGinn, Smith & Co., Inc., et al.*, 752 F. Supp. 2d 194, 216-217 (N.DN.Y

2010).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

31. For "essentially the same" reasons, this Court also continued the asset freeze as to the Vero Beach vacation home and the checking account. Dkt. 86 at 35-36; 752 F. Supp. 2d at 217.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

32. As to the Trust Account and the Sacandaga Lake property, however, the Court found that the SEC had not established a likelihood that it could prove that David Smith was their beneficial owner, and therefore vacated the freeze as to those assets. Dkt. 86 at 37-41; 752 F. Supp. 2d at 218-219.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

33. The Court also vacated the freeze as to McGinn's residence in Niskayuna, NY, because in 2009 McGinn had transferred title to the house to his wife, Nancy McGinn, who was not a party to the initial Complaint. Dkt. 86 at 41-42; 752 F. Supp. 2d at 219-220.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

34. Between July 7, 2010 and August 3, 2010, a total of $944,848 was transferred out of the Smith Trust's brokerage account to, among other things, pay attorney fees and purchase the Sacandaga Lake property from L. Smith.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to

Plaintiff's Statement of Material Facts into this response.

35. On August 3, 2010 – after the SEC discovered a previously undisclosed "Private Annuity Agreement" between David and Lynn Smith and the Smith Trust – the SEC filed an Amended Complaint, motion for reconsideration of the July 7, 2010 decision, and an application for emergency relief requesting that the Court, among other relief, again freeze the Smith Trust's brokerage account. Dkt. 100, 103.

RESPONSE: Objection. This paragraph improperly contains legal argument outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. David L. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

36. On November 22, 2010, following an evidentiary hearing, the Court issued a decision granting the Commission's motion for reconsideration, and vacated that portion of the July 7, 2010 decision lifting the asset freeze as to the Smith Trust. Dkt. 194 at 23; *SEC v. Wojeski, et al.*, 752 F.Supp.2d 220, 233 (N.D.N.Y. 2010). The Court found that the SEC had shown "a substantial likelihood of success as to the Trust" based on, among other things, evidence that "David Smith maintained control of Trust assets after the Trust was created . . . to ensure that the annuity payments required by the Annuity Agreement could be made beginning in 2015." *Id.*

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

37. The November 22, 2010 decision also found evidence of "fraud, misrepresentation, and misconduct" by L. Smith and others in concealing the existence of the Annuity Agreement, and granted the SEC "leave to move for sanctions against the Trust,

[Trusteee David] Wojeski, [former Trustee Thomas] Urbelis, [Trust attorney Jill] Dunn, Lynn Smith and Lynn Smith's counsel for the conduct described herein." Dkt. 194 at 20 n.17, 24; 752 F.Supp.2d at 231 n.17, 233.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

38. On July 20, 2011, this Court issued a decision granting the SEC's motion for sanctions, finding "that Lynn Smith, Dunn and Wojeski acted with subjective bad faith." Dkt. 342 at 37; *SEC v. Lynn Smith, et al.*, 798 F.Supp.2d 412, 436 (N.D.N.Y. 2011).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

39. Among other sanctions, the July 20, 2011 decision held L. Smith liable for disgorgement of the $944,848 transferred out of the Smith Trust's account; Dunn and Wojeski were ordered to disgorge the fees they received. L. Smith was also ordered to pay the SEC's attorneys' fees of $51,232 incurred in connection with the Annuity Agreement. Should L. Smith fail to pay such amounts, the "SEC may have judgment against L. Smith for any amount which remains unpaid," and the Receiver was granted leave "to take whatever action he deems in his judgment to be financially appropriate to obtain the maximum possible return on the [Sacandaga Lake property], including the sale or rental of that property[.]" Dkt. 342 at 50-5 1; 798 F. Supp. 2d at 442.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

40. On October 6, 2011, this Court entered a Judgment in favor of the SEC stating that "L. Smith is liable for attorney's fees and costs in the amount of $51,232." Dkt. 399 at 2.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

41. The Smith Trust, L. Smith, Dunn and Wojeski filed appeals (Dkt. 128, 279, 296, 379, 380, 381) with the United States Court of Appeals for the Second Circuit. In three opinions, the Second Circuit affirmed all of this Court's orders.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

42. First, Second Circuit affirmed the orders freezing the Stock Account and the Trust. *Smith v. SEC*, 432 Fed. Appx. 10 (2d Cir. 2011).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

43. Second, the Second Circuit affirmed the order allowing the Receiver to sell the Smiths' Vero Beach house. *Smith v. SEC*, 653 F.3d 121 (2d Cir. 2011).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

44. Finally, the Second Circuit affirmed the sanctions against L. Smith; and found no jurisdiction to hear the appeals by Dunn and Wojeski. *SEC v. Smith*, 710 F.3d 87, 98 (2d Cir. 2013) ("The court's finding that Lynn Smith acted in bad faith in not revealing her interest in the Trust is amply supported by the record.").

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

45. As to the order authorizing the Receiver to dispose of the Sacandaga Lake property if L. Smith failed to pay the disgorgement order, the Second Circuit remanded "to allow

the magistrate judge to consider the Trust's arguments in the first instance." 710 F.3dd. at 99.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

46. On remand, and after further briefing, this Court ordered that the Receiver could proceed with the sale of the Sacandaga Lake property. Dkt. 647 at 7.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

47. On December 1, 2010, following the filing of another emergency motion by the SEC, the Court found that, after the entry of the Preliminary Injunction, McGinn engaged in a fraudulent securities offering and that "McGinn has recklessly and willfully initiated and participated in violations of the anti-fraud provisions of the securities laws." Dkt. 207 at 8. The Court, therefore, found McGinn in contempt of the Preliminary Injunction Order, and enjoined him from proceeding with any offering without prior Court approval. Dkt. 207 at 14.

RESPONSE: Objection. This paragraph contains legal argument and opinion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

48. On January 26, 2012, a grand jury returned an Indictment against McGinn and Smith. *United States v. Timothy M. McGinn and David L. Smith,* 12-cr-00028 (DNH) ("MS Criminal Case"), Dkt. 1.

RESPONSE: Admitted.

49. On October 11, 2012, a grand jury returned a Superseding Indictment against McGinn and Smith, which charged them with conspiracy to commit mail and wire fraud (Count 1); mail fraud (Counts 2-10); wire fraud (Counts 11-20); securities fraud (Counts 21-26); and

filing false tax returns (Counts 27-32). App. Ex. 6; MS Criminal Case, Dkt. 25.

RESPONSE: Admitted.

50. A four-week jury trial took place from January 7 through February 1, 2013, in Utica, NY, before Judge Hurd.

RESPONSE: Admitted.

51. On February 6, 2013, after 23 hours of deliberation over four days, the jury returned verdicts. Both Smith and McGinn were found guilty of conspiracy to commit mail and wire fraud (Count 1). McGinn was found guilty of seven counts of mail fraud (Counts 4-10), all ten counts of wire fraud (Counts 11-20), all six counts of securities fraud (Courts 2 1-26), and all three counts of filing false tax returns (Counts 27-29). Smith was found guilty on three counts of mail fraud (Counts 8-10), two counts of wire fraud (Counts 14 and 17), all six counts of securities fraud (Counts 21-26), and all three counts filing false tax returns (Counts 30-32). App. Ex. 23, 24 (MS Criminal Case, Dkt. 104, 108).

RESPONSE: Admitted.

52. Judgments of acquittal were entered as to McGinn (on Counts 2 and 3) and Smith (on Counts 2-7, 11-13, 15, 16 and 18-20). MS Criminal Case, Dkt. 109, 110.

RESPONSE: Admitted.

53. On April 26, 2013, the Court denied McGinn's and Smith's motions for acquittal or, in the alternative, for a new trial. MS Criminal Case, Dkt. 135*; United States v. Timothy M. McGinn and David L. Smith*, 941 F. Supp. 2d 260 (N.D.N.Y. 2013).

RESPONSE: Admitted.

54. On August 7, 2013, the Court sentenced Smith to 10 years' imprisonment and ordered him to pay a $50,000 fine, and sentenced McGinn to 15 years' imprisonment and

ordered him to pay a $100,000 fine. The District Court also ordered that Smith and McGinn be jointly and severally liable for payment of $5,748,722 in restitution payable to the victims of their fraud. In addition, Smith and McGinn were ordered to pay $241,014 and $244,078, respectively, to the Internal Revenue Service. App. Ex. 25, 26.

RESPONSE: Admitted.

55. Judgments against McGinn and Smith were entered on August 13, 2013. App. Ex. 10, 11 (MS Criminal Case, Dkt. 231, 232).

RESPONSE: Admitted.

56. Notices of appeal were filed by Smith and McGinn, on their convictions and sentences, and by the United States, on the sentence only. MS Criminal Case, Dkt. 237, 238, 249, 250,

RESPONSE: Admitted.

57. On July 24, 2012, Brian Shea, the chief financial officer for MS & Co. from April 2009 through April 20, 2010, pled guilty to one count of corruptly interfering with the administration of the internal revenue laws. In his plea agreement, Shea admitted to, at Smith and McGinn' s direction, making false accounting entries and backdating promissory notes to disguise improper transfers of investor funds. App. Ex. 12 at 3-8, 13.

RESPONSE: Objection. This paragraph improperly characterizes and summarizes the felony plea agreement outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Notwithstanding and subject to this objection, the paragraph is otherwise admitted.

58. On March 7, 2013, Shea was sentenced to two years' probation, ordered to perform 100 hours of community service, and ordered to pay a $5,000 fine. App. Ex. 14.

RESPONSE: Admitted.

59. On November 29, 2011, Matthew Rogers, a former senior managing director at MS & Co., pled guilty to one count of filing a false tax return. In his plea agreement, Rogers admitted that he failed to declare as income $948,000 he received from certain McGinn Smith entities from 2008 through 2009 and, at McGinn's insistence, signed backdated promissory notes in November 2009. App. Ex. 15 at 4-8.

RESPONSE: Objection. This paragraph improperly characterizes and summarizes the felony plea agreement outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Notwithstanding and subject to this objection, the paragraph is otherwise admitted.

60. On April 12, 2013, Rogers was sentenced to one year probation and ordered to pay a $10,000 fine. App. Ex. 16.

RESPONSE: Admitted.

61. On November 11, 2011, Ronald Simons, a certified public accountant and partner at the accounting firm of Piaker & Lyons, who prepared tax returns for Smith, McGinn and MS & Co., pled guilty to one count of delivering and disclosing a false federal income tax return. In his plea agreement, Simons admitted to preparing Smiths' 2006 tax return, which did not report $407,000 distributed to Smith from TDM Cable Funding LLC. App. Ex. 17 at 3-4, 21.

RESPONSE: Objection. This paragraph improperly characterizes and summarizes the misdemeanor plea agreement outside the scope and requirements of a Statement of Material Facts pursuant to Federal Rule of Civil Procedure 56 and Local Rule 7.1(a)(3). Notwithstanding and subject to this objection, the paragraph is otherwise admitted.

62. On March 14, 2013, Simons was sentenced to one year probation and ordered to

pay a $5,000 fine. App. Ex. 18.

RESPONSE: Admitted.

63. On April 5, 2010, FINRA charged Smith, McGinn and MS & Co. with violating Section 10(b) of the Securities Act and Rule 10b-5 thereunder, and various FINRA rules. App. Ex. 19.

RESPONSE: Objection. This paragraph improperly characterizes and summarizes FINRA's administrative proceedings outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Mr. Smith specifically objects to the use of the term "charged" in that FINRA is a regulatory entity and lacks the ability to pursue any relief other than administrative remedies pursuant to a complaint. Notwithstanding and subject to this objection, the paragraph is otherwise admitted.

64. On September 14, 2011, FINRA issued a *Default Decision as to Respondents Smith and McGinn*, which barred Smith and McGinn from association with any FINRA member firm. App. Ex. 20.

RESPONSE: Admitted.

65. On February 20, 2014, an Administrative Law Judge issued an *Initial Decision Making Findings and Imposing Sanctions by Default as to Timothy M. McGinn* which permanently barred McGinn from, among other things, associating with any broker, dealer, or investment adviser. App. Ex. 59 (Initial Decision). *See also* App. Ex. 60 (Notice That Initial Decision Has Become Final).

RESPONSE: Admitted.

66. On April 23, 2014, the Commission issued, on consent, an *Order Making*

Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940 as to David L. Smith, which permanently barred Smith from, among other things, association with any broker, dealer, and investment adviser. App. Ex. 61.

RESPONSE: Admitted.

67. The PPMs for the Four Funds did not authorize use of offering proceeds to invest in affiliates of MS & Co.; to redeem investors in earlier MS & Co. offerings; to purchase an investment from an affiliate for more than the affiliate paid; or to redeem investors in the Trust Offerings. App. Ex. 86-89. Nevertheless, Smith used Four Funds proceeds for all these prohibited purposes, starting almost immediately after the launch of FIIN in September 2003.

RESPONSE: Denied. This paragraph is a blatant misstatement on behalf of the plaintiff, contains conclusory statements, and otherwise improperly characterizes and summarizes the content with the exhibit referred to. The PPMs for each of the Four Funds state: "We may acquire such Investments directly, or from our managing member or an affiliate of us or our managing member that has purchased the Investment." Plaintiff's App. Ex. 86-89.

68. Smith approved the content of the Four Funds PPMs.

RESPONSE: Objection. This paragraph is vague, misleading, and ignores that the law firm of Gersten Savage created the Four Funds PPMs. D. Smith Ex. "A", Eric Roper Trial Transcript Excerpts at 764-66. Notwithstanding and subject to said objection, the paragraph is otherwise admitted.

69. The PPMs for the Four Funds all include a subsection titled "Use of Proceeds." App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15.

RESPONSE: Admitted.

70. The "Use of Proceeds" subsection states that net proceeds will be used "to acquire various public and/or private investments." App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15.

RESPONSE: Objection. This paragraph is vague, misleading, and ignores the full three paragraphs contained in the Use of Proceeds subsections. Plaintiff's App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15. Notwithstanding and subject to this objection, the paragraph is otherwise admitted.

71. The PPMs does not state that the proceeds of the Four Funds may be used to invest in affiliates of MS & Co.

RESPONSE: Denied. The PPMs each state "We may acquire such Investments directly, or from our managing member or an affiliate of us or our managing member that has purchased the Investment." Plaintiff's App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15.

72. The PPMs for the Four Funds which state that the Four Funds "may acquire such investments directly or from... an affiliate or managing member," and that if any of the Funds "purchase[s]" an investment from a managing member or affiliate, that Fund will pay the same price it would have paid had it directly purchased the investment. App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15.

RESPONSE: Admitted.

73. The PPMs disclose that MS & Co. as placement agent would receive a one-time 2% commission. App. Ex. 86 at 1, 87 at 1, 88 at 1, 89 at 1.

RESPONSE: Admitted.

74. Each of the Four Funds' PPMs made clear that the investors' risk arose from the investments made by the Funds: "[o]ur cash flow is wholly dependent on our ability to find and

acquire suitable investments. If we are unable to generate a sufficient cash flow, our results of operations and financial condition would be materially and adversely affected and we may be unable to make payments on the notes." See, e.g., App. Ex. 86 at 13. The PPMs also stated that "[o]ur profitability is largely determined by the difference, or 'spread,' between the effective rate we pay on the Investments we acquire and the full rate of return received on such Investments." See, e.g., App. Ex. 86 at 13.

RESPONSE: Admitted.

75. Contrary to the PPMs and at Smith's direction, investor proceeds from the Four Funds offerings were used to pay investor redemptions or interest to investors of pre-2003 MS & Co. offerings and to make loans to entities controlled by McGinn and Smith. App. Ex. 1 at ¶¶ 8-29, 32-34 and 36.

RESPONSE: Objection. This paragraph contains legal arguments and conclusions outside of the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

76. Between the early 1990s and 2003, MS & Co. raised approximately $185 million from investors in dozens of trusts formed to invest in pools of security alarm contracts (the "Pre-2003 Trust Offerings"). App. Ex. 352; App. Ex. 334 at 1. These Pre-2003 Trust Offerings had fixed interest rates and maturity dates. See, e.g., App. Ex. 314 (RTC Trust PPM), 29, 31, 33, 338 (SPT Trust PPMs).

RESPONSE: Admitted.

77. Most of the alarm contracts owned by the Pre-2003 Trust Offerings were rolled into the $200 million IPO of IASG and the Trust investors were redeemed from IPO proceeds. App. Ex. 332 at 15. However, several Pre-2003 Trust Offerings were not rolled into the IASG

IPO and relied on $12.8 million in financial support from the Four Funds offerings. App. Ex. 1 at ¶ 8; at 44 (Palen Ex. 8).

RESPONSE: Objection. This paragraph contains legal arguments and conclusions outside of the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

78. Under the Pre-2003 Trust Offering PPMs, the noteholders were supposed to be paid from the cash flow generated by the pool of contracts. See, e.g., App. Ex. 29 at 13.

RESPONSE: Objection. This paragraph is vague, overbroad, and otherwise irrelevant. It is therefore denied.

79. Smith's 1999 letter to McGinn acknowledged the failure of the Pre-2003 Trust Offerings. App. Ex. 54, and 55 Smith stressed the need to "develop[] a course of action that will stave off our immediate financial crisis" because "if our trusts go into default, everything else will come apart." App. Ex. 55 at 3, 5. MS & Co. had "become addicted to the cash flow from the trust business, and without them will have a difficult time surviving." App. Ex. 55 at 5. Smith characterized the use of new dollars to "fulfill the investment promise to earlier investors" as a "Ponzi scheme." App. Ex. 55 at 7. Smith stated that the "default of the trusts will drastically reduce revenues, . . . bring on crushing litigation . . and prosecution by regulators or worse." Id.; see also id. at 6, 10 (Smith feared criminal prosecution). Smith suggested that MS & Co. "restructure debt and reduce present financing costs." App. Ex. 55 at 20.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and

included only to mislead the Court. It is therefore denied.

80. The "restructure" that Smith wrote of came in the form of the IASG IPO: MS & Co. solved its Pre-2003 Trust Offering cash flow shortfall by using approximately $35 million raised through the IASG IPO to redeem Pre-2003 Trust Offering investors. App. Ex. 332 at 16; App. Ex. 55 at 20. As Shea testified, "a big part of the IPO was to relieve all the high interest rate payments."

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

81. Smith used Four Funds proceeds to either: (1) purchase alarm contracts from Pre-2003 Trust Offerings for more that their initial cost; or (2) make loans to these trusts for the purpose of redeeming or making interest payments to investors. App. Ex. 1, ¶¶ 8-29. This was contrary to the investment mandate in the Four Funds PPMs, which stated that investments were acquired from affiliates "we will not pay above the price paid by our managing member or such affiliate for the Investment." App. Ex. 86 at 15, 87 at 15, 88 at 15, 89 at 15).

RESPONSE: Objection. This paragraph contains improperly legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

82. The Four Funds purchased alarm contracts from four of the Pre-2003 Trust Offerings, Security Participation Trust I ("SPT I"), Security Participation Trust II ("SPT II"), Security Participation Trust III ("SPT III"), and Security Participation Trust IV ("SPT IV") for

an amount equal to the amount these trusts needed to redeem SPT investors. The amount the Four Funds paid for the alarm contracts exceeded the amount that the SPTs initially paid for them years earlier, despite the fact that the income from those same contracts had, in Smith's words, "been substantially reduced due to attrition." App. Ex. 1, at ¶¶ 8-29; at 45 (Palen Ex. 9) App. Ex. 27 at 3, App. Ex. 47 at 3.

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, it contains improper characterization of Mr. Smith's writing and is taken from a time period years prior to the allegations contained in plaintiff's Second Amended Complaint. It is therefore denied.

83. These purchases were negotiated and signed by and between Smith for the Four Funds, as the "buyer," and McGinn for the Pre-2003 Trusts, as the "seller." App. Ex. 1 at ¶ 40. App. Ex. 28, 30, 32. Smith instructed his staff to create purchasing agreements retroactively in April 2009. App. Ex. 35. In September 2007, MS & Co.'s accounting staff determined that the Four Funds paid a total premium of around $5.5 million for the SPT Trust alarm contracts. App. Ex. 49 at 6.

RESPONSE: Objection. This paragraph contains improper characterization of the transactions and instructions from Mr. Smith. It is therefore denied.

84. FIIN, FEIN, and TAIN funds were used to redeem a customer invested in Pacific Trust. App. Ex. 1, ¶¶ 22-23. Letters of credit between the Funds and Pacific Trust were backdated for this transaction as well. Id. at ¶ 23. Similarly, FEIN and FAIN loaned over $750,000 to pay RTC Trust interest after that trust failed to generate sufficient income. Id. at ¶¶ 24-27. FAIN made a $1 million "investment" in SAI Trust in connection with an investor

redemption. Id. at ¶¶ 2 8-29.

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It further improperly characterizes the transactions. It is therefore denied.

85. Smith acknowledged the use of Four Funds money to support the Pre-2003 MS Trusts in an internal memorandum dated November 25, 2007: "A substantial amount of investment dollar went to refinance alarm contracts that were due in 2003. The income from these contracts had been substantially reduced due to attrition . . . we felt that other investment returns would make up for the shortfall in cash flow from the alarm contracts. This proved not to be the case." App. Ex. 47, 27.

RESPONSE: Admitted.

86. The SPT notes were three-year notes due on or about November 1, 2003 at maturity. App. Ex29 (SPT PPM).

RESPONSE: Admitted

87. FIIN entered a purchase agreement with SPT in the amount of 2,090,000, dated November 1, 2003 ("SPT I"). App. Ex. 1, ¶ 12, App. Ex. 28, 339 Smith Dep. 210:11-16, 203:24 – 205:8.

RESPONSE: Admitted.

88. The SPT I purchase agreement was signed by Smith on behalf of FIIN as managing director and McGinn on behalf of SPT I. App. Ex. 1, ¶ 20; App. Ex. 28; App. Ex. 339.

RESPONSE: Admitted.

89. Smith and McGinn jointly decided on behalf of MS Advisors to pay $2,090,000

for the assets acquired pursuant to SPT I. App. Ex. 289; 290 (Smith Dep. 211:16-24, December 13, 2011; Smith Dep. 238:6-13, December 14, 2011.)

RESPONSE: Admitted.

90. MS & Co. as trustee of SPT made the decision on behalf of SPT to accept $2,090,000 for the assets in question in SPT I. App. Ex. 28; App. Ex. 289 (Smith Dep. 212:6-11, December 13, 2011.)

RESPONSE: Admitted.

91. Smith and McGinn, as principals of MS Advisors, had a fiduciary responsibility to FIIN note holders to pay the least possible price for the SPT I assets. App. Ex. 289 (Smith Dep. 216:20 – 217:22, December 13, 2011.)

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

92. As principals of MS & Co., Smith and McGinn had a fiduciary responsibility to the SPT note holders to receive the highest possible price for the SPT I assets. App. Ex. 289 (Smith Dep. 216:20 – 217:22, December 13, 2011.)

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

93. No third party was brought in to conduct an independent evaluation of the SPT I assets. App. Ex. 289 (Smith Dep. 218:3 – 219:16, December 13, 2011.)

RESPONSE: Admitted.

94. The Four Funds subsequently acquired other SPT assets, in purchase agreements

SPT II, III, and IV. App. Ex. 1, ¶ 14-19; App. Ex. 290; (Smith Dep. 267:17 – 268:5, December 14, 2011; McGinn Dep. 110:13 – 112:21, December 15, 2011.)

RESPONSE: Admitted.

95. The sales of SPT I, II, III, and IV assets to the Four Funds all coincided with the maturation of the SPTs. (McGinn Dep. 112:22-25, December 15, 2011.)

RESPONSE: Admitted.

96. If the SPT I, II, III, and IV assets had not been sold to the Four Funds, McGinn, representing the trustee for the SPT, would have had to seek the consent of SPT note holders to extend the maturity dates. (McGinn Dep. 113:6 – 114:10, December 15, 2011.)

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

97. Overall, MS & Co. overpaid for the SPT contracts by at least $5.5 million. (See App. Ex. 49 at 6)

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

98. The Four Funds PPMs did not disclose that the Funds would directly invest in affiliates of McGinn and Smith. See, e.g. App. Ex. 86 at 15. In November of 2007, Smith recognized that:

> [O]ne of the more troubling aspects of the [Four Funds] investments has been my willingness to make substantial investments in affiliated entities, both because they were available and in some cases, such as Coventry, new investments were needed to support past investments. Thus, in the case of Coventry, alseT, EXBV the pattern was often the same; invest more money to support the original investment. In all cases this has proved to be a poor decision and has not only

aggravated our cash flow problems, but puts us in some legal jeopardy as well. App. Ex. 47 at 3, 27 at 3.

RESPONSE: Objection. This paragraph improperly characterizes Mr. Smith's November 2007 writing and the PPMs of the Four Funds See Plaintiff's App. Ex. 86 at 15. It is therefore denied.

99. By December 31, 2007, investments in affiliates accounted for over half of the investments made by the Four Funds – a total of approximately $40.3 million. App. Ex. 1, ¶ 30; see also id. at 46-52 (Palen Ex. 10-14). With the exception of an investment in Pine Street Capital Partners ("Pine Street"), most the affiliated investments provided no cash flow to the Four Funds, however, the investment plus accrued interest remained on the Four Funds balance sheet at cost. App. Ex. 1 at ¶ 30.

RESPONSE: Objection. This paragraph improperly characterizes investments and is based on an inaccurate understanding of the investment structures. It is therefore denied.

100. Joseph Carr was General Counsel at MS & Co. Smith and McGinn never asked Carr whether the Four Funds could make loans to affiliated companies. App. Ex. 354 at 33. In early 2010, Carr read the PPMs for the Four Funds, and testified at his deposition that "I formed an opinion that they [loans to affiliates] were not appropriate . . . it couldn't loan money to an affiliated company. That was my reading of the PPMs." Id. At 33-34.

RESPONSE: Objection. This paragraph is irrelevant and mischaracterizes how MS & Co.'s legal work was performed as the law firm of Gersten Savage primarily handled the securities work for MS & Co. Notwithstanding and subject to said objection, the paragraph is otherwise admitted.

101. The Four Funds invested approximately $8.8 million – 10% of the money raised from

Four Funds investors – in an affiliated start-up company, alseT IP Management ("alseT"). App. Ex. 1, ¶ 31; at 67 (Palen Ex. 23).

RESPONSE: Admitted.

102. Newton Advisors, which was owned by Smith (30%) and Livingston (70%), was a managing member of alseT and owned a 24.1% interest. App. Ex. 306 at 2. App. Ex.323 at 27. App. Ex. 53 at 41. Livingston was also an officer of alseT.

RESPONSE: Admitted.

103. alseT had no revenues. App. Ex. 1 ¶ 31. To make its quarterly interest payments due on loans from FIIN, TAIN, and FAIN, alseT had to borrow additional money. App. Ex. 1 ¶ 31; id. at 67 (Palen Ex. 23); App. Ex. 318.

RESPONSE: Objection. This paragraph improperly characterizes the alseT investment. It is therefore denied.

104. In a memorandum to Smith and McGinn in December 2007, Livingston recognized "the obvious conflicts of interest that existed between [alseT as] borrower and [MS & Co. as] lender." App. Ex. 50 at 4. As of December 2, 2007, MS & Co. considered its investment in alseT to be worthless. App. Ex. 1 ¶ 31 (citing App. Ex. 47 and 48).

RESPONSE: Objection. This paragraph improperly characterizes the exhibits upon which it relies. It is therefore denied.

105. Livingston was paid $40,000 per month from alseT beginning in January 2006 through April 2007, for a total of $640,000. App. Ex. 324.

RESPONSE: Admitted.

106. Another example of a failed affiliated entity investment is FEIN' s investment in Capital Center Credit Corporation ("C4"). C4 was an MS & Co. entity controlled and used by

Smith and McGinn to cover cash short falls in the Pre-2003 Trust Offerings. App. Ex. 1, ¶ 32; App. Ex. 55 at 6-7; App. Ex. 307.

RESPONSE: Objection. This paragraph improperly characterizes the investment and the 1999 unsent letter written by Mr. Smith. Furthermore, it contains conclusory statements outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

107. On March 23, 2004, Smith wrote to the SEC Broker-Dealer Inspection Program—which had concluded that C4 was "an unregistered broker-dealer," see RMR Ex. 874—to report that "[C4] is a business that will shortly be liquidated" and that "the only solution is to cease any activities [of C4] that might be construed as a securities transaction and to orderly liquidate the [C4]." App. Ex. 56 at 2.

RESPONSE: Admitted.

108. In January 2004, FEIN made a $500,000 loan to C4 to redeem an investor. App. Ex. 1 at ¶¶ 32-34. By the end of 2007, the Four Funds had a cumulative total investment in C4 of $720,231, including accrued interest, which was written off in full as of December 31, 2009. Id. at ¶ 34.

RESPONSE: Admitted.

109. In June 2004, FEIN loaned MS & Co. affiliated entity JV Associates $95,000, which JV Associates used to pay four delinquent mortgage payments for August to November 2002. App. Ex. 1 ¶ 35. Smith and McGinn were limited partners of JV Associates, each owning approximately 20% interest, and the FEIN promissory note was signed by McGinn on behalf of JV Associates. App. Ex. 342. No interest or principal payments were ever made to FEIN, and the balance remained on FEIN's books through December 31, 2009, when it was written off.

App. Ex. 1 ¶ 35.

RESPONSE: Admitted.

110. Beginning in 2005, Smith invested Four Funds proceeds in two companies controlled by MS & Co. Senior Vice President of Corporate Finance Mark Casolo: Atlantis Strategic ($12,500) and Caribbean Club International (CCIG) ($1.2 million). App. Ex. 1 at 51 (Palen Ex. 14). Casolo is currently in a state prison after pleading guilty to stealing $1.7 to $2.2 million (after leaving MS & Co.).

RESPONSE: Objection. This paragraph contains irrelevant statements that do not pertain to any of the claims in plaintiff's Second Amended Complaint. It is therefore denied.

111. In 2007, Smith caused FEIN, TAIN and FAIN to invest $2 million in 107th Associates, a company whose assets Smith controlled. App. Ex. 1 at 51 (Palen Ex. 14); see also Dkt. No. 96 at 13 (107th Associates listed as a Receivership entity "controlled by McGinn and/or Smith").

RESPONSE: Admitted.

112. Smith invested a total of $120,000 raised from Four Funds investors in Century Same Day Surgery and approximately $7.6 million in Coventry Resources Corporation ("Coventry"). App. Ex. 1 at 46-51(Palen Ex. 10-14). Smith served as chairman of the board of directors for both entities**.** App. Ex. 369 at 6; App. Ex. 360**.**

RESPONSE: Admitted.

113. All of the Four Funds provided loans to Coventry. App. Ex. 290 (Smith Dep. 307:22 – 308:2, December 14, 2011.) McGinn, Smith Partners had an ownership interest in Coventry. App. Ex. 290 (Smith Dep. 308:6-12, December 14, 2011.) The Four Funds continued

to invest in Coventry even after losses became apparent. App. Ex. 290 (Smith Dep. 3 12:20 – 313:4, December 14, 2011.)

RESPONSE: Admitted.

114. In his December 2007 memorandum to Smith and McGinn, Livingston criticized the "losses approaching some $45 million" that the Four Funds had suffered, as well as the "HUGE conflicts" in the Coventry investment. App. Ex. 50 at 4.

RESPONSE: Objection. This paragraph improperly characterizes the exhibit upon which it relies as the exhibit does not make any specifications to the Four Funds. It is therefore denied.

115. The Four Funds made numerous transfers to McGinn Smith affiliates, including M&S Partners (approximately $604,000); McGinn, Smith Acceptance Corp. ($121,790); McGinn, Smith & Co. Preferred Stock ($820,800); MS Holdings ($350,000); and McGinn, Smith Licensing LLC ($75,000). App. Ex. 1 at 140 (Palen Ex. 14); see also Dkt. No. 96 at 13-14 (Order listing entities "controlled by McGinn and/or Smith").

RESPONSE: Admitted.

116. Seton Hall, which received $14,190 from FAIN, was a medical office building in Troy, NY, that Smith and McGinn purchased through a limited partnership; they also financed the mortgage through a private placement. App. Ex. 1 at 51 (Palen Ex. 14); ,Dkt. No. 96 at 14 (Seton Hall Associates listed as a Receivership entity "controlled by McGinn and/or Smith").

RESPONSE: Admitted.

117. Smith invested $1.4 million raised from TAIN investors in State Street Hospitality, a hotel project in which MS & Co. had an equity interest. App. Ex. 1 at 51 (Palen

Ex. 14).

RESPONSE: Admitted.

118. Other Four Funds' investments in affiliated entities are described in Exhibit 14 to the Palen Declaration. App. Ex. 1 at 5 1-52 (Palen Ex. 14).

RESPONSE: Admitted.

119. The Four Funds paid approximately $7.7 million in underwriting, management and administrative fees to MS & Co. during the period 2003 through 2009. App. Ex. 1 at ¶ 39; id. at 58 (Palen Ex. 16); App. Ex. 21. Tax returns reflect that the Four Funds paid MS & Co. fees of approximately $1.5 million in 2004; approximately $2.6 million in 2005; approximately $2.5 million in 2006 and approximately $380,000 in 2007. App. Ex. 1, ¶ 39; id. at 58 (Palen Ex. 16).

RESPONSE: Objection. This paragraph improperly characterizes the fee structure of the funds and does not account for legal fees or advisory fees. It is therefore denied.

120. The Four Funds used money from each other to pay investor redemptions and interest. For example, FEIN's January and February 2005 interest payments, and a $2 million investor redemption, were paid in part using nearly $2 million of TAIN investor funds. According to bank and accounting records, in February 2007, TAIN "loaned" FEIN $450,000 to redeem an investor and to pay interest due to investors. App. Ex. 1 ¶ 36; at 51 (Palen Ex. 14).

RESPONSE: Objection. This paragraph contains conclusory statements outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

121. Just before November 25, 2007, around the time Smith acknowledged in writing the "troubling" problems that arose from his "willingness to make substantial investments in affiliated entities, App. Ex. 27 at 3-4, Smith used Four Fund assets to redeem preferred investors

approximately $2.7 million. Smith used Pine Street Capital, one of the only assets the Four Funds owned that had any real value, to redeem his preferred customers out of the Four Funds in September and October 2007. App. Ex. 1, ¶ 40 (citing App. Ex. 320 and 317).

RESPONSE: Objection. This paragraph contains conclusory statements outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

122. By the end of 2007, the Four Funds owed investors a total of approximately $84 million according to the Funds' financial statements. App. Ex. 1 at ¶ 37, at 51 (Palen Ex. 14). MS & Co. estimated that at that time, the investments held by the Four Funds were worth only approximately $37 million. App. Ex. 1 at ¶ 37 (citing App. Ex. 47 and 48).

RESPONSE: Objection. This paragraph assumes that the Funds' financial statements were accurate despite the plaintiff's knowledge that there were hundreds if not thousands of accounting errors that were made by the MS & Co. accounting staff over the course of the time in question. It is therefore denied.

123. In addition to the Four Funds' cash deficits and inability to pay fees during 2007, and the problems with redeeming investors' Four Funds notes maturing in 2008, Smith's more immediate concern was the inability to pay the approximately $700,000 due to the brokers for their Four Funds annual commission payment on December 15, 2007. See App. Ex. 47 at 1. As discussed below, the shortfall that MS & Co. was experiencing from the lack of fees coming in from the Four Funds was made up by unauthorized payments made to MS & Co. from the Trusts.

RESPONSE: Objection. This paragraph mischaracterizes the exhibit upon which it relies and otherwise contains conclusory statements outside the scope and requirements

of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

124. By at least December 2006, Smith instituted a policy (hereinafter the "Redemption Policy") that in order for the Four Funds LLC to redeem an existing customer on his or her maturing Four Funds note, MS & Co. brokers needed to find a new customer to purchase that note. *See, e.g.,* App. Ex. 37.

RESPONSE: Objection. This paragraph improperly characterizes the direction given by Mr. Smith and ignores the purpose of avoiding duplicate sales commissions to the brokers. It further has no relevance to any of the claims in plaintiff's Second Amended Complaint. It is therefore denied.

125. The Redemption Policy, which required brokers to find a buyer for maturing notes if the customer wanted to redeem, was a significant departure from the terms of the PPM. The Four Funds PPMs provided that interest payments and redemptions would be made from underlying assets and their cash flow, and contained no language making redemption contingent upon finding a new customer. *See, e.g.,* App. Ex. 86 at 12.

RESPONSE: Objection. This paragraph contains an improper characterization of the internal directive. Further, it is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

126. The existence of the Redemption Policy is confirmed by numerous emails. On November 14, 2006, at 11:31 am, Guzzetti received an email from Sicluna stating: "Andy, Lex is going to replace all of his clients that are redeeming. We need to know what Frank, Phil, Brian and Dick are going to do." App. Ex. 44.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

127. On December 21, 2006, Sicluna forwarded Guzzetti an email exchange between her and Smith. Sicluna had informed Smith that a Rabinovich client wanted to purchase a $100,000 TDM Cable 06 note with the proceeds of a maturing TAIN $100,000 note, and she asked Smith "Is there any problem with him doing this?" Smith responded "yes. Phil needs to replace the $100,000 before doing the trade. I am running on fumes with all these redemptions and cannot afford any more. Please inform Andy [Guzzetti]." App. Ex. 37.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

128. In his deposition, Guzzetti testified that this email meant that TAIN did not have sufficient capital on hand to redeem a noteholder, and that Smith's instruction in the email was not consistent with the PPM. App. Ex. 110 at 156.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

129. On February 2, 2007, Guzzetti forwarded to Smith an email stating "I want to make sure you are aware of this possible problem." In the email, an administrative staff person noted that "[w]e do not have the funds ava[ilable] [to redeem a $200,000 FEIN note] unless you have cks/pmts that come in today's mail, we would need about 125K to come in to cover this request." App. Ex. 41.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

130. On November 10, 2007, Smith emailed Guzzetti after learning that Feldmann and Gamello "were redeeming some Fains in order to roll into First Line." Smith's instructions to Guzzetti were clear: "I want it clear to all brokers that is not permissible. With the interest

payment coming due and commissions payable in December I do not have the liquidity. ***Any redemptions have to have replacement sales beforehand***. . . . My preference is for there to be no redemptions. . . . Please handle this with TLC. We need some team play and cooperation." App. Ex. 42 (emphasis added).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

131. Guzzetti responded to Smith the next day and, referring the Guzzetti' s regular Monday conference calls with all brokers, told Smith that "[y]ou may have to get on the call Monday afternoon." App. Ex. 42.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

132. On November 12, 2007, Guzzetti reported back to Smith on the same day that "[c]all went well. Not a lot of discussion. I am not sure they believe us about redemptions. I have a feeling they are thinking if push comes to shove we have to redeem." App. Ex. 43.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

133. On November 15, 2007, Guzzetti emailed an MS & Co. broker to point out that the broker's clients "redeemed $235,000 of the 1yr FAINS and we have not gotten any replacement tickets for the redemptions." App. Ex. 38. Guzzetti followed up on November 16, 2007, by stating "As we have discussed on numerous calls. Dave has asked that you replace all redemption $'s with new money." *Id.*

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

134. On January 16, 2008, responding to an email from another MS & Co. broker asking for "an answer on payout to [customer] redemptions," Guzzetti stated "Sorry for not getting the answer sooner, but I wanted to connect with Dave Smith. ***Dave [Smith] is not changing his position....if a client wants to redeem out of a 1 yr piece of paper. We must have the fc [financial consultant] replace it***." App. Ex. 46 (emphasis added).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

135. The Redemption Policy continued through 2009. On March 17, 2009, in response to an email from an MS & Co. broker requesting immediate redemption for certain TDM Verifier 07R customers, Smith instructed "[i]t would be helpful if you could sell the $125,000 worth of redemptions." The broker responded "[w]hen the TDM was given to the sales force to sell about 20 months ago, we were not told that investors could only redeem if a new client took them out. My clients continue to ask me if they've bought into a Ponzi Scheme[.]" App. Ex. 39.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

136. On November 23, 2009, Guzzetti emailed McGinn and Smith about a client who is "very antsy" about a redemption that had been requested in June. Smith responded the next day: "Andy, Brokers are asked to replace clients seeking redemption." App. Ex. 45.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

137. On or about January 15, 2008, Smith wrote a letter that was sent to Four Funds junior note holders, informing them that their interest payments would be reduced to 5% from 10.25%, and attributing the change to "the sub prime mess."); App. Ex. 121 at 1.

RESPONSE: Admitted.

138. The January 2008 reduction in interest on the Four Funds junior notes constituted an Event of Default, as defined in the Four Funds PPMs, because it was "a failure to pay interest on a note" and a "failure to observe or perform any material covenant." *See, e.g.,* App. Ex. 86 at 19. The PPMs provided that if an Event of Default occurred, "the trustee or the holders of at least a majority in aggregate principal amount of the then outstanding notes for such tranche may declare the unpaid principal and any accrued interest on the notes to be due and payable immediately." *Id.*

RESPONSE: Objection. This paragraph contains legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Summary Judgment 56. It is therefore denied.

139. On or about January 25, 2008, an MS & Co. broker emailed Smith that, "I think the fiduciary responsibility to the clients has been breached since none of these clients were aware of the pending problems in the Third Albany Income Notes.... [C]lients have expressed concern that they were misled about material characteristics of these investments. I was not aware that the same investments were put in each note. I went out of my way to make sure clients were spread among the various notes so that they would have DIVERSIFICATION." App. Ex. 371.

RESPONSE: Admitted.

140. On or about April 11, 2008, Smith sent a second letter to the junior note holders. App. Ex. 355 at 1.

RESPONSE: Admitted.

141. The April 2008 letter stated that in light of the circumstances highlighted in the

earlier January 2008 letter, and because two investments had eliminated their dividends or ceased distributions, the Four Funds were "forced" to eliminate the interest payments on Secured Junior Notes for the quarter. App. Ex. 355 at 1-2.

RESPONSE: Admitted.

142. On or about October 13, 2008, Smith wrote and caused to be sent a letter to note holders in all tranches of the Four Funds. App. Ex. 356 at 1.

RESPONSE: Admitted.

143. The October 2008 letter included an attached restructuring plan extending the maturity dates of the notes and reducing interest payments for all tranches. App. Ex. 356 at 8-9.

RESPONSE: Admitted.

144. The October letter stated that MS Advisors and MS & Co. "will be making its own sacrifice" by "forfeit[ing] all such future fees while this reorganization plan is in effect." App. Ex. 356 at 4. The October 2008 letter also described the "financial crisis" broadly, including the collapse of hundreds of banks and mortgage companies, and a 500-point drop in the Dow Jones Industrial Average. App. Ex. 356 at 2-3.

RESPONSE: Admitted.

145. MS & Co. raised approximately $41 million from investors in the Trust Offerings and MSTF. App. Ex. 1 at ¶¶ 41, 70; id. at 39-40 (Palen Ex. 3, 5).

RESPONSE: Denied. This amount improperly includes the "roll ups" that were included in a number of the Trust Offerings. See Plaintiff's App. Exs. 64-82. The amount raised was $32,347,000.00. See D. Smith Ex. "B", Analysis of Trust Payments.

146. Proceeds raised from the Trust Offerings were supposed to be used to invest in specific streams of receivables, usually related to long term contracts for burglar alarm service,

"triple play" (broadband, cable and telephone) service or luxury cruise cabin bookings. App. Ex. 1 at ¶ 42.

RESPONSE: Admitted.

147. According to the Trust Offerings PPMs, the funds raised from investors would first be deposited into the Trust's escrow account and, after deducting the disclosed fees and other deal costs, the "net proceeds" would be advanced to a funding entity, which would or had already entered into an agreement with a third party to purchase the underlying asset. App. Ex. 1 at ¶ 42. The funding entity was typically McGinn Smith Funding LLC or TDM Cable Funding LLC. *Id*.; see also App. Ex. 1 ¶ 42; *id*. at 59 (Palen Ex. 17).

RESPONSE: Admitted.

148. Once the investor funds were deposited into the escrow account and transferred to the funding entity, they were used to enrich McGinn, Smith or M. Rogers personally, to support MS & Co. or to support other MS & Co. entities as liquidity needs dictated. App. Ex. 1 ¶ 43.

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. The funds were used in accordance with the terms of the PPMs. See Plaintiff's App. Exs. 64-82.

149. For each Trust offering, less than the amount represented in the PPM was actually invested in the specific streams of receivables. App. Ex. 1 ¶ 44.; see also id. at 60-62 (Palen Ex. 18). In the aggregate, only 58% of money raised from Trust Offering investors was invested in disclosed assets, as compared to the 85% promised (in the aggregate) by the Trust Offerings PPMs. App. Ex. 1 ¶ 44 and App. Ex. 1 at 60-62 (Palen Ex. 18).

RESPONSE: Denied. See Plaintiff's App. Exs. 64-82. See D. Smith Ex. "C", G.

Smith Trial Transcript.

150. Smith, McGinn and M. Rogers took approximately $4.7 million from Trust escrow and funding entity accounts. App. Ex. 1 at ¶ 47, at 42-43 (Palen Ex. 7). These payments were not authorized by the Trust Offering PPMs. Id. ¶ 47.

RESPONSE: Denied. See Plaintiff's App. Exs. 64-82. See D. Smith Exs. "C" and "D", G. Smith Trial Transcript, R. Engel Trial Transcript.

151. The Trust Offerings PPMs disclosed combined maximum underwriting fees and other fees payable to MS & Co of up to $3.2 million. App. Ex. 1, ¶ 46, id. At 40 (Palen Ex. 5). However, from October 2006 through December 2009, MS & Co. received in excess of $6.4 million in connection with the Trust Offerings. App. Ex. 1, ¶ 46; id. at 41 (Palen Ex. 6).

RESPONSE: Denied. See D. Smith Ex. "C", G. Smith Trial Transcript.

152. In December 2005, MS & Co. and NFS entered into a Fully Disclosed Clearing Agreement (the "Clearing Agreement"), which required that MS & Co. maintain a minimum net capital of $250,000. App. Ex. 52.

RESPONSE: Admitted.

153. NFS kept track of MS & Co.'s net capital through its Focus Reports. In an MS & Co. management meeting on March 17, 2009 attended by McGinn and Smith, one of the agenda items was "[r]eview of current financial position, including net capital[.]" App. Ex. 40.

RESPONSE: Admitted.

154. On October 3, 2007, NFS sent a letter to Smith stating that MS & Co.'s Focus Report indicated that its "net capital is below the NFS Net capital requirement." This letter further requested that Smith "address this deficiency immediately as continued violation may result in termination of the [Clearing Agreement]." App. Ex. 52 at 1.

RESPONSE: Admitted.

155. Seven subsequent letters from NFS to Smith dated March 28, 2008; April 30, 2008; October 28, 2008; December 1, 2008; January 29, 2009; March 5, 2009; and April 7, 2009, similarly noted MS & Co.'s net capital violation and requested that Smith bring MS & Co. back into compliance. App. Ex. 51, 52.

RESPONSE: Admitted.

156. In a letter dated April 24, 2009, which noted that "NFS has sent McGinn Smith numerous notices informing McGinn Smith of such net capital deficiency," NFS exercised its right "to terminate its clearing relationship with McGinn Smith effective May 26, 2009." App. Ex. 51 at 7. NFS rescinded the termination on May 15, 2009, "due to the representation by [MS & Co.] that capital has been infused into the broker dealer to meet the NFS net capital requirement and contingent upon [MS & Co.'s] agreement to transition all proprietary Promissory Notes from the NFS platform to another custodian." App. Ex. 51 at 9.

RESPONSE: Admitted.

157. As soon as June 3, 2009, Smith received yet another letter from NFS stating that its net capital was below the NFS requirement. App. Ex. 51 at 11. Additional violations were noted in letters dated June 29, 2009 and August 31, 2009. App. Ex. 51 at 12, 13. Smith's response to NFS emphasized MS & Co. securities offerings as an answer to its net capital problems. A letter from Smith to NFS dated March 20, 2009, stated "we are presently pursuing as capital raise of approximately $500,000 which we believe will be in place by June 1, 2009." App. Ex. 51 at 5.

RESPONSE: Admitted.

158. The final violation letter from NFS dated September 29, 2009, stated that due to

MS & Co.'s continued breach of the Clearing Agreement, "NFS has decided to terminate its clearing relationship with McGinn Smith." App. Ex. 51 at 15.

RESPONSE: Admitted.

159. Smith was principally responsible for the Four Funds and made the investment decisions. App. Ex. 108 at 3163.

RESPONSE: Admitted.

160. David Rees was the comptroller at MS & Co. from August 2002 through April 2009. App. Ex. 105 at 903. As comptroller, Rees' responsibilities were "preparing the financial statements, ensuring brokers were paid, doing accounts payable, maintaining the firm's financial statements, and handling the net capital calculation for the firm." App. Ex. 105 at 905.

RESPONSE: Admitted.

161. Rees testified that, "it became difficult for the [Four] Funds to make their regular interest payments." App. Ex. 105 at 913-914.

RESPONSE: Admitted.

162. In late 2007, Rees analyzed the Four Funds portfolio and determined that they "were under water by . . . forty million dollars"; in other words, they were worth only about 50% of the amount owed investors. App. Ex. 105 at 9 14-915. Rees told Smith about the losses in the Four Funds. App. Ex. 105 at 916-9 17.

RESPONSE: Denied. Mr. Rees lacked the background and ability to analyze the Four Funds portfolio and any analysis performed by him is unreliable, inaccurate, and without any adequate basis. See D. Smith Ex. "E", D. Smith Four Funds Analysis; Plaintiff's App. Ex. 108 at 3165-3166.

163. On December 2, 2007, Smith received an email from Rees showing a $48.8

million deficit in the Four Funds. App. Ex. 108 at 3165-3166.

RESPONSE: Admitted.

164. On December 27, 2007, Smith signed a subscription agreement for a $20,000 purchase of a TAIN 7.75% note for an investor named Harold Smith. App. Ex. 174 (GM26). Smith did not alert the investor or his broker to the issues regarding the Four Funds losses or to avoid the sale. App. Ex. 108 at 3168-3169.

RESPONSE: Admitted as to the first sentence only. Objection to the second sentence as it conclusory and assumes Mr. Rees's analysis was accurate. It is therefore denied.

165. Smith had access to the bank balances for the Four Funds and could see whether interest payments were being made. App. Ex. 105 at 916.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

166. In 2008, interest payments to Four Funds investors were reduced and then eliminated. App. Ex. 121; App. Ex. 122.

RESPONSE: Admitted.

167. Brian Cooper was a senior accountant at MS & Co. from April 2007 to July 2010. App. Ex. 102 at 980. He maintained the Quicken records, reconciled the bank statements, tracked funds in and out of the accounts, and made scheduled payments to investors. App. Ex. 102 at 981-982.

RESPONSE: Admitted.

168. At McGinn's direction, however, Cooper testified that certain "preferred investors" received their interest payments while others did not. App. Ex. 102 at 1015-1016.

MSTF funds were used to pay the preferred investors. App. Ex. 102 at 1017.

RESPONSE: Objection. This paragraph contains legal argument and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. It is further denied on the basis that MSTF funds were not used to pay preferred investors, but rather accumulated advisory fees due to Mr. Smith and Mr. McGinn were used to pay certain investors. See D. Smith Ex. "C", G. Smith Trial Transcript.

169. Four Funds proceeds, however, as directed by McGinn or Smith, were used to pay MS & Co.'s payroll. See App. Ex. 119; App. Ex. 102 at1021-1023.

RESPONSE: Objection. This paragraph contains legal argument and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. It is further denied on the basis that any Four Funds proceeds that were allocated to payroll was an error on the behalf of Mr. Cooper, not at the direction of Mr. McGinn or Mr. Smith. See D. Smith Ex. "C", G. Smith Trial Transcript.

170. After the Four Funds were restructured, "they stopped paying interest. There was a preferred bunch of investors that were invested in the Four Funds that were receiving payments from MSTF." App. Ex. 105 at 942; App. Ex. 118. Rees also knew that Four Funds money was moved through MSTF to meet payroll. App. Ex. 105 at 944-945; App. Ex. 119.

RESPONSE: Denied. Mr. Smith's incorporates his responses to paragraphs 168 and 169 into this response.

171. The Four Funds PPMs did not permit offering proceeds to be used for MS & Co.'s payroll. App. Ex. 107 at 500.

RESPONSE: Admitted.

172. Four Funds proceeds were also improperly used to redeem investors in pre-2003 MS & Co. offerings. Cooper kept the books for RTC Trust, a pre-2003 MS & Co. offering. App. Ex. 102 at 982. As a result, he knew that "[t]here was not sufficient money being generated to pay the RTC investors. Money was coming from other sources to pay the [RTC] investors." App. Ex. 102 at 983.

RESPONSE: Objection. This paragraph contains opinion, legal argument, and conclusion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

173. When asked if he "mismanaged the assets of the Four Funds," Smith replied that "in hindsight some of my judgments could have been better." App. Ex. 108 at 3169. When asked the same question in his SEC deposition testimony, Smith said "I believe I had some responsibility, yes." App. Ex. 108 at 3170-3171.

RESPONSE: Objection. This paragraph suggests that Mr. Smith's statements are inconsistent and are irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. Notwithstanding and subject to said objection, the paragraph is admitted.

174. McGinn received a total of $1,386,142, and Smith received a total of $1,567,000, from the Trust Offering proceeds. App. Ex. 115 (GA1G). These payments were not authorized by the PPMs for any of the Trust Offerings. The investors did not know that offering proceeds were transferred directly to McGinn and Smith. App. Ex. 109 at 2986.

RESPONSE: Denied. The investor funds were transferred to an operating company (LLC) which was disclosed to investors. There is no requirement that the transactions of the operating company be disclosed. See D. Smith Ex. "D", R. Engel Trial

Transcript.

175. These unauthorized transfers began in November 2006 with the $3.75 million TDM Cable Trust 06 offering – from which McGinn and Smith received $407,000, and Rogers received $392,800 –and continued through 2009. App. Ex. 112, 114, 157, 166, 158; App. Ex. 102 at 1004-1005; 996-1001.

RESPONSE: Objection. This paragraph improperly characterizes the transactions and contains opinion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates his response to paragraph 174 into this response.

176. Smith directed Rees to classify the fees they took from TDM Cable Funding in November 2006 as loans. App. Ex. 105 at 921.

RESPONSE: Admitted.

177. Rees learned about the transaction when he saw the wire confirmations. App. Ex. 105 at 923. He was "a little shocked" at the amount of the transactions because it was 33% of a $3 million deal. App. Ex. 105 at 923. Rees considered this "excessively high and didn't seem to jive with my understanding of how origination fees relative to deals would work in that they are typically a couple percent of a deal." App. Ex. 105 at 923-924.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. Notwithstanding and subject to said objection it is otherwise admitted.

178. Rees initially book them as fees, and saw no evidence they were loans. App. Ex. 105 at 924. Rees subsequently changed to accounting to loans at Smith's instruction. App. Ex. 105 at 927; App. Ex. 143; App. Ex. 357. In 2008, Rees asked when the loan would be repaid, Smith told him that it would be for his "estate to figure out," which Rees understood to mean

"there was no real intent to pay it." App. Ex. 105 at 929.

RESPONSE: Admitted to the first two sentences in the paragraph. Denied as to the last sentence in the paragraph.

179. Smith instructed Rees to make false accounting entries so that fees taken by Smith, McGinn and Rogers from TDM Cable 06 would be reclassified as loans and therefore not taxable. App. Ex. 105 at 921-922.

RESPONSE: Objection. This paragraph improperly contains speculation, opinion, legal argument, and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

When Shea returned to MS & Co. in April 2009, MS & Co. "was failing . . . [t]here was marginally enough capital . . . and their revenues were heavily reliant on related party transactions." App. Ex. 107 at 471. MS & Co. was also having difficulties meeting its net capital requirement due to "lack of revenue, and high expenses." App. Ex. 107 at 472. Shea found approximately 80 entities other than MS & Co. App. Ex. 107 at 475. Shea immediately became aware of the net capital pressures on MS & Co., and he "personally experienced [this pressure] every month." App. Ex. 107 at 546.

RESPONSE: Objection. This paragraph improperly contains speculation and opinion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

181. In April 2009, Shea told Smith that the broker-dealer should be shut because "[t]here is not enough money." App. Ex. 107 at 473.

RESPONSE: Objection. This paragraph improperly contains speculation and opinion

outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

182. Shea knew that Smith and McGinn frequently used funds from one Trust to pay investors in other Trusts. Shea challenged them about this practice because "[i]t would leave investors at risk." Nevertheless, Smith and McGinn continued. App. Ex. 107 at 573.

RESPONSE: Objection. This paragraph improperly contains speculation and opinion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

183. Each of the Trusts had an operating and an escrow account. App. Ex. 105 at 920. Smith and McGinn could move money among the accounts, and McGinn would "very frequently" move money without telling the accounting staff. App. Ex. 105 at 920-92 1.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It further improperly characterizes the actions of the principals outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

184. Rees resigned in April 2009 because "financial pressures on the broker-dealer were causing a lot of stress in my personal life." App. Ex. 105 at 903-904.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

185. By 2009, "funds were not there to cover the interest payments. So funds had to be moved in order to make those interest payments to investors." App. Ex. 102 at 992-993.

RESPONSE: Objection. This paragraph improperly contains opinion and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of

Civil Procedure 56. It is therefore denied.

186. Cooper told McGinn about the dwindling bank account balances. App. Ex. 102 at 993; App. Ex. 161, App. Ex. 163, App. Ex. 164.

RESPONSE: Objection. This paragraph improperly contains opinion and is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint. It is therefore denied.

187. Cooper testified that "it was stressful that the funds weren't there to cover interest payments . . . there was a lot of pressure on [McGinn] to come up with the funds to make these payments." App. Ex. 102 at 993. McGinn decided where the money would come from the pay investors. App. Ex. 102 at 996; App. Ex. 157 (GG9). See also App. Ex. 102 at 997-1002; App. Ex. 166 (GG30), App. Ex. 158 (GG12) (transfers to McGinn and Smith from Integrated Excellence escrow account).

RESPONSE: Denied. Mr. Smith incorporates his responses to paragraphs 185 and 186 into this response.

188. Cooper provided Smith and McGinn with daily information on the bank account balances. App. Ex. 102 at 986-988; App. Ex. 124 (GB10), App. Ex. 126 (GB15); App. Ex. 127 (GB19).

RESPONSE: Admitted.

188. Only McGinn and Smith had authority to transfer funds from accounts. App. Ex. 102 at 989 (Cooper). Cooper testified that money was transferred from one trust account to another "[b] ecause the funds were not there to cover the interest payments." App. Ex. 102 at 992 (GA1D) – Integ Excellence transfers to Luxury Cruise Trust 07 and Firstline. App. Ex. 102 at 1005-1006.

RESPONSE: Admitted as to the first sentence. Objection to the second sentence as it improperly contains speculation, opinion, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

189. In an email to McGinn dated February 24, 2009, Smith expressed concerned that MS & Co.'s "net capital will be wiped out" due to inadequate cash flow, and that "if no solution is found in the next couple of weeks we will have to report the net capital violation and more likely than not consider closing our doors." App. Ex. 145.

RESPONSE: Admitted.

190. Rees said the financial problems described in Smith's February 24, 2009 email had been occurring since July 2008. App. Ex. 105 at 913.

RESPONSE: Objection. This paragraph improperly contains speculation, opinion, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

191. As a result, Smith instructed Rees not to pay certain employees to avoid a net capital violation. App. Ex. 105 at 908; App. Ex. 145.

RESPONSE: Admitted.

192. According to Rees, McGinn "very frequently" wired money from the various accounts "without any involvement from the [MS & Co.] staff." App. Ex. 105 at 920.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint. Mr. Smith further objects to the opinion of "very frequently". It is therefore denied.

193. McGinn directed $40,000 of investor fund to be used to pay Matthew Rogers'

membership at the Waterville Golf Club in Ireland. App. Ex. 107 at 562; App. Ex. 102 1043-1044; App. Ex. 116.

RESPONSE: Denied. See D. Smith Ex. "C", G. Smith Trial Transcript.

195. The PPM for MSTF authorized two uses for the money raised in the offering: purchase McGinn Smith preferred stock and bridge financing. Instead, however, McGinn directed payments to certain investors who were not MSTF investors. App. Ex. 107 at 481-482. McGinn also took $230,000. App. Ex. 117.

RESPONSE: Denied. See D. Smith Ex. "C", G. Smith Trial Transcript. Shea testified that McGinn had directed numerous improper uses of MSTF investor funds, including payments to favored investors. App. Ex. 107 at 484-487. *See also* App. Ex. 134, 135, 136.

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

196. Rees also testified that MSTF was "used to make payments to investors in other trusts that were being made whole through payments to them from [MSTF]". App. Ex. 105 at 93 8-939. Rees knew that these payments, which were made at McGinn's instruction, "were not legal, nor authorized by [MSTF's] purpose." App. Ex. 105 at 941.

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore Mr. Rees lacked familiarity with the PPMs and the structure of the entities. D. Smith Ex. "F", D. Rees Trial Transcript Excerpts. It is therefore denied.

197. Shea knew that McGinn's uses of funds was not authorized by the PPM. App.

Ex. 107 at 488.

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

198. Shea grouped approximately $600,000 the improper MSTF payments into three buckets: (1) payments to Four Funds investors; (2) payments to Joseph Cornacchia, one of McGinn' s favored investors; and (3) payments for a "failed investment," SAI Trust. App. Ex. 107 at 488-496; App. Ex. 118; App. Ex. 123.

RESPONSE: Objection. This paragraph improperly contains legal argument and opinion beyond the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

199. McGinn told Shea that the payments to Cornacchia were "to keep Joe happy . . . to avoid an arbitration." App. Ex. 107 at 633. App. Ex. 105 at 944 (Rees testimony that McGinn directed $5,000 per month payments to Cornacchia). App. Ex. 128 at 1 (schedule of payments to Cornacchia), at 2 (payments to favored Four Funds investors), at 3 (payments to non-MSTF investors with MSTF funds) App. Ex. 209 at 2967-296 8.

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

201. In April 2009, Shea told Smith that non-MSTF investors were being paid with MSTF funds. App. Ex. 107 at 496. Shea testified that Smith told him that he knew that McGinn was doing that and that "it wasn't allowed by the private placement [memorandum]." App. Ex. 107 at 497. *See also* App. Ex. 137; App. Ex. 107 at 577-584 (MSTF).

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

202. Rees maintained the financial records for MSTF. 938. He noticed payments to McGinn from the escrow accounts. App. Ex. 105 at 938-939; App. Ex. 117.

RESPONSE: Admitted.

203. The MSTF escrow account was "used to make payments to investors in other trusts that were being made whole through payments to them from [MSTF]." App. Ex. 105 at 93 8-939. Rees knew these payments "were not legal, not authorized by [MSTF's] purpose." App. Ex. 105 at 941.

RESPONSE: Denied. D. Smith Exs. "G" and "H", B. Shea Trial Transcript Excerpts and D. Rees Trial Transcript Excerpts; Plaintiff's App. Exs. 108-109.

204. MSTF funds were used to pay MS & Co.'s payroll. App. Ex. 105 at 944-945. MSTF also was "used to make payments to investors in other trusts that were being made whole through payments to them from [MSTF]" App. Ex. 105 at 93 8-939. Rees knew that these payments, which were made at McGinn's instruction, "were not legal, nor authorized by [MSTF's] purpose." App. Ex. 105 at 941.

RESPONSE: Denied. Furthermore Mr. Rees lacked familiarity with the PPMs and the structure of the entities. D. Smith Exs. "G" and "H", B. Shea Trial Transcript Excerpts and D. Rees Trial Transcript Excerpts; Plaintiff's App. Exs. 108-109.

205. After the Four Funds were restructured, "they stopped paying interest. There was a preferred bunch of investors that were invested in the Four Funds that were receiving payments from MSTF." App. Ex. 105 at 942; App. Ex. 118. Rees also knew that Four Funds money was

moved through MSTF to meet MS & Co.'s payroll. App. Ex. 105 at 944-945; App. Ex. 119.

RESPONSE: Denied. Furthermore Mr. Rees lacked familiarity with the PPMs and the structure of the entities. D. Smith Exs. "G" and "H", B. Shea Trial Transcript Excerpts and D. Rees Trial Transcript Excerpts; Plaintiff's App. Exs. 108-109.

206. Cooper testified that the payments to preferred investors "[weren't] correct . . . [b] ecause these investors invested together as a group of investors. And if some are discontinued not receiving interest payments, they all should not be receiving interest payments." App. Ex. 102 at 1020.

RESPONSE: Denied. Furthermore, Mr. Cooper lacked familiarity with the PPMs and the structure of the entities. D. Smith Exs. "G" and "I", B. Shea Trial Transcript Excerpts and B. Cooper Trial Transcript Excerpts; Plaintiff's App. Exs. 108-109.

207. In April 2009, Smith and McGinn owed MSTF investors $140,000 in interest payment. App. Ex. 125. To pay the investors, Smith and McGinn took money from TDMM Cable Junior Trust 09 ($53,000), FIIN ($25,000), TDM Luxury Cruise ($10,000), without telling the MSTF investors or the investors in the other offerings. App. Ex. 109 at 2964-2965.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

208. On October 9, 2009, McGinn and Smith met with Jay Kaplowitz, MS & Co.'s attorney, for 90 minutes. App. Ex at 370 at 727. They told Kaplowitz "that they had taken monies from some of the funds and used them as advances for other of the funds," and asked him if he "could come up with a solution." App. Ex. 370 at 728.

RESPONSE: Denied. D. Smith Ex. "J", D. Smith Trial Transcript Excerpt.

209. Kaplowitz told them that "what you did was wrong," and that they should "make a settlement amongst all the partners." App. Ex. 370 at 729.

RESPONSE: Denied. D. Smith Ex. "J", D. Smith Trial Transcript Excerpt.

210. On October 10, 2009, Smith faxed to Kaplowitz a twelve-page handwritten letter. App. Ex. 129; 130, 131;132; 107 at 541-550. The letter stated that "[s]tarting in late 2007, the [Four] FUNDS began to realize a shortfall of income sufficient to meet the debt obligations of the FUNDS due to the under performance of its loans and investments." App. Ex. 129 at 2, 130 at 2.

RESPONSE: Admitted.

211. The letter stated that "it is apparent to us that there is no place in the PPM of MSTF that permits fees payable to MS. Why we booked fees that are clearly owed by the Funds to MSCH and MSA and then ran them through the books of MSTF is absolutely inexplicable and incredibly stupid." App. Ex. 129 at 6; 130 at 6; 108 at 3189.

RESPONSE: Admitted.

212. Smith's letter to Kaplowitz also acknowledged that "arbitrations, in addition to questions that arose during a FINRA routine audit in the fall of 2008, have sent FINRA on a never-ending request for information. . . . Tim and I have sat with an on-the-record, OTR, interview with FINRA in April 2009. In June of 2009, FINRA sent six auditors to our offices to review the Funds. We have supplied them with approximately 30,000 pages of documentation and over 20,000 emails. On September 30, 2009, FINRA asked for additional information for a large number of related entities, some going back to 1982. In preparing the documentation, we became aware that we had run a number of related transactions through MSTF that were specific to the interests of MS affiliates and its principals. And because of outside investment in MSTF, the use of MSTF as the transaction vehicle was most likely improper. In addition, the documentation supporting these transactions was either unavailable or not up to date. Realizing

the possibility that the appearance of these transactions could be interpreted as the improper use of investor funds, or the commingling of funds, we have sought your counsel on how to rectify this mistake." App. Ex. 129 at 3-4; 130 at 3-4.

RESPONSE: Admitted.

213. Smith's letter also referred to "advances from MSTF to McGinn Smith & Co.", which Shea testified were "fees paid . . . [for which] there was no commercial reason or wasn't allowed for in the private placement [memorandum]." App. Ex. 107 at 541.

RESPONSE: Denied. See D. Smith Ex. "G", B. Shea Trial Transcript Excerpts.

214. The letter also acknowledged the payments to favored customers and stated that this was "where the major risk is. There is no support or plausible reason why monies from MSTF were used to pay clients of the firm." App. Ex. 129 at 6; 130 at 6.

RESPONSE: Objection. This paragraph contains improper characterizations outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

215. These notes discuss paying back funds to MSTF, and state that "Jay has expressed a concern that repaying the monies at the same time as we are being asked to provide financial files looks like a cover-up." App. Ex. 129 at 7; 130 at 7.

RESPONSE: Admitted.

216. Kaplowitz testified that he "thought what they did was wrong and they would be drawing attention to it." App. Ex. 370 at 737. App. Ex. 133 (GB34) (additional fax). Kaplowitz also testified that "I have never received a letter from a client admitting to a crime, to what I felt was a crime, at least." App. Ex. 370 at 739.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to plaintiff's

claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

217. Kaplowitz told Smith and McGinn "that they couldn't alter the records to reflect another way of accounting for the advances they took out." App. Ex. 370 at 740-741.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

218. Shea falsified the accounting records on October 12, 2009. Two days later, the falsified records were sent to FINRA. App. Ex. 168; App. Ex. 107 at 534-535.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It further contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

219. In a letter dated November 16, 2009, Shea, at Smith's direction, forwarded the backdated promissory notes to FINRA. App. Ex. 107 at 563; App. Ex. 169. The notes were prepared on November 2, 2009, although they reflect transactions from 2006. App. Ex. 107 at 564-5 65.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied. Furthermore, the promissory notes were not backdated. See D. Smith Ex. "K", J. Carr Trial Transcript Excerpt.

220. Smith told Shea to make accounting entries to conceal the fact that MS & Co. was failing, such as not properly accruing expenses such as salaries, legal fees relating to arbitrations,

and rent on the NYC office. App. Ex. 107 at 472-473.

RESPONSE: Objection. This paragraph contains improper characterizations outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

221. Smith also directed Rees to manipulate MS & Co.'s financial records to avoid a net capital violation by not accruing liabilities for a particular month. App. Ex. 105 at 909-9 10.

RESPONSE: Objection. This paragraph contains improper characterizations outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is further irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

222. In the Fall of 2009, Shea and Smith discussed the MSTF payments and the Four Funds payroll payments. App. Ex. 107 at 500. Smith told Shea "to create certain accounting transactions that would disguise the nature of all these payments." App. Ex. 107 at 501. Shea created the false accounting entries as directed by Smith. App. Ex. 107 at 503-510, 531, 552-556 552 (Shea: "I created false accounting entries" to hide the money that McGinn and Smith were taking); App. Ex. 120; 135; 134 . When Shea questioned Smith, Smith said "this is my money . . . I can do with it whatever we want. Go ahead and make the entries." App. Ex. 107 at 532.

RESPONSE: Objection. This paragraph contains improper characterizations outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is further irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

223. In October 2009, Shea received a handwritten notes from Smith that was Smith's "master plan to how to address all these [MSTF] transactions." App. Ex. 107 at Tr. 519. In this

document, Smith listed the transfers by the Four Funds to MSTF. App. Ex. 107 at Tr. 520-21; App. Ex. 136 at 8.

RESPONSE: Objection. This paragraph contains improper characterizations outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is further irrelevant and immaterial to plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

224. In these notes, Smith wrote that "we obviously should not have used MSTF as our personal bank, but [McGinn] had access to the cash." App. Ex. 136 at 9.

RESPONSE: Objection. This paragraph takes a statement from Mr. Smith's writing out of context and he respectfully refers the Court to the full document. Notwithstanding and subject to said objection, the paragraph is otherwise admitted.

225. In the four Firstline offerings, MS & Co. raised money from investors that was loaned to Firstline, Inc., an alarm company in Utah. App. Ex. 107 at 571.

RESPONSE: Admitted.

226. On August 8, 2007, Firstline's CEO notified McGinn that "[w]e have been notified by ADT by letter and email that they allege we are in breach of our ADT Dealer Agreement." App. Ex. 148. And on October 7, 2007, the allegation was repeated along with the fact that "ADT may seek damages that would exceed $7.5 million." App. Ex. 149 at 7. McGinn never included this material information in the Firstline PPM. App. Ex. 109 at 2920.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

227. In late 2007, Firstline engaged MS & Co. to advise it in negotiations with ADT.

App. Ex. 150 at 2; App. Ex. 109 at 2890-91

RESPONSE: Admitted.

228. Firstline filed for bankruptcy on January 25, 2008, and McGinn found out about the filing almost immediately. 2887. After the bankruptcy filing, Firstline did not make any further payments. App. Ex. 109 at 2910.

RESPONSE: Admitted.

229. McGinn and Smith knew about the bankruptcy, that the bankruptcy meant that Firstline could not make the loan payments, and that it was necessary to "continue making payments out of other accounts to fund that interest stream due investors" App. Ex. 105 at 946-947 (Rees).

RESPONSE: Objection. This paragraph contains improper mischaracterization regarding Mr. Smith's knowledge of the bankruptcy. See D. Smith Ex. "J", D. Smith Trial Transcript Excerpts. It is therefore denied.

230. On February 6, 2008, Shea emailed McGinn that due to the bankruptcy filing "the Trusts would not receive any cash until the bankruptcy plan is approved which could be 5 to 9months! . . . [W]e have to either suspend investor payments or cover them from other sources." App. Ex. 151.

RESPONSE: Admitted.

231. McGinn concealed the bankruptcy filing from MS & Co.'s brokers, who continued to offer and sell Firstline. App. Ex. 109 at 2888, 2891. . The bankruptcy was material information that the investors did not have. App. Ex. 109 at 2888.

RESPONSE: Objection. This argument contains improper legal argument and conclusion outside the scope and requirements of a Statement of Material

Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

232. There was a total of $670,979 post-bankruptcy sales. App. Ex. 147

RESPONSE: Admitted.

233. McGinn made the decision to keep paying Firstline investors for another 21 months after the bankruptcy. App. Ex. 109 at 2911. McGinn used approximately $2 million taken from other trusts to pay Firstline investors. App. Ex. 109 at 2911-2912; App. Ex. 111.

RESPONSE: Admitted as to the first sentence. Denied as to the second sentence. Firstline investors were paid by MS Funding LLC, which was not a Trust Offering. D. Smith Ex. "C", G. Smith Trial Transcript.

234. The Firstline PPM states that investors would be paid from monitoring payments received by the Trust, and not from whatever source was available. App. Ex. 67-68; 70-71; 109 at 2915-2918.

RESPONSE: Denied. Plaintiff's App. Exs. 67-68; 70-71.

235. McGinn signed subscription agreements for post-bankruptcy sales of Firstline, but never told the broker or the customer about the bankruptcy. App. Ex. 109 at 2895-2899.

RESPONSE: Admitted.

236. Guzzetti sent 31 post-bankruptcy emails, that McGinn received, notifying brokers that Firstline was available for sale. App. Ex. 146. *See also* App. Ex. 109 at 2899-2901;144. McGinn never told the brokers to stop selling Firstline. App. Ex. 109 at 2901.

RESPONSE: Admitted.

237. McGinn directed the transfer of $97,000 from Integrated Excellence to pay Firstline investors. App. Ex. 113; 109 at 1006-1007; 159; 160.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

238. McGinn made the decision to continue paying Firstline investors with MSTF funds. App. Ex. 107 at 574. This was not a permitted use of funds under the MSTF PPM. App. Ex. 107 at 574-575.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

239. McGinn emailed an MS & Co. broker on February 8, 2009, to say the "[e]verything OK with . . . Firstline." App. Ex. 152; 109 at 3043 -3044.

RESPONSE: Denied. The email correspondence occurred on February 28, 2009. Plaintiff's App. Ex. 152.

240. McGinn directed transfers to Firstline and other accounts so investors could be paid. App. Ex. 102 at 1013-1014; App. Ex. 155-1 55.

RESPONSE: Admitted.

241. On August 4, 2009, at McGinn's direction, $67,000 was diverted from TDM Verifier Trust 07R escrow account to pay Firstline investors. App. Ex. 111.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

242. Pursuant to an Agreement dated May 15, 2008, "MSTF has agreed to assume the obligations of Firstline to pay principal and interest to the Trusts pursuant to the terms of the PPM's." App. Ex. 138 (GB52). McGinn signed the Agreement for MSTF and Smith signed for the Firstline Trusts. App. Ex. 138; App. Ex. 107 at 577.

RESPONSE: Admitted.

243. Many Firstline sales were made after the May 15, 2008, agreement was signed. Ap. Ex. 147; 109 at 2924-2925. The May 15, 2008 agreement, however, was not executed until June 2, 2009. 2926. McGinn and Smith never told the brokers about the June 2009 agreement,

which sold the underlying income stream from the trusts to MSTF. App. Ex. 109 at 2929-2930.

RESPONSE: Objection. This paragraph is vague, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Motion for Summary Judgment. It is therefore denied. It is further denied on the basis that brokers were told about the June 2009 agreement at a later date.

244. McGinn and Smith had ongoing discussions about whether to tell the brokers about the bankruptcy. App. Ex. 109 at 2927-2928.

RESPONSE: Objection. This paragraph is vague and is unsupported by the exhibit upon it relies. It is therefore denied.

245. McGinn knew that it would be harder to sell MS & Co. products once the bankruptcy was disclosed. App. Ex. 109 at 2933.

RESPONSE: Admitted.

246. Cooper knew that McGinn made decisions about paying Firstline investors, and other offerings, from other sources. App. Ex. 102 at 1006-1007; App. Ex. 159, 160, 165.

RESPONSE: Objection. This paragraph is vague, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

247. Rees knew that Firstline investors were being paid by other entities. App. Ex. 105 at 947.

RESPONSE: Objection. This paragraph is vague, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

248. Investors were not told about the Firstline bankruptcy until they were sent a letter

dated September 10, 2009, which McGinn signed as Chairman of MS Capital Holdings. App. Ex. 156; App. Ex. 109 at 2919. McGinn's letter attached a memorandum from MS & Co.'s in-house counsel, which stated that "Firstline concealed from [MS Funding] that it was embroiled in a massive disagreement with ADT." App. Ex. 156 at 2.

RESPONSE: Admitted.

249. Firstline did not conceal the ADT issue from McGinn. *See supra* ¶¶ 225-228.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

250. The letter to investors also states that "[MS] Funding was able to secure immediate financing, securities by its Firstline receivables in order to have funds available to make monthly payments due to its lenders." App. E. 156 (GF41). In fact, the money to pay Firstline investors came from investors in other Trust Offerings. App. Ex. 109 2922-2923; App. Ex. 138.

RESPONSE: Denied. D. Smith Ex. "C", G. Smith Trial Transcript.

251. In Smith's February 24, 2009, email to McGinn, he acknowledged that "[w]e have been living on the edge for some time, and Tim's deals have kept us alive by fronting our profit." App. Ex. 145.

RESPONSE: Objection. This paragraph is vague, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Motion for Summary Judgment. It is therefore denied.

252. Rees testified that McGinn "was sending money from some of these trust LLC entities that [were] created in the form of advanced profits that were sent to [MS & Co.], and we were using that to get cash in the door." App. Ex. 105 at 910. Rees said that "we couldn't live like that forever, but it got us through another payroll run." App. Ex. 105 at 911.

RESPONSE: Objection. This paragraph improperly contains speculation and opinion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

253. Shea assisted Smith and McGinn in the preparation of personal financial statements. App. Ex 107 at 567. Shea testified that McGinn had "a very high level of personal expenses . . . there was always pressure to get deals closed to get money. . . . his paycheck was nowhere near enough money . . . his monthly burn rate was somewhere between thirty and forty thousand dollars a month . . . the private placements were pulled together very quickly . . . if there was any review from legal, Joe Carr, it may have been, you know, brushed aside in the sake of speed." App. Ex. 107 at 569-70.

RESPONSE: Objection. This paragraph is vague, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It therefore denied.

254. The FINRA examination that Smith referred to in his letter to Kaplowitz began in October 2008, when Steven Rowen and Christopher Rattiner, Principal Examiners with FINRA, conducted a cyclical examination of MS & Co. App. Ex. 106 at 361, 367; 104 at 435. This review lasted five weeks, and covered MS & Co.'s net capital violations, and private placements. App. Ex. 106 at 367-3 68. At the completion of the 2008 exam, FINRA and Smith attended and exit conference. App. Ex. 106 at 379.

RESPONSE: Admitted.

255. Based on areas that were noted during the 2008 exam, FINRA conducted investigative testimony of Smith and McGinn on April 29, 2009. App. Ex 106 at 381.

RESPONSE: Admitted.

256. FINRA conducted a for-cause exam of MS & Co., as well as a cyclical exam, that began in June 2009 and continued through September 2009. App. Ex 106 at 38 1-2.

RESPONSE: Admitted.

257. The Four Funds were a focus of the 2009 exam. App. Ex 106 at 383; 104. FINRA also saw evidence of payments to and from L. Smith. App. Ex. 104 at 430.

RESPONSE: Admitted as to the first sentence. The second sentence is denied as it is unsupported by the exhibit upon which plaintiff's relies. It is therefore denied.

258. In addition, FINRA learned that in late 2006 TDM Cable Funding had transferred approximately $1 million to Smith, McGinn and Matthew Rogers. App. Ex. 106 at 384; 104 at 440. In early September 2009, FINRA personnel, including Rowen and Rattiner, met with Smith and McGinn to ask about the transfers. App. Ex. 106 at 386. At this meeting, Rowen testified that "Mr. Smith responded that these were fees, and then immediately Mr. McGinn jumped in and noted that these were loans." App, Ex. 106 at 388; 104 at 442-444. FINRA then sent a letter asking for "all documentation related to the "loans" to Smith, McGinn and Rogers. App. Ex. 167.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

259. Cooper testified that the environment during the FINRA exam was "stressed," there was "a lot of pressure from FINRA to get answers," and there was no documentation regarding the "loans" taken by McGinn and Smith. App. Ex. 102 at 1024-1025.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore

denied.

260. Shea testified there was "overriding fear . . . FINRA was obviously all over us . . . there may be legal problems down the road." App. Ex. 107 at 669. Smith told Shea to mark documents as "Attorney/Client Privilege" so "than in the event that they were seized, they couldn't be used against any of us." App. Ex. 107 at 669.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

261. McGinn and Smith told Cooper to create a loan document that would then be given to an assistant to create the promissory note. App. Ex. 102 at 1026-1027, App. Ex. 139.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied. Further, Joseph Carr's assistant provided the templates for the promissory notes. D. Smith Ex. "K", J. Carr Trial Transcript Excerpts.

262. Cooper collected the information on the loans. App. Ex. 102 at 1028-1029; App. Ex. 142. The backdated promissory notes were all prepared and executed in November 2009 after FINRA requested them, although they purported to reflect transactions from 2006. App. Ex 102 at 1025, 1038, 1040; GD16, GD18. Smith signed the backdated promissory notes in early November 2009. App. Ex 108 at 3229.

RESPONSE: Denied. D. Smith Ex. "K", J. Carr Trial Transcript Excerpts.

263. On November 2, 2009, at Smith's direction, Shea forwarded to FINRA documents purporting to be the loan agreements pertaining to the 2006 loans. App. Ex. 106 at 398-401, 411, 433, 449. App. Ex. 169, 170, 171, 172.

RESPONSE: Objection. This paragraph improperly contains opinion and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

264. In late 2009, after several arbitral awards were made against MS & Co., FINRA informed MS & Co. that it was not in compliance with FINRA's net capital requirements. App. Ex. 106 at 417; App. Ex 104 at 453.

RESPONSE: Objection. This paragraph is cumulative, repetitive, irrelevant, and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

265. In 1999, Smith wrote a 26-page handwritten letter to McGinn. App. Ex. 108 at 3154. Smith kept the letter in his home office, where it was seized in 2010 when a search warrant was executed.[2] App. Ex. 108 at 3153.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

266. In this letter, Smith described the serious financial problems facing the pre-2003 trust offerings, which mirrored the problems that arose later. In the letter, Smith wrote to McGinn: "The business has become addicted to the cash flow from the trust business and without them we will have a difficult time surviving. The default of the trusts will drastically reduce revenues, cause us to lose brokers, and at least their confidence in us, bring on crushing litigation, and devastating publicity, and I am convinced prosecution by regulators or worse. The

impact on our employees, customers, friends, and family will be devastating." App. Ex. 108 at 3156.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

267. Smith also wrote: "I, unlike you, feel that we are vulnerable to criminal prosecution." App. Ex. 108 at 3156.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

268. Smith also wrote to McGinn, "While you have previously rejected my characterization of these acts as similar to a 'Ponzi' scheme because new dollars being raised are in fact buying new product and only 'profit dollars' are being used to cover shortfalls. I believe our actions could be defined otherwise. The reason for my beliefs is that we are now in possession of indisputable empirical evidence that the new investments have no chance of being repaid in full. Whether less than 100% collections (66%) is due to normal attrition, fraud, billing errors, or poor credit judgment, it really does not matter. The facts are that we will never collect 100% or close to it. Therefore, our 'profits' which we use are not profits at all, but rather monies that should be held in reserve to allow for the deficit collections for the protection of the new

investors." App. Ex. 108 at 3159-3160.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

269. Smith also wrote to McGinn, "For us not to allow for these deficits by setting up adequate reserves is, in my judgment, bordering on fraud. Certainly by not disclosing in the prospectus our poor history of collections, we are not providing the prospective investor an accurate picture of his risk. We both know why we don't make that disclosure–because such disclosure would cause our salesmen to cease selling and investors to cease buying. Thus, we are misleading both our own employees and customers. Distributions to Tim and Dave going forward should be eliminated. Not only should those monies be set up as reserves for investor protection, but in future litigation, those distributions would be extremely detrimental to us. Hard to justify investors losing half their money while we continue to prosper at compensation levels that would seem obscene to the average citizen sitting in judgment." App. Ex. 108 at 3161-3162.

RESPONSE: Objection. This paragraph contains an improper characterization of an unsent letter written sometime in 1999, which is prior to any of the allegations in plaintiff's Second Amended Complaint. It is further irrelevant and immaterial to any of the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and included only to mislead the Court. It is therefore denied.

270. Thomas Brown was a New York State employee whose goal was "investing for retirement, strictly for retirement." App. Ex. 90 at 1701

RESPONSE: Admitted.

271. Brown purchased a $25,000 TAIN five-year junior note in November 2004. 1705. Based on the PPM, Brown expected to receive quarterly interest payments, and his principal back in 2009. App. Ex. 90 at 1709.

RESPONSE: Admitted.

272. Brown believed that his money would be used consistently with "Use of Proceeds" section of the PPM. App. Ex. 90 at 1710. Brown expected that all fees would be disclosed in the PPM, did not expect that his investment would be used to pay MS & Co.'s payroll. App. Ex. 90 at 1710-1711.

RESPONSE: Denied. Mr. Brown understood and expected that there would be advisory fees associated with his investment and he stated that what was done with the advisory fees "doesn't really concern [him] or wouldn't have affected [his] investment choices certainly." D. Smith Ex. "L" at 1719, T. Brown Trial Transcript Excerpts.

273. Brown also invested $10,000 in Firstline Senior Trust 07 in November 2007. App. Ex. 90 at 1712. Brown believed that his money would be used consistently with the PPM, and did not know that McGinn or Smith were planning to use $300,000 to pay themselves. That information would have been important to Brown in making his investment decision. App. Ex. 90 at 1714-1715.

RESPONSE: Objection. This paragraph contains legal argument and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Brown relied on the advice of his broker, Donald Anthony, regarding any of his investment decisions. D. Smith Ex. "L" at 1720, T. Brown Trial Transcript Excerpts. It is therefore denied.

274. Brown did not know that prior to making his investment, ADT had threatened a

multi-million dollar lawsuit against Firstline Security, Inc., and that information would have been significant to him. App. Ex. 90 at 1716.

RESPONSE: Denied. Mr. Brown relied on the advice of his broker, Donald Anthony, regarding any of his investment decisions. D. Smith Ex. "L" at 1720, T. Brown Trial Transcript Excerpts. It is therefore denied.

275. Brown's interest payments stopped and he has not received his principal back. App. Ex. 90 at 1718.

RESPONSE: Objection. This paragraph is vague as to when Mr. Brown's interest payments stopped and specifically what investment the paragraph is referring to. Notwithstanding and subject to said objection, the paragraph is otherwise admitted.

276. Cahn, an attorney from New York City, invested a total of $35,000 in Firstline Trust 07 on November 5, 2007, and another $25,000 on April 25, 2008. App. Ex. 91 at 1409-10.

RESPONSE: Admitted.

277. At the time he made his investment, Cahn thought his investment would be used consistently with the PPM. App. Ex. 91 at 1413.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

278. It would have been important for Cahn at the time to know that Smith and McGinn used more than $300,000 for themselves. App. Ex. 91 at 1414.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local

Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

279. At the time of his April 2008 investment, Cahn did not know about the ADT lawsuit, and that information would have been important to him at the time. App. Ex. 91 at 1415.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. D. Smith Ex. "M" at 1579, R. Pugliese Trial Transcript Excerpts. It is therefore denied.

280. Cahn received the September 10, 2009 letter. App. Ex. 91 at 1417. Cahn did not know that other MS & Co. entities were paying the Firstline investors. App. Ex. 91 at 1418.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. . It is therefore denied.

281. Cahn has not received back his principal form his Firstline investment. App. Ex. 91 at 1418-1419.

RESPONSE: Admitted.

282. Crist is a doctor who lives in Hershey, PA. 1725. Around 2004, Crist was looking for an investment that was "perfectly secure because I was 64 at the time." App. Ex. 92 at 1726.

RESPONSE: Admitted.

283. In October 2007, Crist purchased a $75,000 Firstline junior note, and in January 29, 2008, he purchased another $30,000 Firstline note. App. Ex. 92 at 1728.

RESPONSE: Admitted.

284. Crist assumed the investments were being handled consistently with the PPMs, and it would have been important to Crist to know that McGinn and Smith used more than

$300,000 in investor funds to pay themselves. App. Ex. 92 at 1732.

RESPONSE: Denied. Mr. Crist "basically followed the recommendation and advice" of his broker, William Lex and did not read or understand the related PPM ("I'm afraid that these are complex to me . . . and I rely on the people who are knowledgeable.") D. Smith Ex. "N" at 1727-28, H. Crist Trial Transcript Excerpts.

285. Crist did not know that a source other than the alarm contracts was paying investors, and it would have been significant to him to know that. App. Ex. 92 at 173 3-1734.

RESPONSE: Denied. Mr. Crist "basically followed the recommendation and advice" of his broker, William Lex and did not read or understand the related PPM ("I'm afraid that these are complex to me . . . and I rely on the people who are knowledgeable.") D. Smith Ex. "N" at 1727-28, H. Crist Trial Transcript Excerpts.

286. Crist has not received back his principal. App. Ex. 92 at 1737.

RESPONSE: Admitted.

287. Dale is a retiree who lives in Florida, who worked for 48 years as a registered nurse. App. Ex. 93 at 1382. Her investment goal was "[t]o be able to retire and live in the manner in which I had been accustomed." App. Ex. 93 at 1384.

RESPONSE: Admitted.

288. In December 2007, Dale invested $50,000 in a 4-year Firstline note. App. Ex. 93 at 1386.

RESPONSE: Admitted.

289. Dale thought her money would be invested consistently with the PPM. App. Ex. 93 at 1390. She did not know that Smith and McGinn were planning to take $300,000 of investor proceeds, and it would have been important to her to know that. App. Ex. 93 at 1391.

RESPONSE: Objection. This paragraph contains legal argument and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

290. Dale also did not know about the ADT lawsuit, or that her payments would be coming from another MS & Co. entity; it would have been important to her to know those things. App. Ex. 93 at 1392-1393.

RESPONSE: Objection. This paragraph contains legal argument and conclusion outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56.

291. Dale has not received her principal back. App. Ex. 93 at 1397.

RESPONSE: Admitted.

292. Ronald DeLeonardis was a high school classmate of McGinn's and they later served in the Army reserves together. App. Ex. 94 at 674.

RESPONSE: Admitted.

293. In 2002, DeLeonardis sold the restaurant he had owned and operated in Albany for 34 years. App. Ex. 94 at 674, 676. DeLeonardis "acquired a large amount of money" from the sale, and his "intention was to invest money so that I could retire and make a lot of money and help my children out, as well as being able to enjoy somewhat of the life that I felt I deserved because of all the hard work and sacrifice I had put it." App. Ex. 94 at 676.

RESPONSE: Admitted.

294. At McGinn's recommendation, DeLeonardis invested in a total of $170,000 in two five-year junior FIIN notes, that were expected to pay 10.25% quarterly interest. GM43, GM44.

RESPONSE: Admitted.

295. DeLeonardis has not received back any of his principal. App. Ex. 94 at 682. Interest payments were made through 2007. App. Ex. 94 at 682. He received $1,250 in interest in 2008"and then the payments stopped." App. Ex. 94 at 682.

RESPONSE: Admitted.

296. DeLeonardis believed that his investment would be used in accordance with the terms of the PPM. App. Ex. 94 at 684-6 85. Based on the PPM, DeLeonardis would have been "shocked" to know that investor funds would be used to meet MS & Co. payroll in 2008. App. Ex. 94 at 684-685; GC1.

RESPONSE: Denied. Mr. DeLeonardis did not read the entire PPM, including the relevant portion related to advisory fees. D. Smith Ex. "O" at 687-89. R. DeLeonardis Trial Transcript Excerpts.

297. DeLeonardis testified that he did not believe that FIIN was a risky investment because of "[t]he trust we built over twenty years of investment, I have to rely on their knowledge." App. Ex. 94 at 691-692.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

298. William Ferraro was an administrator with Empire State College for 34 years. App. Ex. 95 at 696. Smith was a member of the college's foundation, and worked with Ferraro in that capacity. App. Ex. 95 at 696-697.

RESPONSE: Admitted.

299. Around 2006, Ferraro started discussing his retirement assets with Smith. 698. On

April 8, 2009, Ferraro invested $100,000 with TDM Verifier Trust 07R. App. Ex. 95 at 700; GM10, GA19. He has not received his principal back. App. Ex. 95 at 705. Ferraro believed that his investment would be sued consistently with the terms of the PPM. App. Ex. 95 at 704-705. Ferraro did not know that this investment would be used to pay Firstline investors, and would not have invested had he known that. App. Ex. 95 at 705.

RESPONSE: Denied. Mr. Ferraro did not read the PPMs in their entirety, "I skimmed them, and I went through the purposes and interest rates and the summaries, I would say." D. Smith Ex. "P" at 717, W. Ferrraro Trial Transcript Excerpts.

300. On September 25, 2008, Ferraro invested $200,000 with Firstline Trust 08. App. Ex. 95 at 706; GM9. He has not received his principal and interest back. App. Ex. 95 at 709. Ferraro expected that investor funds would be used in accordance with the PPM. App. Ex. 95 at 708; GA13. He would have wanted to know that MS & Co. was taking more than the 6% in fees disclosed in the PPM, and would not have made the investment had he knows. App. Ex. 95 at 709.

RESPONSE: Denied. Mr. Ferraro did not read the PPMs in their entirety, "I skimmed them, and I went through the purposes and interest rates and the summaries, I would say." D. Smith Ex. "P" at 717, W. Ferrraro Trial Transcript Excerpts.

301. In September and October 2008, Ferraro invested a total of $175,000 with MSTF. GM35, GM36, App. Ex. 85 (GB2). He has not received his principal back. App. Ex. 95 at 715.

RESPONSE: Admitted.

302. Ferraro expected that his investment would be handled consistently with the PPM. App. Ex. 95 at 713. He testified that it would have been important for him to know that MS &

Co. had taken more in fees than set forth in the PPM, and that MSTF funds would be used to pay Firstline investors. App. Ex. 95 at 714-715.

RESPONSE: Denied. Mr. Ferraro did not read the PPMs in their entirety, "I skimmed them, and I went through the purposes and interest rates and the summaries, I would say." D. Smith Ex. "P" at 717, W. Ferrraro Trial Transcript Excerpts.

303. Ferraro testified that "I put a lot of faith and trust in what David [Smith] was telling me about these things, and they sounded good. And so I went along with the investment." App. Ex. 95 at 710.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

304. On December 21, 2007, Greenberg invested in TDM Verifier Trust 08. 2033. Greenberg received the PPM, and would have wanted to know if McGinn and Smith were taking money other than as disclosed in the PPM. App. Ex. 96 at 2035.

RESPONSE: Objection. This paragraph improperly characterizes the transactions and the disclosures in the PPM. It is therefore denied.

305. Greeenberg also invested $20,000 in a three-year Fortress Trust note. App. Ex. 96 at 2036. Greenberg expected that his money would be invested as described in the Fortress Trust PPM. App. Ex. 96 at 2037.

RESPONSE: Admitted.

306. Greenberg did not know that McGinn and Smith would take more than $800,000 to pay themselves and another person, which is information that would have been important to know when making the investment. App. Ex. 96 at 203 8-2039.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

307. Greenberg also invested $20,000 in TDM Cable Trust 06. App. Ex. 96 at 2040. Greenberg did not think his investment would be used for purposes other than as set forth in the PPM, and did not know funds from this offering would be used to pay Firstline investors. App. Ex. 96 at 2041.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

308. Greenberg also invested a total of $50,000 in MSTF. App. Ex. 96 at 2049. Greenberg never knew that Smith and McGinn were planning to take $250,000 above and beyond the fees in the PPM. App. Ex. 96 at 2051. In late 2009 or early 2010, Greenberg spoke with Smith and McGinn and asked that his MSTF investment be returned. They told Greenberg that the MSTF money was "invested in a number of things, such as "a cruise ship" and "a security company in New York." 2056. Smith and McGinn did not disclose that MSTF was paying up to $3 million to Firstline investors. App. Ex. 96 at 2057-205 8, App. Ex. 138 (GB52).

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

309. Kogan is a retired employee of the New York Police department. In July 2007, Kogan invested $300,000 in a four-year TDM Luxury Cruise Trust 07. App. Ex. 97 at 1432. She did not receive her principal back at maturity. App. Ex. 97 at 1433.

RESPONSE: Admitted.

310. Kogan expected that her money would be used consistently with the PPM. App. Ex. 97 at 1435. She did not know that TDM Luxury Cruise Trust funds would be used to pay Firstline investors. App. Ex. 97 at 1435.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

311. In April 2008, Kogan invested $150,000 in a four-year Firstline note. App. Ex. 97 at 1436. She expected the investor funds would be sued consistently with the PPM, and she did not know that McGinn and Smith were planning to take $300,000 for themselves. App. Ex. 97 at 1438. That information would have been very significant to het. App. Ex. 97 at 1438-1439.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

312. Kogan also did not know about the Firstline bankruptcy or that her payments were coming from other MS & Co. entities, and that information would have been important to her at the time. App. Ex. 97 at 1440. She has not received her principal back. App. Ex. 97 at 1441.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

313. Novack, a commodities trader in New Jersey, purchased a five-year $25,000 Integrated Excellence note in August 2008. App. Ex. 98 at 1548-1 549.

RESPONSE: Admitted.

314. At the time of his investment, Novack believed that his funds would be used in accordance with the PPM, and not for other undisclosed purposes. App. Ex. 98 at 1551.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Novack did not read the PPM. See D. Smith Ex. "Q" at 1554. It is therefore denied.

315. Novack did not know that McGinn and Smith would use $97,000 of funds raised through the Integrated Excellence offering to pay Firstline investors. App. Ex. 98 at 1552. 10.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Novack did not read the PPM. See D. Smith Ex. "Q" at 1554. It is therefore denied.

316. Pugliese is retired from a military career. App. Ex. 99 at 1563. In July 2007, Pugliese invested a total of $25,000 in two four-year TDM Luxury Cruise notes. App. Ex. 99 at 1567.

RESPONSE: Admitted.

317. Pugliese expected that his investment would be used consistently with the PPM. App. Ex. 99 at 1569. In November 2007, Pugliese also invested $25,000 in Firstline in November 2007, and another $55,000 in June 2008. App. Ex. 99 at 1570-1 571.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Pugliese did not

have an understanding of the entity structure of the investments. D. Smith Ex. "R" at 1579, R. Pugliese Trial Transcript Excerpts. It is therefore denied.

318. His subscription agreement was signed by Smith on June 10, 2008. App. Ex. 99 at 1571.

RESPONSE: Admitted.

319. Pugliese believed that his investment would be used consistently with the PPM, and he would have wanted to know that Smith and McGinn were taking $300,000 for themselves. App. Ex. 99 at 1572-1 573.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Pugliese did not have an understanding of the entity structure of the investments. D. Smith Ex. "R" at 1579, R. Pugliese Trial Transcript Excerpts. It is therefore denied.

320. When Pugliese made his June 2008 investment in Firstline, he did not know that Firstline had filed for bankruptcy, and that information would have been significant to him at the time. App. Ex. 99 at 1574.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

321. Pugliese has not received his principal back. App. Ex. 99 at 1575.

RESPONSE: Admitted.

322. Sokol is a self-employed home builder. In April 2009, Sokol invested a total of $75,000 in a TDMM Cable Trust 09 five-year note. App. Ex. 100 at 1589. These funds

represented Sokol's savings for his son's college education. App. Ex. 100 at 1589.

RESPONSE: Admitted.

323. Sokol never received any of the interest payments or principal. App. Ex. 100 at 1590.

RESPONSE: Admitted.

324. Sokol expected that his investment would be used according to the PPM. App. Ex. 100 at 1592. Sokol never knew that $30,000 in investor funds would be taken by McGinn, which was information he would have wanted to know before making the investment. App. Ex. 100 at 1593.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. Furthermore, Mr. Sokol relied on his broker and left the bulk of the investment decision to him. D. Smith Ex. "S" at 1595, P. Sokol Trial Transcript Excerpts. It is therefore denied.

325. Wargo is the pastor of St. Joseph's Church in Orefield, PA, and was also in charge of the finance committee at the church. App. Ex. 101 at 2068-2069.

RESPONSE: Admitted.

326. The church invested $40,000 on Integrated Excellence Senior Trust 08. App. Ex. 101 at 2070. Wargo expected that the funds raised in the offering would be used consistently with the terms of the PPM. App. Ex. 101 at 2071-2072.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

327. Wargo did not know that McGinn and Smith would take an additional $85,000 in fees beyond what was described in the PPM. App. Ex. 101 at 2073; GA1C. Wargo also expected that the interest would come from the investments described in the PPM, and not from sources unrelated to the investment. App. Ex. 101 at 2073-2074.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

328. The church also invested in TDMM Cable Senior Trust 09. 2075. At the time of the investment, Wargo thought that that investor proceeds would be used as described in the PPM, or that money from this issuer would be paid to investors in Integrated Excellence. App. Ex. 101 at 2077. This information would have been significant to know. App. Ex. 101 at 2077.

RESPONSE: Objection. This paragraph is vague, argumentative, and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

329. The Four Funds PPMs made clear that the "notes are being offered only to 'accredited investors,' as that term is defined by Regulation D under the Securities Act . . . who . . . have the expert knowledge to evaluation information and data." *See, e.g.,* App. Ex. 85 at 3; *see also id.* at 10 ("[s]ubscriptions will be accepted only from 'accredited investors'"), at 23 ("[e]ach investors must represent in writing that it qualifies as an 'accredited investor' . . . and must demonstrate the basis for such qualification").

RESPONSE: Admitted.

330. In order to purchase a Four Funds note, a subscriber had to sign a subscription agreement attesting that she was an accredited investor. *See, e.g.*, App. Ex. 86 at 38.

RESPONSE: Admitted.

331. On April 20, 2010, the Court entered a temporary restraining order freezing the assets in a stock account in the name of L. Smith maintained at RMR Wealth Management, LLC containing $1,786,430.01 in assets as of April 30, 2010 (the "Stock Account"). App. Ex. 344 (TRO dated April 20, 2010, Dkt. No. 5); App. Ex. 341 (RMR 6004-60 12).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

332. On July 8, 2010, the Court granted the Commission's motion for a preliminary injunction freezing the assets in the Stock Account pending resolution of this action. App. Ex. 345 (July 8, 2010 MDO, Dkt. No. 86 at 7-10; 42).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

333. In opposing the freeze of the Stock Account, L. Smith stated that the assets in the Stock Account originated solely from a stock account worth approximately $60,000 that she received as part of an inheritance from her father in 1969. App. Ex. 244 (L. Smith 5/21/10 Aff., Dkt. 23), at ¶ 13-14; 170. L. Smith stated that the stock account has always been her "separate property" and has "always been held in my name and my name alone." App. Ex. 244 (L. Smith 5/21/10 Aff. Dkt. 23, at ¶ 17).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

334. L. Smith stated that the Stock Account was always kept separate from David Smith's assets, and that the account did not receive any additions to principal from David Smith from his personal or business activities or from any other sources but instead grew solely through

David Smith's management and investment returns on the original inheritance. See, e.g., App. Ex. 244 (Lynn Smith 5/21/10 Affidavit, Dkt. 23, at ¶ 17-18); App. Ex. 252 (Lynn Smith 5/27/10 Deposition at 102:13-2 1).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

335. These statements were all false. See below.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

336. In 1973, L. Smith used an unspecified portion of the stock account inherited from her father to make a down payment on the Smiths' primary residence in Clifton Park. App. Ex. 244 (Lynn Smith 5/21/10 Affidavit, Dkt. 23, at ¶ 15).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

337. L. Smith stated that at some point the stock account she inherited from her father was as low as $10,000. App. Ex. 252 (Lynn Smith 5/27/10 Deposition at 33:11-22).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

338. The Stock Account, in the name of L. Smith, Account No. 405-04091, was opened on November 21, 1991 with Bears Stearns as the clearing broker. App. Ex. 343 (MGS DOJ 000164-1 65); App. Ex. 264, 263 (MGS DOJ 000138 (Report of New Account dated November 11, 1991)).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

339. On that date, David and L. Smith transferred all cash and securities from a joint stock account in both their names to the Stock Account. App. Ex. 284 (MGS DOJ 000242).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

340. Prior to the opening of the Stock Account, the joint account, No. 405-00065, was the only brokerage account holding the Smiths' cash and marketable securities, aside from small IRA accounts. App. Ex. 284 (MGS DOJ 000242).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

341. The Stock Account was managed by David Smith through the McGinn Smith brokerage firm until 2010, when the Stock Account was transferred to RMR Wealth Management after McGinn Smith ceased doing business. See, e.g., App. Ex. 341 (RMR 6004-6012); App. Ex. 221 (MGS DOJ 000185) and App. Ex. 222 (MGS DOJ 000226); App. Ex. 255 (Lynn Smith Answer to SAC, ¶ 114).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

342. Prior to the opening of the Stock Account on November 21, 1991, the Smiths' financial statements reported that all the securities they owned were either owned by David Smith or owned jointly by David and L. Smith. See below.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

343. David and L. Smith had joint financial statements prepared on at least twenty-one different dates between September 1984 and August 2008. See App. Exs. 181-187, 189, 192,

194, 197, 200, 203, 206-210 (Smiths' Financial Statement from 1984 through 2008).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

344. The Smiths' financial reports were sent to regulators at the Pennsylvania Department of Insurance and regulators in Texas. App. Ex. 108 (D. Smith testimony in U.S. v. Smith et al. at Tr. 3224).

RESPONSE: Admitted.

345. The Smiths' joint financial statement as of September 30, 1984 report that Mr. Smith owned securities with a market value of $144,348App. Ex. 181 at 4.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

346. The Smiths' joint financial statement as of December 31, 1985 report that the Smiths' owed a liability on a short stock position, but held no securities. App. Ex. 182.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

347. The Smiths' joint financial statements for 1986, 1987 and 1989 report no securities held by either Smith. App. Exs. 183-185.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

348. The Smith's joint financial statement as of June 1, 1990 report that they jointly held cash and securities totaling $298,000. App. Ex. 186.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

349. The cash and securities contained in the June 1, 1990 financial statement are not reported as owned solely by L. Smith. App. Ex. 186.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

350. The Smiths' joint financial statement dated April 1, 1991 reports cash and securities totaling $302,000. App. Ex. 187 at 2.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

351. The first available statement for the Stock Account, dated March 3,1992, reports a balance of $446,449 in cash and securities as of March 3, 1992. App. Ex.262. The statement also shows that a deposit in the amount of $55,755 on February 4, 1992 and other smaller transactions were made to the account during the months of January and February 1992. App. Ex. 262 (MGS DOJ 001446-47).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

352. The first joint financial statement prepared after the creation of the Stock Account is the joint financial statement dated May 1, 1992. App. Ex. 189.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

353. The May 1, 1992 financial statement reports that the Smiths jointly owned cash and marketable securities totaling $530,000. App. Ex. 189.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

354. The 1992 Financial Statement for the first time listed the two-family house, three cottages and a lake front lot, which L. Smith stated she inherited from her father, as "owned by Mrs. Smith" (in all prior years they are listed as assets of both Smiths). App. Ex. 189 at 3.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

355. However, the 1992 Financial Statement continued to list all cash and securities, totaling $530,000 including the assets in the Stock Account, as joint assets of both Smiths. App. Ex. 189.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

356. There is no documented evidence of a non-IRA brokerage account solely in L. Smith's name prior to November 1991.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

357. David Smith had full trading authorization over the Stock Account, and the right to withdraw money and securities from the Stock Account, since on or about December 3, 1991. App. Ex. 221 (MGS DOJ 000185) App. Ex. 222 (MGS DOJ 000226).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

358. "Most" investment decisions were made by David Smith. App. Ex. 252 (L. Smith 5/27/10 Deposition at 34:8-35:3).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

359. L. Smith did not know whether any money from the Stock Account was used to invest in any McGinn Smith entities. She left those decisions to David Smith. App. Ex. 252 (L. Smith 5/27/10 Deposition at 78:22-79:8).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

360. L. Smith conceded that David Smith was allowed to use the Stock Account for his own benefit on numerous occasions during the at least 15 years preceding the PI hearing. App. Ex. 272 (PI Tr. at 404-405).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

361. The Stock Account was frequently used to fund common expenses and fund assets that benefitted both David and L. Smith. App. Ex. 218 (D. Smith Responses to SEC Request for Admissions, ¶ 31) See also below.

RESPONSE: Objection. This paragraph is vague and the term "frequently" is misleading. Notwithstanding and subject to said objection, the Stock Account at times was used to fund common expenses of both David and L. Smith. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

362. For example, the Smiths financed the purchase of their prior primary residence in Clifton Park from the Stock Account. App. Ex. 252 (L. Smith 5/27/10 Deposition at 29:24-30:8).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

363. In the mid-1980s, the Stock Account was used to purchase a ski condominium in Vermont for approximately $125,000. App. Ex. 252 (L. Smith 5/27/10 Deposition at 35:20-36:19).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

364. Money from the Stock Account was used to purchase a residence in Vero Beach, Florida in the name of David and Lynn Smith in 2001. App. Ex. 252 (L. Smith 5/27/10 Deposition at 20:19-25 to 21:1-15); App. Ex. 272 (PI Hearing T.371-72).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

365. The Smiths' paid approximately $1,389,000 for the Vero Beach house, including a $130,000 down payment and $270,905 at closing on or about June 21, 2001. App. Ex. 286, (HUD-1 Settlement Statement).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

366. Brokerage records show that a transfer of $100,000 from the Stock Account to David Smith's checking account was made on May 7, 2001 and a transfer of $300,000 was made from the Stock Account to David Smith's checking account on June 19, 2001, two days before the closing. App. Ex. 1 (Palen Ex. 25).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

367. The Smiths financed their two children's college education from the Stock Account. App. Ex. 252 (L. Smith 5/27/10 Deposition at 30:7-10).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

368. Brokerage records show that the Stock Account contributed approximately $142,500 to IRAs for David Smith, Lynn Smith, Geoffrey Smith and Lauren Smith over the years. App. Ex. 1 (Palen Ex. 24 at 2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

369. Bank records show that on two occasions, April 14, 2006 and April 10, 2007, David Smith used monies from his checking account, $4,500 and $5,000 respectively, to fund an IRA in L. Smith's name and used monies from his checking account to fund IRAs for himself, and the Smiths' children Geoffrey and Lauren Smith. App. Ex. 1 (Palen Ex. 26); App. Ex. 244 at 19 (L. Smith 5/21/10 Declaration, Ex. B); App. Ex. 252 (L. Smith 5/27/10 Deposition at 58:19-60:3; 61:6-9).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

370. Brokerage and bank records show that on June 19, 2003, $70,000 was transferred from the Stock Account to David Smith's account. The funds were used to make the down payment on the Smiths' residence in Saratoga Springs, NY that was purchased in both their names. App. Ex. 252 (L. Smith 5/27/10 Deposition at 24:15-25); App. Ex. 1 (Palen Exs. 25 and 26) App. Ex. 204 at 1-3.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

371. David Smith caused numerous other transfers of stocks and monies to be made

from the Stock Account for the benefit of himself, his family and various McGinn Smith entities. For example, brokerage and bank records show that between August 28, 1999 and April 5, 2010, approximately $4.7 million was transferred from the Stock Account to David Smith's checking account, and only $390,000 was transferred back from David Smith's checking account to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Objection. This paragraph improperly contains opinion, speculation, legal argument, and conclusion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

372. From November 21, 1992 through August 27, 1999, a period for which incomplete records exist, brokerage records show that at least $2,585,000 was transferred from the Stock Account to David Smith's checking account, with no known transfers back to the Stock Account from the checking account. App. Ex. 1 (Palen Ex. 24 at 2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

373. David Smith repeatedly used funds transferred from the Stock Account to his checking account to pay large common expenses of him and L. Smith, such as mortgage payments on their primary residence in Saratoga Springs, New York, and their home in Vero Beach, Florida, golf club dues, federal and state taxes, payments to their children Geoffrey and Lauren Smith, car payments and insurance. App. Ex. 1 (Palen Ex 25 and 26).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

374. L. Smith testified at the preliminary injunction hearing that David Smith used: "his checking account for items that maybe I could not afford to write checks out of mine. We had two mortgages, car payments, insurance, and so on. And that's what he used his account for, the big things. And I used mine for household daily, lawn service, groceries, that kind of thing." App. Ex. 272 (PI Tr. at 283:8-13).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

375. David Smith also made contributions to the Stock Account. For example, David Smith used monies he obtained as a loan from McGinn Smith to partially fund the purchase of ALBANK stock that was eventually converted into the Charter One stock. See below.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

376. On March 23, 1992, David Smith placed an order for 50,000 shares of ALBANK Financial Corporation at a price of $ 10.00 per share, and submitted $500,000 in payment. App. Ex. 237 (Dep. Ex. 446); App. Ex. 238 (Dep. Ex. 447).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

377. $354,000 of that amount consisted of money withdrawn from the Stock Account on March 16, 1992. App. Ex. 235.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

378. $150,000 of that $500,000 consisted of a loan that David Smith took out from McGinn Smith and Co on March 23, 1992. App. Ex. 235 (Dep. Ex. 444), App. Ex. 236 (Dep. Ex.

445).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

379. Because of demand for the ALBANK shares, David Smith was issued only 40,688 shares of ALBANK stock on or about April 5, 1992. App. Ex. 239 (Dep. Ex. 448).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

380. On March 31, 1992, a check in the amount of $93,674.85 was issued to David Smith from Albany Savings Bank, including $544.85 in interest as a refund for the 9,322 shares that were not issued to him. App. Ex. 239 at 2 (Dep. Ex. 448). Thus, David Smith purchased 40,688 shares of ALBANK stock for approximately $406,880 dollars, using portions of the $349,000 withdrawn from the Stock Account and portions of the $150,000 David Smith borrowed from McGinn Smith. See also App. Ex. 290 (D. Smith 12/14/11 Dep. at 328:5-25).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

381. The 40,688 shares of ALBANK stock were not deposited into the Stock Account until September 18, 1992. App. Ex. 234 (Dep. Ex. 443).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

382. In opposing the freeze of the Stock Account, L. Smith stated that: "In approximately April 1992, using assets in my stock account, I purchased 40,000 shares of Albank stock at $10 per share at the initial public offering. ... I held this stock in my brokerage account for many years and, because of subsequent mergers and acquisitions involving Albany

Savings Bank, Citizens Bank and Charter One Financial, and the resulting stock splits and increases in value, my holdings in this banking institution increased to 110,735 shares of Charter One stock by 1999.... [the shares were] valued at $24.75 per share in August 1999. App. Ex. 244 (L. Smith 5/21/10 Affidavit, Dkt. 34, at ¶ 3).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

383. This statement was also false because, as demonstrated above, David Smith also contributed money to purchase the initial ALBANK stock.

RESPONSE: Objection. This paragraph is argumentative and speculative beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

384. L. Smith's statement was also false because Charter One stock was not held in the Stock Account for many years. See below.

RESPONSE: Objection. This paragraph is argumentative and speculative beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

385. By the end of August 1999, the Stock Account had 110,735 shares of Charter One worth $24.75 per share, or $2,740,691. App. Ex. 280 (Dep. Ex. 451-Summary Chart of Charter One stock transactions).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

386. Each September from 1999 to 2002, Charter One issued a 5% stock dividend resulting in a total of an additional 21,269 shares added to the Stock Account. App. Ex. 280 (Dep. Ex. 451). The Charter One stock also continued to appreciate during this time. App. Ex. 280 (Dep. Ex. 451); App. Ex. 218 (D. Smith's Responses to Requests for Admission, ¶ 35).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

387. During the period from August 1999 to September 2002, the Smiths sold a total of 24,530 shares of Charter One stock from the Stock Account for a gross profit of approximately $800,000, and transferred an additional 2,574 shares of Charter One stock out of the Stock Account. App. Ex. 280 at 4 (Dep. Ex 451); App. Ex. 218 (D. Smith's Responses to Requests for Admission, ¶ 36).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

388. By early October 2002, the Stock Account had 105,000 shares of Charter One stock worth over $3 million. App. Ex. 280 (Dep. Ex. 451).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

389. The Stock Account was also used to benefit David Smith's professional interests. See below. See also, App. Ex. 218 (D. Smith's Responses to SEC's Requests for Admissions, ¶ 31).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to

Plaintiff's Statement of Material Facts into this response.

390. In explaining the reasons for certain transfers from the Stock Account to McGinn Smith entities, David Smith admitted that the transfers were loans from both him and his wife. For example, he stated: "Defendant's best recollection is that he and his wife lent to MS Holdings $150,000 in July 2007 that was to be repaid as soon as possible, but no later than one year from the loan date. Financial circumstances at McGinn Smith prevented that schedule from being fulfilled, with $50,000 being paid through October 2008 and the balance of $100,000 remaining outstanding." App. Ex. 217 (D. Smith Responses to Plaintiff's First Request for Interrogatories, ¶ 16 Response).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

391. Brokerage and bank records show that the $150,000 was transferred from the Stock Account to MS Holdings on July 30, 2007. App. Ex. 1 (Palen Ex. 25).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

392. David Smith also admitted that: "...in late April or early May of 2009 the Smiths lent an additional $100,000 to MS Holdings." App. Ex. 217 (D. Smith Responses to Plaintiff's First Request for Interrogatories, ¶ 16 Response).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

393. Brokerage and bank records show that the $100,000 was transferred from the Stock Account to David Smith's checking account on April 30, 2009 and a corresponding transfer of $100,000 from David Smith's checking account to McGinn Smith's Operating

account occurred on the same date. App. Ex. 1 (Palen Exs. 25 and 26), App. Ex. 346 (MS-E3 1013 83).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

394. On October 14, 2002, all 105,000 shares of Charter One stock in the Stock Account were journaled out of the Stock Account and were deposited as a "loan" into an account for KC Acquisition Corp., a McGinn Smith Entity. App. Ex. 270 at 57 (PI EX. 126 (10/14/02 LOA)); App. Ex. 280 (Dep. Ex. 451 -also Dkt. 662-3).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

395. David Smith was Treasurer of KC Acquisition Corp. App. Ex. 270 at 57 (PI EX. 126 (10/14/02 LOA)); App. Ex. 218 (D. Smith's Responses to Requests for Admissions, ¶38); App. Ex. 265 (Lynn Smith Responses to Requests for Admissions, ¶ 12).

RESPONSE: Admitted.

396. The 105,000 shares of Charter One stock were loaned to KC Acquisitions, in part, so that it could obtain a "going concern" letter from its auditors. App. Ex. 304 (Dep. Ex. 374, paras. 118-129).

RESPONSE: Objection. This paragraph contains argument and speculation beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure. It is therefore denied.

397. The 105,000 shares of Charter One stock remained out of the Stock Account from October 14, 2002 to July 29, 2003, when the shares were journaled back into the Stock Account from the KC Acquisition Corp. account. App. Ex. 270 at 57 (PI EX. 126 (10/14/02 LOA)App.

Ex. 280 at 4 (Summary Chart of Charter One stock transactions – also Dkt. 662-3); App. Ex. 265 (Lynn Smith's Response to Requests for Admissions, ¶ 13; App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 39).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

398. David Smith, as the treasurer of KC Acquisition Corp., signed the letter authorizing the transfer of shares back to the Stock Account. App. Ex. 270 at 57 (PI EX. 126 (10/14/02 LOA); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 40).

RESPONSE: Objection. The exhibits upon which this paragraph relies do not support the statement that David Smith signed the letter. It is therefore denied. Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

399. The assets in the Stock Account were extensively co-mingled with the assets held in accounts for MS & Co. or related entities throughout the existence of the Stock Account. For example, David Smith and MS & Co. personnel routinely initiated, created, authorized and/or requested transfers from the Stock Account to meet liquidity needs of MS & Co. or related entities or to provide bridge financing for MS & Co. related entity deals. App. Ex. 244 (L. Smith 5/21/10 Affidavit at 27).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

400. Brokerage and bank records show that from August 28, 1999 through April 5, 2010, approximately $ 17.2 million was transferred from the Stock Account to various McGinn Smith related entities. App. Ex. 1 (Palen Ex. 24).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

401. Brokerage and bank records show that from August 28, 1999 through April 5, 2010, approximately $13.7 million was transferred from various McGinn Smith related entities to the Stock Account. App. Ex. 1 (Palen Ex. 24).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

402. For example, during this period, brokerage and bank records show that approximately $7.9 million was transferred from the Stock Account to Capital Center Credit Corp ("C-4"), and approximately $7.2 million was transferred from C-4 to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

403. C-4 was owned by David Smith and Timothy McGinn. App. Ex. 289 (D. Smith 12/13/11 Dep. at 53:10-21).

RESPONSE: Admitted.

404. Brokerage and bank records show that approximately $2,000,000 was transferred from the Stock Account to FIIN and approximately $2,015,556 was transferred from FIIN to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the

Trust's Response to Plaintiff's Statement of Material Facts into this response.

405. Brokerage and bank records show that approximately $300,000 was transferred from the Stock Account to MS & Co. and approximately $29,500 was transferred from MS & Co to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

406. Brokerage and bank records show that approximately $1.2 million was transferred from the Stock Account to McGinn Smith Advisors, LLC. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

407. Brokerage and bank records show that approximately $300,000 was transferred from the Stock Account to McGinn Smith Firstline Funding, LLC. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

408. Brokerage and bank records show that approximately $395,000 was transferred from the Stock Account to McGinn Smith Funding, LLC. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

409. Brokerage and bank records show that approximately $150,000 was transferred from the Stock Account to McGinn Smith Holdings, LLC. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

410. Brokerage and bank records show that approximately $300,000 was transferred from the Stock Account to TDMM Benchmark Trust 09. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

411. Brokerage and bank records show that approximately $100,000 was transferred from the Stock Account to TDMM Cable Funding and approximately $260,000 was transferred from TDMM Cable Funding, LLC to the Stock Account. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

412. Brokerage and bank records show that approximately $175,000 was transferred from TDMM Cable Jr. Trust 09 to the Stock Account. App. Ex. 1 (Palen Exhibit 24 at 1).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

413. Brokerage and bank records show that $3,143,625 was transferred from the Stock Account to Integrated Alarm Services ("IA"), a McGinn Smith related entity, and $3,339,625 was transferred from IA to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

414. Brokerage and bank records show that approximately $599,000 was transferred from the Stock Account to and approximately $149,000 was transferred from McGinn Smith Capital Holdings to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

415. In addition, between November 21, 1992 and August 27, 1999, a period for which there are incomplete records, financial records show at least $3.3 million was transferred from the Stock Account to McGinn Smith & Co., and at least $1.5 million was transferred from the Stock Account to C-4. App. Ex. 1 (Palen Ex. 24 at 2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

416. During the same period, financial records show that at least $2 million was transferred from McGinn Smith & Co. to the Stock Account and at least $762,000 was transferred from C-4 to the Stock Account. App. Ex. 1 (Palen Ex. 24 at 2).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

417. On September 29, 2006, David Smith loaned approximately $2,625,000 from FIIN to TDM Cable Funding, LLC. App. Ex. 289 (D. Smith 12/13/11 Dep. at 5-28); App. Ex. 215 (Dep. Ex. 508).

RESPONSE: Admitted.

418. On October 3, 2006, David Smith, Timothy McGinn and their partner Matthew Rogers each received $350,000 from TDM Cable Funding LLC. App. Ex. 295, 296, 245 (Dep. Exs. 509; 510; 511).

RESPONSE: Admitted.

419. On October 4, 2006, Timothy McGinn used $85,000 of the monies he received from TDM Cable Funding LLC to repay the Stock Account a portion of a loan he had received from the Stock Account. App. Ex. 1 (Palen Ex. 25) App. Ex. 347 (M&T01 193-011195 at 2 and 3).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

420. In February and March 2009, David Smith caused cash and securities totaling at least $635,000 to be transferred to the Stock account. App. Ex. 272 (PI Tr. 300-30 1); see also below.

RESPONSE: Objection. This paragraph is vague and the exhibit upon which is relied does not support the statement advanced. It is therefore denied. Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

421. In February 2009, David Smith transferred all of the cash and securities, valued at $610,095.54 as of February 1, 2009 from the David L. Smith Lifetime QTip Trust to his personal brokerage account. App. Ex. 292 (D. Smith QTip Trust Statement dated 2/28/09); App. Ex. 293 (D. Smith brokerage statement dated 2/28/09).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

422. The QTip Trust was created with funds that were transferred from David Smith's personal account ending in 9965 that were proceeds of the fraud. For example, on May 10, 2007, D. Smith received $310,000 from MS Funding, LLC. App. Ex. 1 (Palen Ex. 26).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

423. These funds from MS Funding LLC were improperly diverted funds payments to David Smith made in connection with the Firstline Trust offering. App. Ex. 337 (GJ1A).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

424. On May 25, 2007, David Smith transferred those funds to the QTip Trust. App. Ex. 1 (Palen Ex. 26).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

425. Again, on October 10, 2008, David Smith transferred $230,000 from his checking account to the QTip Trust. App. Ex. 1 (Palen Ex. 25). The funds were received from NEI Capital LLC on October 3, 2008 ($265,000) and on October 6, 2008 ($75,000). App. Ex. 1 (Palen Ex. 25). These were unauthorized payments made to David Smith in connection with the Fortress offering. App. Ex. 337 (GJ1A).

RESPONSE: Objection. This paragraph improperly contains legal arguments and conclusions outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

426. Thus, the Stock Account received fraudulent proceeds of the McGinn Smith fraud through its receipt of funds, totaling $610,095.54 from David Smith's QTip Trust.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

427. In addition, on February 4, 2009, David Smith caused a transfer of $38,430.46

from C-4 to the Stock Account. App. Ex. 1 (Palen Ex. 25); App. Ex. 252 (L. Smith 5/27/10 Deposition at 62:23-63:10; Dep. Ex. 612).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

428. This transfer was not repayment of any loan from the Stock Account to C-4. App. Ex. 252 (L. Smith 5/27/10 Deposition at 62:23-63:10).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

429. L. Smith stated that this transfer was a "gift" from David Smith. App. Ex. 252 (L. Smith 5/27/10 Deposition at 62:23-63:10).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

430. The Court found that David Smith's transfers of certain of these assets to the Stock Account in 2009 were done "for no apparent reason other than to shield those assets from investors." *SEC v. McGinn Smith et al*., 752. F. Supp.2d 194 at 203 (MDO dated 7/7/10, Dkt No. 86, at 10) citing PI Hearing Tr. 290-92; 296-30 1).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

431. The Smiths used monies from the McGinn Smith entities for their personal benefit. For example, in 2010, the Smiths leased two cars, an SUV Lexis and a compact Infiniti. Prior to the assets freeze, the leases were paid for by MS & Co. L. Smith 5/27/10 App. Ex. 252 (Deposition at 27:24-28 15).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the

Trust's Response to Plaintiff's Statement of Material Facts into this response.

432. The transfers from the Stock Account were frequently made pursuant to Letters of Authorization ("LOA"). App. Ex. 270 (PI Ex. 126); App. Exs. 177-180; 188; 190; 191; 193; 195; 196; 198, 199; 201; 202; 204; 205.

RESPONSE: Admitted Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

433. L. Smith signature appears on the majority of the LOA's. App. Ex. 1 (Palen Ex. 24); App. Ex. 270 (PI Ex. 126); App. Exs. 177-1 80; 188; 190; 191; 193; 195; 196;198, 199; 201; 202; 204; 205.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

434. However, at times, David Smith directed McGinn Smith employees to cut and paste L. Smith's signature on LOAs. For example, on March 6, 2002, David Smith asked Patty Sicluna to prepare a wire and to do a "cut and paste job," indicating that the L. Smith signature line on the LOA should be cut from one document and pasted to another. App. Ex. 178 (MGS DOJ 000526 and MGS DOJ 000518).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

435. Also on March 6, 2002, a LOA for a $3,000 wire transfer to David Smith's account has attached to it a handwritten instruction from David Smith : "Patty: Wire $3,000 into my account at M&T... cut and paste again." App. Ex. 177 (MGS DOJ 000525; MGS DOJ 000524).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

436. During the period from at least 2001 to 2009, L. Smith typically signed 10-15 LOAs in blank, i.e., with no information concerning the amount to be transferred or the recipient, and provided them to David Smith to be used for making transfers from the Stock Account. App. Ex. 271, 272 (PI Hearing Tr. at 175-184; 188-189; 219-220; 341-43, 384-86, 413-14).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

437. David Smith then gave these blank but signed authorizations to a subordinate to be maintained in the subordinate's desk for use as directed by David Smith. App. Ex. 271, 272 (PI Hearing Tr. 175-84, 341-43, 384-86, 413-14).

RESPONSE: Admitted.

438. Over 137 LOAs were processed by various McGinn Smith employees in connection with transfers into and out of the Stock Account. App. Ex. 1 (Palen Ex. 25); App. Ex. 270 (PI Ex. 126); App. Ex. 177-180; 188; 190; 191; 193; 195; 196;198, 199; 201; 202; 204; 205.

RESPONSE: Admitted.

439. For a period of time, MS & Co, was required by their clearing broker to have a second signature on the LOAs. David Smith, Timothy McGinn, Patty Sicluna, and David Rees, provided these authorizations. App. Ex. 1 (Palen Ex. 25); App. Ex. 270 (PI Ex. 126); App. Ex. 177-180; 188; 190; 191; 193; 195; 196;198, 199; 201; 202; 204; 205.. App. Ex. 300 (P.Sicluna 11.2.11 Deposition at 39-40).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims

in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

440. Many of the LOAs reflected the need for urgent transfers of funds. For example, on June 3, 1999, Brian Shea wrote to Patty Sicluna, "$400,000 Lynn Smith to Capital Center Credit Corp. Need ASAP. Thank you." App. Ex. 199 at 18-19 (1999 – Letters of Authorization: MGS DOJ 000162-3). This LOA contained a second approval signature by Timothy McGinn. Id.

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

441. Timothy McGinn, rather than David Smith, countersigned over 80 of the LOAs. App. Ex. 1 (Palen Ex. 25); App. Ex. 270 (PI Ex. 126);App. Ex. 177-180; 188; 190; 191; 193; 195; 196;198, 199; 201; 202; 204; 205. At times, other McGinn Smith employees, such as Patty Sicluna and David Rees, provided the second signature. *Id.*

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion. It is therefore denied.

442. Many of the transfers to McGinn Smith were short term infusions of capital to help the entities continue operations or meet minimum raise thresholds so that deals could go forward. For example, financials records show a transfer of $125,000 from the Stock Account to C-4 on November 1, 1995 and a transfer of $125,000 from C-4 back to the Stock Account on November 30, 1995. App. Ex. 1 at 70 (Palen Ex. 25).

RESPONSE: Objection. This paragraph contains conclusory statements outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56.

Notwithstanding and subject to said objection, the paragraph is otherwise admitted.

443. Financial records show a transfer of $325,000 from the Stock Account to C-4 on June 27, 1997 and a transfer of $325,000 from C-4 to the Stock Account on July 11, 1997. App. Ex. 1 at 70 (Palen Ex. 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

444. Financial records show a transfer of $160,000 from the Stock Account to C-4 on February 5, 1999 and a transfer of $160,000 from C-4 back to the Stock Account on April 14, 1999. App. Ex. 1 at 71 - 72 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

445. Financial records show a transfer of $300,000 from the Stock Account to C-4 on September 30, 1999 and a transfer of $300,000 from C-4 back to the Stock Account on October 1, 1999. App. Ex. 1 at 72 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

446. Financial records show a transfer of $500,000 from the Stock Account to C-4 on October 22, 1999 and a transfer of $502,630 from C-4 back to the Stock Account on November 15, 1999. App. Ex. 1at 72 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims

in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

447. Financial records show a transfer of $350,000 from the Stock Account to C-4 on July 2, 2001 and a transfer of $350,000 from C-4 back to the Stock Account on July 5, 2001. App. Ex. 1 at 75 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

448. Financial records show a transfer of $500,000 from the Stock Account to C-4 on September 28, 2001 and a transfer of $500,000 from C-4 to the Stock Account on October 1, 2001. App. Ex. 1 at 75 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

449. Financial records show a transfer of $550,000 from the Stock Account to C-4 on October 30, 2002 and a transfer of $552,712 from C-4 back to the Stock Account on November 19, 2002. App. Ex. 1 at 78 (Palen Exhibit 25).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and Summary Judgment Motion and pertains to a time period years prior to any of plaintiff's allegations. It is therefore denied.

450. Financial records show a $3,000,000 transfer from the Stock Account to IASG was made on January 14, 2003 for "working capital" to effect the public offering and was repaid on July 29, 2003 with offering proceeds. App. Ex. 1 (Palen Ex. 25); App. Ex. 450 (Excerpt from

Prospectus, PI Ex. 450 at Gersav 0015923).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

451. L. Smith could not recall whether she had ever loaned money to IASG. App. Ex. 272 (PI Tr. 344: 18-23).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

452. On October 1, 2003, financial records show that the Stock Account transferred $2 million to First Independent Income Notes. FIIN repaid the amounts to the Stock Account on October 30, 2003, along with $15,556 in interest. App. Ex. 1 at 80 (Palen Exhibit 25).

RESPONSE: Admitted.

453. Financial records show that, on June 5, 2009, two transfers, totaling $366,000, were made from the Stock Account for the benefit of TDMM Cable Funding, LLC. App. Ex. 1 at 85 (Palen Ex. 25); App. Ex. 244 (L. Smith 5/21/10 Affidavit at 27); App. Ex. 291 (MS- N-00777476).

RESPONSE: Objection. This paragraph improperly contains characterization and opinion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

454. Financial records show that the Stock Account was repaid $160,800 of these monies on June 10, 2009 and $175,000 of these monies on July 30, 2009 from investor funds raised by TDMM Cable Jr. Trust 09. App. Ex. 1 at 85 (Palen Ex. 25); App. Ex. 294 (MERC 000045; MERC 000233).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to

Plaintiff's Statement of Material Facts into this response.

455. Although a promissory note was prepared at some point in connection with this transfer, L. Smith never signed the note, did not see it before the transfer was made and never even saw it until after this case was brought. App. Ex. 252 (L. Smith 5/27/10 Deposition at 53:5-55:20); App. Ex. 254 (L. Smith 5.21.10 Aff.).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

456. Financial records show that on November 29, 2007, $375,000 was transferred from the Stock Account to McGinn Smith Funding, LLC to provide a bridge loan for the Firstline Trust offering. App. Ex. 1at 83 (Palen Ex. 25); App. Ex. 252 (L. Smith 5/27/10 Deposition at 61:19-62:15).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

457. Financial records show that on December 20, 2007, the $375,000, plus an additional $5,000, was repaid by McGinn Smith Funding to the Stock Account via David Smith's checking account. App. Ex. 1 at 83 (Palen Exs. 25 and 26).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

458. L. Smith did not know the circumstances concerning the bridge loan, why the loan was made or what McGinn Smith Funding was at the time of the loan. App. Ex. 252 (L. Smith 5/27/10 Deposition at 61:19-62:15).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

459. Financial records show that on March 10, 2008, the Stock Account transferred $200,000 to M&S Partners; the money was then transferred to McGinn Smith Holdings LLC, then to TAIN's Operating Account, then to TAIN's account at NSF to meet a margin call. App. Ex. 1 at 83 (Palen Ex. 25); App. Ex. 288 (M & T 001634; M&T 001820; M&T 003257; NFS008405-8412; MS-E-1092268).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

460. Financial records show that on October 30, 2009, the Stock Account made a $300,000 investment in TDMM Benchmark Trust 09. App. Ex. 1 at 85 (Palen Exhibit 25).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

461. Few if any of these transfers were accompanied by any formal "loan' documentation.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion beyond the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

462. In a letter dated May 13, 2002 to Brian Shea, a McGinn Smith employee, David Smith summarized the business reasons for various transfers from the Stock Account and other sources to McGinn Smith entities. David Smith stated: "You have asked me to summarize the various investments and loans that Lynn and I have made over the last several years to McGinn Smith & Co. and its affiliates... .The attached summary can be used to confirm the status of both

principal and interest for all of the investments and to serve as a record for my estate should I predecease the satisfaction of these loans and investments." David Smith also noted that various of the "loans" had no loan documentation prepared. App. Ex. 246 (MGS DOJ 00 1392-94).

RESPONSE: Admitted.

463. L. Smith could not explain the business reasons for certain large transfers from the Stock Account that occurred as recently as the prior year. For example, L. Smith did not know the reason for transfers of $15,000 from the Stock Account to David Smith on February 20, 2009 or for a $100,000 check from McGinn Smith payable to the Stock Account on May 4, 2009. App. Ex. 252 (L. Smith 5/27/10 Deposition at 89:23-90:22).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

464. L. Smith did not recall lending money to a company called Mobile Search Security. App. Ex. 252 (L. Smith 5/27/10 Deposition at 91:8-92:2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

465. L. Smith did not recall whether she owned certificates in Benchmark despite the fact that money from the Stock Account had been used to purchase Benchmark notes on October 30, 2009. App. Ex. 252 (L. Smith 5/27/10 Deposition at 92:4-92:18).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

466. Money from the Stock Account was also used to make large personal loans to David Smith's business partner Timothy McGinn. A $900,000 loan was made from the Stock Account to Timothy McGinn in 2003. App. Ex. 259 (L. Smith Statement of Net Assets dated

March 31, 2010; App. Ex. 252 (L. Smith Deposition dated 5/27/2010 at 16:5-25-17:1-11).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

467. Another loan of $ 15,000 was made from the Stock Account to Timothy McGinn. App. Ex. 259 (L. Smith Statement of Net Assets dated March 31, 2010); App. Ex. 252 (L. Smith Deposition dated 5/27/2010 at 16:5-25-17:1-1 1).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

468. L. Smith never spoke to Timothy McGinn in connection with either of these loans. App. Ex. 272 (PI Tr. at 278).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

469. David Smith described his wife's ability to understand financial and business matters, both with respect to the Smith Trust and the Annuity Agreement discussed below and generally, as follows:

A.My recollection is I would have given her the basic background, reasons, benefits, talked about the annuity payment and, you know, 15 minutes later if given a quiz, she would have failed, but that notwithstanding that I had that discussion.

Q. Why did you say that?

A. Because the nature of the beast is my wife is, you know, totally dependent on – well, let me rephrase that. She had a great deal of confidence in my business acumen and experience. She had virtually none. The experience had been reasonably good for all the years we've been married and she quite frankly – and this is not to denigrate her skill sets or her

intellectual capacity whatsoever, she just didn't have a lot of interest in those things. She knew that we were reasonably well off, that our future ability to enjoy a post- retirement was fairly well in place and just did not bother with the details. And like a lot of wives post making that signature, as I said, if I went back to her and had some period of time and asked her what I had just told you ad gave her a test, she would probably fail it.

App. Ex. 290 (David Smith 12/14/11 Deposition Tr. at 346:17-347:13).

RESPONSE: Admitted.

470. David Smith also admitted: "That's an accurate statement, yes." when asked: "All right, Now, I think I understand you to say that your wife really didn't focus that much on the business end of your finances? App. Ex. 290 (D. Smith 12/14/11 Deposition Tr. at 348 :23-349:2).

RESPONSE: Admitted.

471. In December 2003, David Smith, L. Smith, Timothy McGinn, MS & Co. and other entities controlled by Smith and McGinn were named as defendants in a securities fraud suit filed in the United States District Court for the Southern District of New York arising from the June 2003 initial public offering of IASG, Meyers v. Integrated Alarm Services Group, Inc., et al, 03-cv-09748 (S.D.N.Y.). App. Ex. 304 (Dep. Ex. 374); App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 30); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 58); App. Ex. 282 (T. McGinn Responses to Requests for Admissions, ¶ 58).

RESPONSE: Admitted.

472. The complaint asserted 23 causes of action and sought $3 million in damages for each claim. App. Ex. 304 (Dep. Ex. 374).

RESPONSE: Admitted.

473. The Complaint included factual allegations relating to two $3 million loans by L. Smith to certain entities to facilitate a public offering of IASG, a company affiliated with Smith and McGinn. App. Ex. 304 (Dep. Ex. 374, paras. 118-129).

RESPONSE: Admitted.

475. The Stock Account was used to make these loans. See above at 377-3 83. The case was settled in the spring of 2004 and included payments totaling $200,000 to the plaintiff from M&S Partners and IASG. App. Ex. 250 (Dep. Ex. 453 - Settlement Agreement). L. Smith and David Smith were signatories to the Settlement Agreement. Id.

RESPONSE: Admitted as to Mr. Smith being a signatory to the Settlement Agreement. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

476. On February 26, 2004, Steven Vitulano, Branch Chief of the SEC's Broker-Dealer Inspection Team sent David Smith, in his capacity as President of McGinn Smith, a letter setting forth violations of various rules and regulations promulgated under the Securities Exchange Act of 1934 and the National Association of Securities Dealers, Inc. that McGinn Smith had been found, during on-site inspections, to have violated, including a violation of Section 15(a) of the Exchange Act in that McGinn Smith controlled C-4 as an unregistered broker-dealer and a violation of Section 5 of the Securities Act of 1933 in that McGinn Smith had accepted funds for the purchase of IASG's initial public offering prior to the effective date of the offering. App. Ex. 298 (Dep. Ex. 542 – February 26, 2004 Letter from Vitulano).

RESPONSE: Admitted.

477. The SEC's letter also detailed numerous recordkeeping violations. App. Ex. 298 (Dep. Ex. 542 – February 26, 2004 Letter from Vitulano).

RESPONSE: Admitted.

478. At the time of the transfer of the Charter One Stock to the Smith Trust, David Smith was aware of the consequences of committing fraud and that his actions could result in significant financial loss. In a lengthy, prior undated, handwritten "personal confession" to McGinn, Smith wrote that:

The business has become addicted to the cash flow from the trust business, and without that we will have a difficult time surviving. . . . The default of the trusts will drastically reduce revenues, cause us to lose brokers and at least their confidence in us, bring on crushing litigation and devastating publicity and I am convinced prosecution by regulators or worse. . . . I am just overwhelmed by the thought of the financial losses, the humiliation, the perceived betrayal of trust. . . . I, unlike you, feel that we are vulnerable to criminal prosecution. . . .

[W]e are now in possession of indisputable empirical evidence that the new investments have no chance of ever being repaid in full. . . . For us not to allow for these deficits by setting up adequate reserves is, in my judgment, bordering on fraud, certainly, by not disclosing in the prospectus our poor history of collections, we are not providing the prospective investors an accurate picture of this risk. We both know why we don't make that disclosure – because such disclosure would cause our salesman to cease selling and investors to cease buying. Thus, we are misleading both our own employees and customers. . . . This is wrong. I strongly believe that in civil or criminal litigation we would lose badly on this point. . . .

[B]oth you and I are violating the high standards of integrity and ethics that have been the historical standard for us. That bothers me very very much. But what terrifies me is the possibility of being indicted for such conduct, and worse, the prospect of conviction. I cannot emphasize enough how strongly I feel about this point.

App. Ex. 54 at 4-8; App. Ex. 55 (typed version).

RESPONSE: Objection. This paragraph mischaracterizes the unsent 1999 letter written by Mr. Smith prior to the allegations in plaintiff's Second Amended Complaint. It is therefore denied.

479. On May 4, 2004, Charter One publicly announced that it was being acquired in an all-cash deal by Citizens Financial Group, which paid $44.50 per share. The deal was completed on August 31, 2004. App. Ex. 214 (D. Smith Answer to SAC, ¶ 19); App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 26); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 54). David and L. Smith knew, therefore, that their Charter One stock would be converted to cash as a result of the buy-out. Id.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

480. David and L. Smith created the David L. and Lynn A. Smith Irrevocable Trust U/A dated August 4, 2004 (the "Smith Trust") pursuant to a Declaration of Trust. App. Ex. 226 (Dep. Ex. 369 – Declaration of Trust); App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 19); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 47).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

481. The Smith Trust had no assets when it was created. App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 20); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 48).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

482. L. Smith stated that she "transferred 100,000 shares of Charter One stock, then valued at $44.50 per share, to the trust." App. Ex. 254 (Lynn Smith 5/21/10 Aff., Dkt, 34, at ¶ 5).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

483. On September 1, 2004, 100,000 shares of Charter One stock were transferred from the Stock Account to the Smith Trust account. At the time of this transfer, the fair market value of the Charter One stock was approximately $4.45 million. App. Ex. 214 (D. Smith Answer to SAC, ¶ 20); App. Ex. 255 (L. Smith Answer to SAC, ¶ 128).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

484. On the same day that the 100,000 shares were transferred from the Stock Account to the Smith Trust account on September 1, 2004, the cash merger occurred, resulting in the Smith Trust account being credited with $4,450,000 in cash. App. Ex. 214 (D. Smith Answer to SAC, ¶ 20); App. Ex. 255 (L. Smith Answer to SAC, ¶ 129); App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 28); App. Ex. 265 (Smith Trust Trustee, G. Smith and Lauren Smith Response to First Request for Admissions, ¶ 28); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 56). The creation of the Smith Trust and the transfer of the stock through the Annuity Agreement therefore served to shelter this large sum of cash. Id.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope are requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

485. At the time of the transfer of the Charter One stock to the Smith Trust, the FIIN and FEIN fraudulent offerings were well underway. The FIIN offering dated September 15, 2003

and the FEIN offering dated January 16, 2004 each raised $20 million from investors, for a total of $40 million. App. Ex. 1, Ex. 3.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope are requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

486. The private placement memoranda for both offerings did not permit investments in affiliates but Smith from the beginning invested with affiliates. **See above at 69-74.**

RESPONSE: Denied. See above at 69-74.

487. As of December 31, 2003, 11% of the investments were with affiliates, and this grew to 32% by December 31, 2004. App. Ex. 1, Exs. 10-12. Smith therefore knew that he would likely become liable to the defrauded investors and/or to the Commission as a result of his ongoing violations of the federal securities laws. Id.

RESPONSE: This paragraph improperly contains legal argument and conclusion outside the scope are requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

488. In addition, at the time of the transfer to the Smith Trust, the liabilities of FIIN and FEIN far exceeded their assets. As a result, Smith knew that he would be unable to meet the payment obligations of these Funds to investors. Id.

RESPONSE: Objection. This paragraph improperly contains speculation outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

489. L. Smith stated that her reason for creating the Smith Trust was: "to take

advantage of available estate planning laws to fund a trust for my children, from which they could benefit during my lifetime, instead of having these assets sit in a brokerage account until my death." App. Ex. 254 (L. Smith 5/21/10 Aff., Dkt. 34, at ¶ 4).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

490. In a separate Affidavit, L. Smith stated that she and her husband created the Smith Trust: "... to provide security for my children's future apart from my stock account. ... My children were adults, had completed college, and could begin to make financial decisions on their own." App. Ex. 244 (L. Smith 5/21/10 Aff., Dkt. 23 at ¶ 23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

491. In her deposition on May 21, 2010, L. Smith stated that: "The trust, the purpose of the trust was our children are 27 and 30 years old. Presently, we started this about four years ago, this particular trust and I wanted them to be able to have an opportunity to if they wanted to start a business, own a home, I wanted them to have the rewards, reap the rewards of my husband's business and so we both agreed on putting that in the trust." App. Ex. 252 (L. Smith 5/27/20 10 Deposition at 39:16-30:18).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

492. In her Affidavits submitted in opposition to the freeze of the Stock Account and the Smith Trust, L. Smith repeatedly stated that she and her husband had no interest in the assets of the Smith Trust. For example, L. Smith stated: "From the time the trust was created in August 2004, my husband and I have had no interest in or expectation of an interest in the David L. and

Lynn A. Smith Irrevocable Trust. It exists solely, exclusively and permanently for the benefit of my children." App. Ex. 254 (L. Smith 5/21/Affidavit, Dkt. 34, at ¶ 6).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

493. L. Smith also stated: "We cannot take money out of the trust." App. Ex. 252 (L. Smith 5/27/20 10 Deposition at 41:2-8).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

494. L. Smith failed to inform the court that in return for transferring the Charter One stock, worth approximately $4,450,000, to the Smith Trust, the Smiths entered into a Private Annuity Agreement (the "Annuity Agreement") with the Smith Trust on or about August 31, 2004, that entitled the Smiths to yearly annuity payments from the Smith Trust of $489,000 a year beginning in September 2015 and continuing until the death of the last of the Smiths. App. Ex. 227 (Dep. Ex. 370 – Annuity Agreement).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

495. Both David and L. Smith signed the Annuity Agreement with the Smith Trust. App. Ex. 227 (Dep. Ex. 370 - Annuity Agreement); App. Ex. 265 (Lynn Smith Response to First Request for Admissions, ¶ 23); App. Ex. 218 (David Smith Response to First Request for Admissions, ¶ 51).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

496. The effective date of the Annuity Agreement was August 31, 2004. App. Ex. 279

(Smith Trust Trustee, G. Smith and Lauren Smith Responses to First Request for Admissions); App. Ex.265 (Lynn Smith Response to First Request for Admissions, ¶ 21); App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 49).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

497. The Annuity Agreement is a valid and enforceable agreement. App. Ex. 218 (D. Smith Responses to Requests for Admissions, ¶ 53).

RESPONSE: Admitted. Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

498. The Annuity Agreement stated that the Smiths "are the owners of 100,000 shares of stock ... and desire to sell the Property to the Transferee to be relieved of the burden and risk associated with owning and managing the Property in order to receive investment income and a portion of the principal on a regular basis." App. Ex. 227 (Dep. Ex. 370 – Annuity Agreement).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

499. The Annuity Agreement required the Smith Trust to: "hold full title to the Property, free and clear of all liens and encumbrances, and there shall be no collateral liens of any kind on the Property or any other assets of the Transferee to secure payment of the obligations to the Transferors under this Agreement." App. Ex. 227 (Dep. Ex. 370 – Annuity Agreement, at ¶ 3.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

500. In connection with the Annuity Agreement, David and Lynn Smiths' joint life

expectancy was calculated as 31 years. App. Ex. 227 (Dep. Ex. 370 – Annuity Agreement). The Smiths therefore have a joint life expectancy of approximately 20 years from the date the payment obligations are scheduled to begin in September 2015. Id.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

501. The annual payment of $489,932, if paid out over the 20-year joint life expectancy, would entitle David and/or Lynn Smith to payments totaling approximately $10 million from the Smith Trust. Id.

RESPONSE: Objection. This paragraph is speculative and conclusory outside the scope and requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

502. L. Smith failed to produce of a copy of the Private Annuity Agreement in response to discovery requests for all documents relating to her assets and liabilities prior to the preliminary injunction hearing. App. Ex. 219 (D. Stoelting 8.3.10 Decl. – Dkt. 103-2, at ¶ 12-14); App. Ex. 278 (Plaintiff's First Request for the Production of Documents to Relief Defendant Lynn Smith at paras. 1 -4; 9-11; 17).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

503. L. Smith did not disclose the Annuity Agreement, or her and David Smiths' joint right to annuity payments of $489,932 a year beginning in 2015 on the court ordered Statement of Net Assets as of March 31, 2010. App. Ex. 259 (Lynn Smith 3/31/10 Net Asset Statement).

RESPONSE: Objection. This paragraph improperly contains legal argument and

conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

504. L. Smith did not disclose the existence of the Annuity Agreement during her May 27, 2010 deposition in this case despite being asked questions concerning her assets and the Smith Trust, including why the assets of the Smith Trust were listed as assets of David and Lynn Smith in several financial statements reporting the Smiths assets and liabilities. App. Ex. 252 (See, e.g., Lynn Smith 5/27/10 Dep. at pp. 79-85).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

505. L. Smith did not disclose the existence of the Annuity Agreement during her testimony before the Court at the preliminary injunction hearing on June 10, 2010. App. Ex. 272 (PI Tr. 271-420).

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

506. L. Smith did not disclose the existence of the Private Annuity Agreement in the affidavits she submitted to this Court on May 21, 2010 (Dkt. 23) , May 26, 2010 (Dkt. 34) and June 9, 2010, (Dkt. 69-1), in connection with the preliminary injunction hearing. App. Ex. 244, App. Ex. 254 and App. Ex. 260, respectively.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

507. In a Financial Statement dated August 2008, the Smiths listed as part of their cash and securities assets in the Smith Trust. . App. Ex. 210 (Pl 00 351 8); App. Ex. 252 (Lynn Smith 5/27/10 Dep. Ex. 10.).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

508. A handwritten Financial Statement dated December 31, 2007 prepared by David Smith also listed assets the Smith Trust's assets, totaling $4,453,022 as one of the Smiths' assets. App. Ex. 252 (Lynn Smith 5/27/10 Dep. Ex. 13).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

509. In a subscription agreement submitted on behalf of the Smith Trust, David Smith described himself as the "beneficiary" of the Smith Trust, stating: "David Smith, beneficiary of the David L. Smith and Lynn A. Smith Trust dated 8/4/04 as the principal shareholder and president and CEO of the McGinn, Smith & Co , a member of the NASD. McGinn. Smith is an investment banking firm that has served as an underwriter." App. Ex. 268 (PI Dep. Ex. 24 – Deerfield Subscription Agreement).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

510. Thomas Urbelis, a lifelong friend of David and Lynn Smith, was appointed Trustee at the request of David Smith. App. Ex. 252 (L. Smith 5/27/10 Dep. at 37:19-38:7).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

511. Urbelis was a lawyer whose specialty was municipal law, zoning and land use.

App. Ex. 283 (T. Urbelis 6/1/10 Dep. at 6:11-7:8).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

512. Urbelis recalled that it was either David or Lynn Smith but "probably" David Smith who asked him to be Trustee. App. Ex. 283 (T. Urbelis 6/1/10 Dep. at 10:3-8).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

513. Urbelis made clear to David Smith that he would not take responsibility for preparing tax returns. He testified: "I wanted assurance that I was not going to be responsible for preparing tax returns... I make no bones about it. I don't understand it." App. Ex. 283 (Urbelis 6/1/10 Dep. at 12: 7-19).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

514. From 2004 until his resignation in 2010, Urbelis routinely signed documents regarding the Smith Trust when David Smith or employees of McGinn Smith asked him to do so. See, e.g, Dkt. No. 46-7.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

515. Documents were sent to Urbelis from David Smith or McGinn Smith employees with instructions for him to sign them immediately and return them via overnight mail. *See, e.g.*, Dkt. 46-8.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

516. Urbelis relied upon David Smith for all investment decisions for the Smith Trust. App. Ex. 283 (Urbelis 6/1/10 Dep. at 12:20-14:18).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

517. Urbelis signed letters of authorization permitting transfers of approximately $297,786 from the Smith Trust to accounts in the name of either David or Lynn Smith. App. Ex. 275 (Dkt. 46, Ex. 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

518. Urbelis understood that the money was for payment of the Smith Trust taxes, but he did not know what the Smiths did with the money after he sent it to them. App. Ex. 283 (Urbelis 6/1/10 Dep. at 52:1-53:8).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

519. When asked what Urbelis did to manage the Smith Trust, L. Smith stated: "He pays the – well, he signs some things so we can pay the taxes on the trust and I don't think there is anything else he does." App. Ex. 252 (L. Smith 5/27/10 Dep. at 38:16-20).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

520. Geoffrey Smith, one of the two named beneficiaries of the Smith Trust, did not learn of the Smith Trust until Thanksgiving 2004, when David Smith told Geoffrey Smith that he and L. Smith had created a trust for Geoffrey and Lauren Smith that was valued at approximately $4 million funded from Charter One stock. App. Ex. 248 (G. Smith 11/16/11 Deposition at

109:12-25).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

521. During this conversation, Davis Smith showed Geoffrey Smith the Declaration of Trust. App. Ex. 248 (G. Smith 11/16/11 Deposition at108:19-111:25).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

522. David Smith did not discuss the role of the Trustee, Thomas Urbelis, with Geoffrey Smith during this conversation. App. Ex. 248 (G. Smith 11/16/11 Deposition at 112:6-9).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

523. Geoffrey Smith did not discuss the Smith Trust with this mother. App. Ex. 248 (Geoffrey Smith 11/16/11 Deposition at 112:17-23; 121:9-11).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

524. Geoffrey Smith stated that he "never" had a discussion with his parents about the fact that the Smith Trust had entered into an annuity agreement with his parents that entitled them to yearly payments of $489,000. App. Ex. 248 (G. Smith 11/16/11 Deposition at 114:10-16; 125:9-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

525. Geoffrey Smith had no discussions with Thomas Urbelis, the Trustee of the Smith

Trust from 2004 until 2010. App. Ex. 248 (G. Smith 11/16/11 Deposition at 113:3-21).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

526. When Geoffrey Smith was considering a distribution of approximately $200,000 to $300,000 from the Smith Trust in 2009 to start a business venture, he discussed it with his father, David Smith, not with the Trustee, David Smith. App. Ex. 248 (G. Smith 11/16/11 Deposition at 123:7-124:15).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

527. Neither David nor Lynn Smith ever informed their daughter Lauren Smith that she was the beneficiary of the Smith Trust, containing over $4,000,000 in assets. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:8-15; 46:6-8).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

528. Lauren Smith had no conversations whatsoever with her parents about the Smith Trust. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:8-15; 46:6-8).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

529. The Smith family was "close." App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 21:9). Lauren Smith spoke with her parents about five times a week during the period from 2006 to 2009 when she lived in the Boston, Massachusetts area. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 21:10-12). Lauren Smith knew Thomas Urbelis, the Smith Trust Trustee her entire life. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 42:22-25).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

530. Lauren Smith never spoke with the Smith Trust trustee, Thomas Urbelis, about the Smith Trust. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:5-7; 46:24-47:2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

531. Lauren Smith was unemployed and collected unemployment insurance for approximately one and a half years after the Smith Trust was created. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 12: 2-7).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

532. Lauren Smith never withdrew any money from the Smith Trust. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:8-15; 46:6-80.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

533. Lauren Smith learned about the existence of the Smith Trust and the fact that she was a named beneficiary from a brief conversation with her brother Geoffrey Smith one Thanksgiving sometime after the Smith Trust was created. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:16- 44:4).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

534. Geoffrey Smith recalled the conversation with Lauren Smith occurring over the Thanksgiving week-end in 2004 when he first learned of the Smith Trust. App. Ex. 248 (G.

Smith 11/16/11 Deposition at1 19:19-120:5).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

535. Geoffrey Smith told Lauren Smith the trust was worth about $4 million but he did not recall discussing with her whether they would be able to use the funds in the Smith Trust. App. Ex. 248 (G. Smith 11/16/11 Deposition at 120:13-121:4).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

536. Geoffrey Smith told Lauren Smith: "It wasn't money that was going to be touched." App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 43:18-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

537. Lauren Smith understood from Geoffrey Smith that the money was supposed to be for their future but they "did not get into details" when he told her about the Smith Trust. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 45:20-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

538. Lauren Smith never spoke with her parents about the Smith Trust after learning of it. App. Ex. 25 (Lauren Smith 11/28/11 Deposition at 46:6-8).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

539. Between March 27, 2007 and May 27, 2009, L. Smith sent 19 checks totaling $22,100 to Lauren Smith. Most of the checks were in the amount of $1,000. A number of the

checks indicate they are for rent. App. Ex. 224 (Dep. Ex. 417).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

540. Lauren Smith "went through a little bit of a rough period" and her parents helped her pay her rent in Boston for a year. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 84:17-19).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

541. When asked why she didn't withdraw money from the Smith Trust during this period, Lauren Smith stated, in part: "I didn't know I had access to the money. The trust had been set up for my future..." App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 85:5-12).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

542. Prior to April 2010, when the Smith Trust was frozen, the only individuals who benefitted from distributions from the Smith Trust were David and Lynn Smith. App. Ex. 275 (Dkt, 46, Ex. 1 - Summary of Smith Trust Distributions).

RESPONSE: Objection. This paragraph contains legal argument and conclusion beyond the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

543. In April 2010, Geoffrey Smith, after a conversation with David Smith, caused a transfer of $95,000 from the Smith Trust to L. Smith's checking account, $66,500 of which was used to pay the Smiths federal income taxes, $$8,500 of which was used to pay the Smiths' New York state taxes and $20,000 of which was used for payment of the Smith Trust's taxes. App.

Ex. 271-273 (PI Tr. 101; 320-321; 397; 416; 463; 513-16); App. Ex. 252 (L. Smith 5/27/10 Deposition at 92:19-95:2); App. Ex. 269 (PI Dep. Ex. 15) ;App. Ex. 214 (D. Smith Answer to SAC, ¶ 21); App. Ex. 255 (Lynn Smith Answer to SAC, ¶ 130).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

544. L. Smith stated that if she needed money to pay her personal taxes, her son and daughter would definitely take money from the Smith Trust to pay the taxes. App. Ex. 252 (L. Smith 5/27/10 Deposition at 100:16-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

545. David Smith also paid the Smith Trust's taxes one year from his own funds without reimbursement from the Smith Trust. App. Ex. 272 (PI Tr. 464-66).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

546. In a 2007 document discussing the Four Funds, David Smith stated:

5. A major negative on the cash flow has been that a number of the investments got into trouble early and there was no attempt to adjust the coupons on the bond. ... I approached the problem by making more equity type investments that would provide greater yields, but with obviously more risk. For the most part, these riskier investments have only aggravated the problem.

6. In addition, we felt that other investment returns would make up for the shortfall in cash flow from the alarm contracts. That proved not to be the case. 7. One of the more troubling aspects of the investments has been my willingness to make substantial investments in affiliated entities, both because they were available and in some cases, such as Coventry, new investments were

needed to support part investments....In all cases, this has proved to be a poor decision and has not only aggravated our cash flow problems, but puts us in some legal jeopardy as well.

547. App. Ex. 129 (Dep. Ex. 530 at 3 D. Smith 10.10.09 letter to Kaplowitz).

RESPONSE: Admitted.

548. In 2008-2009, McGinn Smith found itself in need of capital for both working capital purposes and regulatory purposes. App. Ex. 218 (D. Smith Responses to Plaintiff's First Request for Interrogatories, ¶ 16).

RESPONSE: Admitted.

549. Internal MS & Co. emails in 2009, including many by McGinn and Smith, reveal a constant need to raise millions of dollars, a growing desperation to make payroll, meet interest payments and assuage investors complaining of a Ponzi scheme, in order to keep their house of cards from collapsing. For example, on February 24, 2009, Smith emailed McGinn regarding an upcoming payroll. He stated: "We have been living on the edge for some time and Tim's deals have kept us alive by fronting our profit. However, the $200,000 + that we are losing every month is just too difficult to keep pace with." App. Ex. 145**.**

RESPONSE: Objection. This paragraph contains improper characterization beyond the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

550. On February 25, 2009, another MS & Co. Partner emailed Smith: "In our many conversations over the last year, I came to understand the depths to which the firm has sunk relative to its revenue." App. Ex. 348.

RESPONSE: Admitted.

551. In 2009, after an investigation by the Financial Industry Regulatory Authority

(FINRA) into MS & Co. had commenced, and as Smith and McGinn learned that they and their firm were named as Respondents in a number of FINRA arbitrations filed by investors, they began to move assets to their wives. See below**.**

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied.

552. L. Smith knew in 2009 that a number of FINRA arbitrations had been filed against McGinn Smith and it concerned her. App. Ex. 272 (PI Tr. at 295:8-25); App. Ex. 252 (L. Smith 5/27/10 Deposition at 22:18-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

553. L. Smith understood that the FINRA arbitrations filed by customers sought money and she was concerned that if those arbitrations were successful she could lose money. App. Ex. 272 (PI Tr. at 296:1-23).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

554. David and Lynn Smith began moving assets that had been jointly held into solely L. Smith's name. App. Ex. 217 (D. Smith Responses to Requests for Admissions, ¶ 42. See also below.

RESPONSE: Objection. This paragraph contains improper characterization beyond the scope and requirements of Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

555. In a January 7, 2009 letter from David Smith to Martin Finn, of Lavelle & Finn, LLP, the Smiths' financial planner, David Smith stated: "Also, I am interested in reducing my exposure to personal liability as a result of the very litigious business that I am in. You mentioned transferring my share in the Vero Beach and Saratoga residence to Lynn or a Trust." App. Ex. 305 (1/7/2009 Letter from D. Smith to M. Finn. - SEC-USAO_NDNY-P-0000556- 56 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

556. In a letter misdated January 11, 2009 (instead of 2010), after his customer David Chang had been awarded a judgment of over $800,000 against David Smith and others, David Smith stated:

I am beginning to realize that by not taking those fees to pay for various liabilities, including attorney's fees, that I am foolishly compromising the rest of my life. I will be forever burdened with at the very least a lien on my wage, and there is some risk that the equity that is not in my wife's name or protected by Trusts could be served with a lien to satisfy the judgments. This equity is primarily in the form of two properties, my home in Saratoga (jointly owned) and my home in Florida (transferred to my wife solely last April).

App. Ex. 213 (Dep. Ex. 610 - D.Smith Letter to David Franceski).

RESPONSE: Admitted.

557. In an e-mail dated January 14, 2009 from David Smith to Timothy McGinn, Smith stated that "Lynn and I have to shift money around between us." App. Ex. 349.

RESPONSE: Admitted.

558. From the beginning of their marriage in 1968, David and Lynn Smith maintained

a joint checking account into which they deposited both of their paychecks and from which they paid their household bills. App. Ex. 254 (Lynn Smith 5/21/10 Aff. at ¶ 16); App. Ex. 252 (Smith 5/27/10 Deposition at 30:13-22).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

559. David Smith's payroll checks from McGinn Smith were routinely deposited into the joint checking account. App. Ex. 272 (PI Tr. at 282).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

560. In or about July 2009, L. Smith opened a checking account at the Bank of America in her name only. App. Ex. 272 (PI Tr. at 282); App. Ex. 252 (L. Smith 5/27/10 Deposition at 3 1:22-32:4).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

561. David and Lynn Smith caused the assets in their joint checking account at the Bank of America to be transferred to the BOA checking account opened in L. Smith's name alone. App. Ex. 214 (D. Smith Answer to SAC, par. 23).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

562. From that time forward, David Smith's McGinn Smith payroll checks began to be deposited into the L. Smith checking account. App. Ex. 272 (PI Tr. at 282).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

563. Between July 15, 2009 and April 8, 2010, David Smith payroll checks totaling $129,096.67 were deposited into the L. Smith checking account. App. Ex. 275 (Daniello 6/3/10 Supp. Decl., Ex. C; - Dkt. No. 46).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

564. L. Smith stated that she opened the checking account in her name only because she wanted "to have some independence" and wanted to be able to write checks to her unemployed daughter without David Smith looking over her shoulder, not to shield assets from creditors. App. Ex. 272 (PI Tr. at 375-376; 405).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

565. However, L. Smith had been writing $1,000 checks to her daughter Lauren Smith to assist in rent payments from the Smiths' joint checking account almost every month from at least March 2007 without any need for a separate checking account. See below.

RESPONSE: Denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

566. The Court found L. Smith's testimony concerning the reason for transfer of the Vero Beach property and her reasons for transferring the joint checking account into her name only "incredible." SEC v. McGinn Smith et al., 752. F. Supp.2d 194 at 203, fn. 13; 7/7/10 MDO, Dkt. No. 86 at p. 9, fn 13.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

567. In September 2009, the Smiths also transferred title of their Vero Beach

residence, which had been held in both their names since its purchase in 2001 to L. Smith's name alone. App. Ex. 214 (D. Smith Answer to SAC, paras. 18; 22); App. Ex. 255 (Lynn Smith Answer to SAC, ¶ 122).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

568. L. Smith testified that in 2009 she "demanded that he [David Smith] put the house solely in my name because I funded the purchase of the house." App. Ex. 252; App. Ex. 272 (L. Smith 5/27/10 Deposition at 21:8-13. See also, PI Tr. at 280-28 1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

569. When asked why she waited nine years after the purchase of the house to demand that it be placed in her name alone, Ms. Smith testified, in part, that: "In light of what was going on in the economy, I wanted the house in my name to protect it." App. Ex. 252 (L. Smith 5/27/10 Deposition at 21:25-22:12).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

570. The transfer of the Vero Beach house was contrary to advice the Smiths had received from their estate planning lawyer that "it was more beneficial for you to own those properties [the Vero Beach and Saratoga Springs homes] jointly as tenants by the entirety." App. Ex. 252 (L. Smith 5/27/10 Deposition at 21:25-22:12); App. Ex. 175 (Dep. Ex. 438 – 1.28.09 Letter from Finn to the Smiths).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

571. David Smith testified at the criminal trial that the Vero Beach house was worth $2.2 million, and that he transferred it to his wife's name. App. Ex. 108 at 3205. In 2009, Smith was aware of arbitrations. App. Ex. 108 at 3207-3208. Smith wrote that he shouldn't be forced to share his earning for the rest of his life with the likes of Dr. Chang, the investor who received the large FINRA award. App. Ex. 108 at 3208.

RESPONSE: Objection. This paragraph misstates the exhibit upon which plaintiff relies. It is therefore denied.

572. Timothy McGinn purchased the Niskayuna house in his name alone in 2003. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 15:19-16:2); App. Ex. 401 (Dep. Ex. 401); App. Ex. 230 (Dep. Ex. 402).

RESPONSE: Admitted.

573. Timothy McGinn and Nancy McGinn began living together at that time. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 15:18-24).

RESPONSE: Admitted.

574. Timothy McGinn and Nancy McGinn were married in July 2006. App. Ex. 267 (N. McGinn Dep. at 15:13-15).

RESPONSE: Admitted.

575. Nancy McGinn did not contribute any money to the marriage or for household expenses after she stopped working, in approximately 2004, through 2010. App. Ex. 267 (N. McGinn Dep. at 13:14-25; 18:14-19:13).

RESPONSE: Admitted.

576. On October 13, 2009, Timothy McGinn attended the testimony of William Lex, a McGinn Smith broker, in connection with a FINRA arbitration hearing arising from a customer

filed against Timothy McGinn, David Smith, McGinn Smith Advisors, McGinn Smith Capital Holdings Corp., Lex, and others. App. Ex. 350 (FINRA Arbitration No. 08-04924, Dispute Resolution Award dated December 31, 2009.

RESPONSE: Admitted.

577. The claimants were seeking compensatory damages of $2,577,000, commissions, interest, attorneys' fees and punitive damages. App. Ex. 350 (FINRA Arbitration No. 08-04924, Dispute Resolution Award dated December 31, 2009).

RESPONSE: Admitted.

578. Timothy McGinn emailed Nancy McGinn from his iPhone: "Lex is very poor witness. We have important points to make. David and I will do so Thurs & Friday. I hate the retail business.' App. Ex. 223 (Dep. Ex. 400).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to any of plaintiff's claims in its Second Amended Complaint and Motion for Summary Judgment. Notwithstanding and subject to said objection, it is otherwise admitted.

579. On October 19, 2009, Timothy McGinn transferred title to his residence located in Niskayuna, New York to his wife, Nancy McGinn, for one dollar consideration. App. Ex. 230 (Dep. Ex. 402 - Quitclaim Deed dated October 19, 2009 transferring Niskayuna residence from Timothy McGinn to Nancy McGinn;); App. Ex. 282 (T. McGinn's Response to SEC Request for Admissions, ¶ 59).

RESPONSE: Admitted.

580. The Niskayuna residence was a five bedroom home which Timothy McGinn bought for approximately $600,000 in 2003 and put approximately $235,000 in improvements into the home. App. Ex. 229 (Dep. Ex 401); App. Ex. 267 (N. McGinn 11/28/11 Dep. at 37:5-

38:5. 66:6-22).

RESPONSE: Admitted.

581. On December 31, 2009, a FINRA arbitration panel held that McGinn Smith and Co, Lex and David Smith were jointly and severally liable to the claimants for $805,111 in compensatory damages and other fees. Timothy McGinn was not found liable for any payments. App. Ex. 350 (FINRA Arbitration No. 08-04924, Dispute Resolution Award dated December 31, 2009). Nancy McGinn knew that Timothy McGinn was called to testify on a number of occasions in connection with a FINRA investigation. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 31:9-32:2).

RESPONSE: Admitted as to the statements in the first two sentences. Mr. Smith lacks any knowledge related to what Mrs. McGinn did or did not know and cannot assess the last sentence of this paragraph. It is therefore denied.

582. Timothy McGinn brought up the idea of making the transfer of the Niskayuna residence in October 2009. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 41:17-22; 74:15-75:3).

RESPONSE: Mr. Smith lacks any knowledge of the conversation between Mr. McGinn and his wife and cannot assess this paragraph. It is therefore denied.

583. Between October 29, 2003 and March 15, 2010, Timothy McGinn made payments totaling at least $65,000 to Nancy McGinn for payment of common living expenses and taxes. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 44:17- 49:13).

RESPONSE: Mr. Smith lacks knowledge of Mr. and Mrs. McGinn's financial arrangements and cannot assess this paragraph. It is therefore denied.

584. Timothy McGinn maintained a separate checking account during this period into which his McGinn Smith paychecks were deposited. App. Ex. 267 (N. McGinn 11/28/11 Dep. at

49:14-20); App. Ex. 231 (Dep. Ex. 403 – Summary Chart re transfers to Nancy McGinn).

RESPONSE: Mr. Smith lacks knowledge of Mr. and Mrs. McGinn's financial arrangements and cannot assess this paragraph. It is therefore denied.

585. When the McGinns purchased a house in Florida in approximately 2008, they placed it in both Timothy and Nancy McGinn's name. App. Ex. 267 (N. McGinn 11/28/11 Dep. at 60:6-22).

RESPONSE: Mr. Smith lacks knowledge of Mr. and Mrs. McGinn's financial arrangements and cannot assess this paragraph. It is therefore denied.

586. Five days after the Smith Trust was temporarily unfrozen on July 7, 2010, Lauren Smith requested that $75,000.00 be wired to her from the Smith Trust as a down payment to her parents for the purchase of the Sacandaga Lake property. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 55:23- 56:15).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

587. Lauren Smith was unaware of any plans to have the Smith Trust purchase the Sacandaga Lake property before the Smith Trust was unfrozen. App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 62:3-5).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

588. On the same date, Lauren Smith requested that $1,800 be withdrawn from the Smith Trust and wired to her for use as a rent security deposit and that $6,200 wired to her to pay off credit card debt she had accumulated. App. Ex. 232 (Dep. Ex. 412 (TR00003250); App. Ex. 256 (Lauren Smith 11/28/11 Deposition at 53:22-55:22).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

589. Lauren Smith received $83,500 from the Smith Trust after July 7, 2010. App. Ex. 279 (Smith Trust Trustee, G. Smith and Lauren Smith Answer to SAC, ¶ 151); App. Ex. 285 (Dkt; No. 142-2 (Trustees' Verified Accounting)).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

590. That amount included the $75,000 that she gave to L. Smith as a partial down payment for the Sacandaga Lake property. App. Ex. 285.

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

591. On July 9, 2010, $95,741 was wired from the Smith Trust to the Dunn Law Firm. App. Ex. 228 (Dep. Ex. 371 - TR000063-66); App. Ex. 285 (Trustees' Verified Accounting - Dkt. 142-2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

592. On July 12, 2010, $96,500 was wired from the Smith Trust to Geoffrey Smith. App. Ex. 228 (Dep. Ex. 371 -TR000063-66); App. Ex. 285 (Trustees' Verified Accounting – Dkt. 142-2); App. Ex. 248 (G. Smith 11/16/11 Deposition at 156:3 16).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

593. Geoffrey Smith used $75,000 of those monies to pay his mother L. Smith a partial down payment for the Sacandaga Lake property and used the remaining $21,500 to pay off credit

card debt, for health insurance and other small uses. App. Ex. 248 (G. Smith 11/16/11 Deposition at 156:3-1 3).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

594. On July 16, 2010, $200,000 was transferred from the Smith Trust to Geoffrey Smith, which he described as an investment by the Smith Trust in his new business venture Capacity One Management, LLC. App. Ex. 228 (Dep. Ex. 371 -TR000063-66); App. Ex. 285 (Trustees' Verified Accounting- Dkt. 142-2); App. Ex. 248 (G. Smith 11/16/11 Deposition at 157:15-159:14); App. Ex. 279 (Smith Trust Trustee, G. Smith and Lauren Smith Answer to SAC, ¶ 150).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

On July 20, 2010, David Smith faxed documents relating to the Annuity Agreement to David Wojeski, the Smith Trust Trustee, including a "Private Annuity Contract" signed by David Smith on October 19, 2004 and a contract term sheet evidencing the Smith Trust's obligation to make yearly payments of $489,932 to the Smiths beginning in September 2015. App. Ex. 241 (Dep. Ex. 472 (TR0000237-241).

RESPONSE: Objection. The exhibit upon which this paragraph relies does not support the July 20, 2010 date stated by plaintiff. It is therefore denied.

595. Wojeski's time records reflect that on July 20, 2010, he read and did research regarding private annuity trusts. App. Ex. 359 (Dep. Ex. 473 -TR0000406-408).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

596. Geoffrey Smith learned of the Annuity Agreement no later than July 20, or July 21, 2010 when he received a telephone call from Wojeski asking about the Annuity Agreement. App. Ex. 248 (G. Smith 11/16/11 Deposition at 116:6-117:14).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

597. Following the call, Geoffrey Smith spoke with David Smith about the Annuity Agreement on either July 20 or July 21, 2010. App. Ex. 248 (G. Smith Deposition at 117:8-22; 138:11-16).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

598. Geoffrey Smith and David Smith met with Wojeski at Wojeski's office on July 21, 2010. App. Ex. 248 (G. Smith 11/16/11 Dep. at 148:19:150:2); App. Ex. 249 (G. Smith 12/9/11 Dep. at 23 1:11-232:14); App. Ex. 359 (Dep. Ex. 473 (TR0000406-408)).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

599. Geoffrey Smith and Wojeski performed certain calculations to determine how much money the Smith Trust would need to earn to meet its annuity payment obligations to the Smiths. App. Ex. 249 (G. Smith Dep. at 222 :22-224:9).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

600. On July 22, 2010, L. Smith executed an Indenture releasing all rights to the Sacandaga Lake property to the Smith Trust. App. Ex. 228 (Dep. Ex. 371 -TR000063-66); App. Ex. 242 (Dep. Ex. 474 -TR0000289-294).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

602. On July 22, 2010, $2,000,000 was wired from the Smith Trust to a newly created bank account at Kinderhook Bank. App. Ex. 228 (Dep. Ex. 371 -TR0000063-66); App. Ex. 285 (Wojeski Verified Accounting - Dkt. 142-2).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

603. On July 23, 2010, $449,878 was wired from the Smith Trust's Kinderhook Bank account to L. Smith as the remainder of the payment for the Smith Trust's purchase of the Sacandaga Lake property. App. Ex. 248 (G. Smith 11/16/11 Deposition at 154:22-155:5); App. Ex. 228 (Dep. Ex. 371 -TR0000063-66); App. Ex. 285 (Wojeski Verified Accounting - Dkt. 142-2); App. Ex. 255 (Lynn Smith Answer to SAC, ¶ 149); App. Ex. 279 (Smith Trust Trustee, G. Smith and Lauren Smith Answer to SAC, ¶ 149).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

604. On July 22, 2010, Wojeski and David and Lynn Smith also entered into an "Indemnity and Hold Harmless Agreement" pursuant to which David and Lynn Smith agreed to release, indemnify and hold harmless Wojeski from any and all current and future claims arising out of the Smith Trust including relating to any "financial transactions, investments, obligations or distributions, and the potential tax consequences thereof, relating to said Trust, its Donors and its beneficiaries..." App. Ex. 240 (Dep. Ex. 462 - TR0000242).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

605. After the asset freeze went into effect, Geoffrey Smith made a number of payments for his parents' living expenses. App. Ex. 249 (G. Smith 12/9/11 Dep. at 235:23-254:9).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

606. On July 15, 2010, L. Smith gave Geoffrey Smith a check in the amount $28,500 in partial repayment of these expenditures out of the above-referenced proceeds she received from the Smith Trust for the sale of the Sacandaga Lake property. App. Ex. 249 (G. Smith 12/9/11 Dep. at 253:4-254:9).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

607. The Receiver subsequently sold the Sacandaga Lake property, pursuant to Court order, for $575,000.00. App. Ex. 302 (Receiver Report filed 3.19.14 -Dkt. 687).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

608. Geoffrey Smith submitted an affidavit, dated October 5, 2010, in opposition to the Commission's motion for reconsideration of that portion of the Court July 7, 2010 MDO lifting the asset freeze on the Smith Trust, in which he stated that he did not learn of the existence of the annuity agreement until "late July, only after the SEC claims to have discovered the document for the first time." App. Ex. 247 G. Smith 10/5/10 Aff. at ¶ 5 (Dkt. 148).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

609. The SEC had previously submitted an Declaration of David Stoelting stating that

the SEC first learned of the existence of an annuity agreement on July 22, during a telephone call with the Trust's attorney Jill Dunn and did not obtain a copy of the Annuity Agreement until July 27, 210 when it received a copy for the first time from Thomas Urbelis. App. Ex. 219 (D. Stoelting 8/3/10 Decl. at ¶ 4. (Dkt. No. 103-2)).

RESPONSE: Mr. Smith incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

610. As the facts set forth above, Geoffrey Smith's statement that he did not learn of the Annuity Agreement until after the SEC learned of it was false as he learned of it before the July 22 telephone call between Jill Dunn and David Stoelting.

RESPONSE: Objection. This paragraph improperly contains legal argument and conclusion outside the scope an requirements of a Statement of Material Facts pursuant to Local Rule 7.1(a)(3) and Federal Rule of Civil Procedure 56. It is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

611. On October 18, 2013, L. Smith filed a motion with this Court requesting a modification of the asset freeze to provide her with monthly living expenses of $4,144 due to her "financial hardship" and to provide $100,000 in partial payment of counsel fees. App. Ex. 261 (Dkt. 610).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

612. In her Affidavit submitted in support of this motion, L. Smith stated that: "Meeting simple daily living expenses has become so difficult that on September 12, 2013, I applied for food stamps. App. Ex. 261 (L. Smith 10/18/13 Aff. at ¶ 5 -Dkt. 610-1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

613. She further stated that she had a monthly income of $965, plus $50 in food stamps, had at least $17,000 in credit card debts, was faced with a $900,000 sanction order in this case, owed $441,573 in legal fees and that she currently had monthly expenses of $5,159. App. Ex. 261(L. Smith Aff. at paras.7-9; 13; 30 - Dkt. 6 10-1).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

614. The Court denied that motion on January 8, 2014. Dkt. 667.

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

615. On January 3, 2014, L. Smith submitted an Affidavit in support of a motion by the Smith Trust to amend the Smith Trust to cancel the Private Annuity Contract. In that Affidavit, L. Smith stated that she and her husband David Smith wanted to cancel the annuity contract, which entitled her and David Smith to yearly annuity payments of $489,932, beginning in September 2015, or, alternatively, "renounce all rights to future payments from the Trust." App. Ex. 258 (L. Smith 1/3/14 Affidavit at paras. 2-3 -Dkt. 662).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

616. L. Smith stated that her reason for cancelling the annuity contract, or alternatively renouncing her and her husband's rights to substantial annuity payments, was because the federal gift tax exclusion had increased from $1,500,000 in 2004 to $5,250,000 in 2013and since the principal remaining in the Smith trust is less than the current gift exclusion amount there is no

longer any need for the annuity agreement. App. Ex. 258 (L. Smith 1/3/14 Affidavit at ¶ 10-11 - Dkt. 662).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

617. She further stated that: "I believe the Trust Amendment will allow the Trust to continue with its original purpose, which his for the benefit of my children." App. Ex. 258 (L. Smith 1/3/14 Affidavit at ¶ 12 - Dkt. 662).

RESPONSE: Admitted. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

618. L. Smith did not make any reference to any actual or potential judgments against her and David Smith as a reason for renouncing their right to annuity payments nor did she explain why she was renouncing her rights to these payments given her current purportedly dire financial condition. App. Ex. 258 (L. Smith 1/3/14 Affidavit -Dkt. 662).

RESPONSE: Objection. This paragraph is irrelevant and immaterial to the claims in plaintiff's Second Amended Complaint and is therefore denied. Mr. Smith further incorporates Lynn Smith's and the Trust's Response to Plaintiff's Statement of Material Facts into this response.

DAVID L. SMITH'S STATEMENT OF ADDITIONAL FACTS IN OPPOSITION OF PLAINTIFF'S SUMMARY JUDGMENT MOTION AND IN SUPPORT OF HIS CROSS MOTION FOR SUMMARY JUDGMENT ON DAMAGES

1. On July 8, 2013, the United States Probation Office filed its Presentence Investigation Report related to Mr. Smith. *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH); Dkt. Nos. 187, 219.

2. The United States Probation Office calculated the total loss amount related to the criminal convictions (including the tax convictions) to be in the total amount of $6,336,440.00. Plaintiff's App. Ex. 26 at 5.

3. The United States Attorney's Office presented a loss amount of $30,233,514.98. and filed its Sentencing Memorandum on July 24, 2013. *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH); Dkt. No. 193.

4. Mr. Smith filed his Sentencing Memorandum on July 24, 2013 and set forth reasons why the loss amount could not be calculated. *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH); Dkt. No. 196.

5. The Sentencing Memoranda were made available to the public, including the plaintiff and any victims prior to Mr. Smith's Sentencing on August 7, 2013. *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH); Dkt. Nos. 193, 196, 210.

6. Mr. Smith was sentenced on August 7, 2013 before Hon. David N. Hurd. At no time prior or at sentencing did plaintiff or any of the victims challenge the Probation Office's loss calculation of $6,336,440.00 or proposed restitution amount. Plaintiff's App. Ex. 26.

7. At the August 7, 2013, Judge Hurd found, based upon a preponderance of the evidence, that a total loss amount of $6,336,440.00 was appropriate. Plaintiff's App. Ex. 26 at 5.

8. On August 13, 2013, Judge Hurd entered a Judgment against Mr. Smith which included that a criminal monetary penalty of restitution to victims in the amount of $5,748,722.00. Plaintiff's App. Ex. 10 at 5.

10. Within the August 13, 2013 Judgment, Judge Hurd provided special instructions regarding the payment of Mr. Smith's criminal monetary penalties and stated:

> The Court orders that any cash value of the assets collected thus far by the Receiver, William J. Brown, appointed by the Court in this case may be deducted from the total restitution amount and may be distributed to the victims by the Receiver as such assets are available for distribution, and for long as the Receiver is in operation. Plaintiff's App. Ex. 10 at 6.

11. According to the Receiver's website, www.mcginnsmithreceiver.com, as of June 27, 2017, the Receiver has a total amount of $20,882,652.00 "on hand for distribution", which includes $15,847,500.00 of "General Funds" separate from any of Lynn Smith or Trust Assets.

12. Mr. Smith filed his Notice of Appeal on his convictions and sentencing on August 16, 2013. *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH); Dkt. No. 238.

13. During jury deliberations at the criminal trial, Judge Hurd instructed the jury that they the conspiracy charge related to "misleading investors" or "FINRA". See D. Smith Ex. "T", Jury Instruction.

14. It was Mr. Smith's understanding that the Four Funds were not investment companies but specialty finance companies not subjection to Regulation D. See D. Smith Ex. "U", Gersten Savage Letter dated July 1, 2008.

15. Some of the investors in the Four Funds included related family members whose notes were paid by another family member who would be accredited. See Plaintiff's App. Ex. 2.

Dated: August 11, 2014

Respectfully submitted,

DREYER BOYAJIAN LLP

/s/

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propriety of using money raised for one set of investors to pay other investors without the permission of both groups of investors?

A. No, it was a very straightforward set of what would be called events of default in legalese within the indenture agreement, itself.

MS. COOMBE: I have nothing further, Your Honor. Thank you, Mr. Roper.

THE COURT: Defense, cross exam, if any.

CROSS-EXAMINATION BY MR. JONES:

Q. Good morning, Mr. Roper.

A. Good morning, sir.

Q. I am Stu Jones. I represent Tim McGinn.

A. How do you do, sir?

Q. Just a couple of questions.

A. Sure.

Q. You indicated that roughly in the year 2000 you first met David Smith and/or Tim McGinn; is that correct?

A. I believe it was David Smith, yes.

Q. Was that in connection with Mr. Smith's business at the time?

A. Basically, yes.

Q. And at that point in time you were affiliated with Gersten Savage?

A. I was just recently joined the firm, yes, sir.

Q. And the relationship between Mr. Smith and his firm and Mr. McGinn and Gersten Savage was a professional relationship from 2000 to 2009?

A. Basically, yes. I mean, we were very friendly with Tim and Dave. I didn't so much, but certain lawyers socialized with them, and they were highly regarded members of the Albany community, and we got to know them inside and outside of the office.

Q. What, during this period of 2000 to 2009, was the nature of Gersten Savage's legal work, not just for them, but generally?

A. Well, Gersten and Savage, the firm, was sort of a securities driven firm. So we did various private placements, public offerings. We represented a number of public companies. It was a fairly diversified securities practice as part of the overall firm.

Q. And in terms of the professional legal relationship, the lawyer/client relationship with McGinn, Smith & Company, that was a relationship in which Mr. Smith or Mr. McGinn or both of them would come to Gersten and Savage from time to time and seek advice and counsel and guidance; is that a fair statement?

A. Yes.

Q. And the work that you were doing with respect to

the -- what we call, FAIN, TAIN, and two other funds, that was work requested by them of you to provide advice, counsel, guidance, and interpretation; is that also a fair statement?

A. It was not just me, but it was other members of the --

Q. No, the whole firm?

A. Yes, other members of the firm as well, yes, sir.

Q. Okay. And the relationship, and again, I am talking about the professional relationship, the relationship between their business and your securities firm. Now, that relationship from 2000 to the work you did in 2009 on the FAIN, TAIN, and related funds, that relationship was a good one for that period of time between lawyer and client, fair statement?

A. Yes, it was.

MR. JONES: Thank you very much, Mr. Roper.

THE COURT: Any further cross exam?

MR. DREYER: No, Your Honor.

THE COURT: Redirect, if any.

MS. COOMBE: Nothing, Your Honor.

THE COURT: All right. You may step down.

(Whereupon, the Witness is excused.)

THE COURT: Members of the jury, I again

Overall Analysis of Trusts and Operating Companies

	Amount Raised	Principal Repaid	Interest Paid	Total Amount Paid to Investors	Amount Paid as a % of Amount Raised	Net Accrued Interest Payable	Amount Paid as % of Total Amount Owed	Partner Loans	Partner Loan Coverage Ratio to Payables
TDM Cable Funding	**$ 13,545,000.00**	**$ 449,919.31**	**$ 2,549,884.34**	**$ 2,999,803.65**	**22.15%**	**$ 536,187.08**	**84.84%**	**$ 2,013,341.00**	**3.8X**
TDM Cable Trust 06	$ 3,595,000.00	$ -	$ 900,887.49	$ 900,887.49	25.06%	$ 104,839.43	89.58%		
TDM Verifier Trust 07	$ 3,475,000.00	$ 194,500.00	$ 824,248.70	$ 1,018,748.70	29.32%	$ 118,345.74	89.59%		
TDM Luxury Cruise Trust 07	$ 3,625,000.00	$ -	$ 703,081.10	$ 703,081.10	19.40%	$ 222,486.96	75.96%		
TDMM Cable Trust 09	$ 2,850,000.00	$ 255,419.31	$ 121,667.05	$ 377,086.36	13.23%	$ 90,514.95	80.64%		
MS Funding	**$ 12,072,000.00**	**$ 917,141.91**	**$ 2,042,660.13**	**$ 2,959,802.04**	**24.52%**	**$ 614,221.94**	**82.81%**	**$ 1,521,251.00**	**2.5X**
TDM Verifier Trust 08	$ 3,850,000.00	$ 24,100.00	$ 613,793.81	$ 637,893.81	16.57%	$ 160,910.13	79.86%		
Firstline Trust 07	$ 3,717,000.00	$ 882,362.53	$ 725,098.49	$ 1,607,461.02	43.25%	$ 212,717.83	88.31%		
Firstline Trust 07 Series B	$ 3,205,000.00	$ 10,679.38	$ 566,540.23	$ 577,219.61	18.01%	$ 209,529.91	73.37%		
TDM Verifier Trust 09	$ 1,300,000.00	$ -	$ 137,227.60	$ 137,227.60	10.56%	$ 31,064.07	81.54%		
NEI Capital	**$ 3,060,000.00**	**$ 656,111.67**	**$ 36,710.87**	**$ 692,822.54**	**22.64%**	**$ 465,405.99**	**59.82%**	**$ 985,000.00**	**2.1X**
Fortress Trust 08	$ 3,060,000.00	$ 656,111.67	$ 36,710.87	$ 692,822.54	22.64%	$ 465,405.99	59.82%		
TDMM Cable Funding	**$ 2,500,000.00**	**$ 22,365.00**	**$ 58,839.20**	**$ 81,204.20**	**3.25%**	**$ 99,276.13**	**44.99%**	**$ 181,500.00**	**1.8X**
TDMM Benchmark Trust 09	$ 2,500,000.00	$ 22,365.00	$ 58,839.20	$ 81,204.20	3.25%	$ 99,276.13	44.99%		
MSTF								**$ 85,000.00**	**3.6X**
Integrated Excellence Trust 08	$ 1,170,000.00	$ 158,056.48	$ 168,823.17	$ 326,879.65	27.94%	$ 23,936.90	93.18%		
TOTALS	**$ 32,347,000.00**	**$ 2,203,594.37**	**$ 4,856,917.71**	**$ 7,060,512.08**	**21.83%**	**$ 1,739,028.04**	**80.24%**	**$ 4,786,092.00**	**2.8X**

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

****

UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

****

Transcript of the Trial Proceedings held on January 24, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

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I N D E X O F P R O C E E D I N G S

I N D E X O F E X H I B I T S

I N D E X O F E X H I B I T S

(WHEREUPON, the proceedings held on January 24, 2013, were commenced at 9:30 a.m..)
(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Good morning and welcome back, members of the jury. I must be honest, it is a cold day. It sure is.
All right. Do we have another witness on behalf of the joint defense?
MS. OWENS: Yes. The defense calls Geoffrey Smith.

GEOFFREY SMITH, having been called as a Witness, being first duly sworn, was examined and testified as follows under oath:

DIRECT EXAMINATION BY MS. OWENS:
MS. OWENS: Your Honor, at this time the defendants would like to move the admission of a number of exhibits. Defense Exhibits 148, 152, 153A. Defense Exhibit 154A through Defense Exhibit 207. And I believe Defense Exhibits 208 to 210 were already admitted during Brian Cooper, but to the extent that they weren't, I will

move them now. Defense Exhibits 220, 227, and Defense Exhibit 232.

MS. COOMBE: Your Honor, the government objects to the admission of a number of these exhibits. We do not object to the admission of Exhibit 188. We do not object --

THE COURT: Okay. Let's be slow here. You don't object to 188?

MS. COOMBE: Correct. The amortization schedules we do not object to. Maybe Ms. Owens can identify which numbers those are, and we do not object to 232, but we object to the remaining exhibits.

THE COURT: Okay. The consented exhibits are admitted and the others are not.

(Exhibit No. 188, 232, received.)

THE COURT: Proceed.

MS. OWENS: May I request a sidebar, Your Honor.

(Whereupon, a sidebar conference was held outside the hearing of the jury.)

THE COURT: What's the issue?

MS. OWENS: Your Honor. These identification exhibits have been disclosed to the government as early as December. Any specific objection, we made the correction so we wouldn't have to come to this.

THE COURT: That's okay. You have to lay a foundation and offer them, and then the government can object, and I can rule. I can't admit exhibits unless they are by consent.

MS. OWENS: The only point is this could have been done --

THE COURT: Absolutely. It should have been done before the jury came in. If you had objections why didn't you ask for a conference beforehand? Are you prepared to go ahead?

MR. DREYER: The problem is it is going to interrupt the flow of the witness because each one is going to have to be argued in a sidebar.

MS. COOMBE: I have always made clear that we have objected to these. I plan to object to the first examples after they lay the foundation.

(Whereupon, the sidebar conference was concluded, and the following occurred in open court in the presence of the jury.)

THE COURT: Members of the jury, I am going to ask you to be excused. We have a legal matter we have to take care of. It should have been done before you were brought in, but it was not brought to my attention, but it is now, so we are going to do it. Don't discuss the case. We will see you shortly.

(Whereupon, the proceedings were held in open court out of the presence of the Jury.)

MR. DREYER: The witness is still here.

THE COURT: Yes, you may leave the courtroom for now.

(Witness Geoffrey Smith leaves the courtroom.)

THE COURT: We had a conference last night. I requested that you agree on exhibits if possible, and if not, let me know before the jury came in. And we should not have brought in the jury until these matters were resolved.

So what is the issue here? Ordinarily if the government doesn't agree, you have to lay a foundation and offer the exhibits. Are you prepared to do that?

MS. OWENS: I am, Your Honor. Just to provide a quick background, Mr. Smith is going to be testifying on some transactions that he has prepared based upon extensive review of the PPMs and extensive of every single bank statement for both the operating accounts, escrow accounts, and operating company bank accounts for each transaction.

So to the extent that the government objects to every single exhibit that I have moved to introduce into evidence, it is going to create a substantial delay along

the way. So if we could try to resolve some of these issues now, I think that that would smooth things along for the jury.

THE COURT: Well, I don't understand. How are we going to resolve them now? They object. They have agreed to certain exhibits. They object to other exhibits. Just explain to me how we are going to resolve this without having the jury present and having -- laying a foundation?

I know it is time consuming and everything else and probably not necessary, but without a stipulation, I have nothing to rule on until an exhibit is offered. If you have got some other suggestion, we will just have to go through the long tedious process.

MS. OWENS: Your Honor, I think for every single exhibit with the exception that the government did agree to stipulate, I think the point is to move this along. Mr. Smith -- some of the documents that I believe the government is objecting to, they were offered to the government after Mr. Smith testified in the Grand Jury back in 2011.

The government declined that they needed any of those documents, and his testimony is going to be a summary of the transactions that -- all of the backup information has been offered to the government. And to any extent that they had specific objections, I have tried to

respond in a timely manner, and they haven't raised anything else that was very specific until last night or this morning. And even last night I sent them an e-mail advising which exhibits we intended to offer today for Mr. Smith, and I did not get a response.

THE COURT: So what are you suggesting we do now?

MS. OWENS: I am suggesting that we address the matter now instead of interrupting the flow of his testimony for the one hundred exhibits that he is going to be discussing.

THE COURT: Ms. Coombe, is that what you want to do? Do you want to have them lay a foundation for each exhibit and make a specific objection and then we rule? Is that the way you wish to proceed? Which, of course, is your right to proceed that way if you wish. If you can't stipulate to an exhibit, they have to lay a foundation.

I do note that the defense stipulated to numerous exhibits to make this matter move in a timely manner. If you have got specific objections that you think that the exhibits are not receivable, then they will have a lay a foundation.

MS. COOMBE: Yes, Your Honor. My position has not wavered. I don't understand the foundation for

many of these exhibits. There is a pattern and repetition of the type of exhibits. I plan to make an objection to the first series of them. It is three or four exhibits that repeat over and over again.

Depending on the Court's ruling, then I will not continue my objections, but I don't think it is unfair for me to ask them to lay a foundation so I understand what is being relied on in these charts. And I have been asking for that information for a long time.

THE COURT: We will have to proceed that way.

Okay. Summon the jury.

And Mr. Smith back on the stand.

Ms. Owens, you may proceed.

(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Have Mr. Smith come back. Take the witness stand. You are still under oath.

BY MS. OWENS, CONTINUED:

Q. Good morning, Mr. Smith.

A. Good morning.

Q. Can you tell the jury where you live?

A. Saratoga Springs, New York.

Q. Are you currently employed?

A. Yes.

Q. And where do you work?

A. I work for a company called Access Trade Management, and I am the only employee. I work for a guy, Tim Walsh, out of Connecticut doing consultancy.

Q. Can you explain a little bit more about what you do in that capacity?

A. Yes. We contact companies and advise them on their advertising strategy, and we finance their advertising budgets by allowing them to pay with whatever it is that they make.

Q. Can you tell us a little bit about your education?

A. Sure. Went to Chenango High School, graduated in 1998 and attended Lehigh University and graduated with a BS in finance in 2002.

Q. And do you hold any designations?

A. Yes. I hold the chartered financial analyst designation.

Q. Do you go to be a CFA?

A. It is, yes.

Q. And what is a chartered financial analyst?

A. It is a designation that requires three fairly vigorous exams. The subject matter covers basically very high concentration in accounting, financial statement analysis, debt investment analysis, equity investment

analysis, alternative investments, and a large concentration in ethics.

Q. Okay, and this CFA designation, is it -- does it give you a designation to -- I guess what does it provide you to do?

A. It is not a license for anything. It is simply an accreditation. There is only, I believe, about one hundred thousand active CFAs in the world.

Q. So it is only related to investment management and financial analysis, is that what you are saying?

A. That's correct, yes.

Q. Okay, and do you hold any -- or have you held any licenses?

A. I previously held a Series 7 license, Series 63 license, and a Series 55 license, which are all FINRA licenses. The Series 7 is a registered broker license. The Series 63 is the state law license. And then the Series 55 is a registered options trader. All those licenses expired, I believe, December 31st of 2012.

Q. Okay, and for the CFA designation, are there any requirements before you can apply for that designation?

A. Yes. You can't begin the program until you have a Bachelor's degree. And you can't complete the program and earn the designation until you have four years of qualified work experience making investment decisions.

Q. And can you tell us about your job history?

A. Sure. My first job was cutting grass on the infield of the Saratoga race track.

Q. You don't have to go back that far. I am sorry, go ahead.

A. Following my freshman year in college I got a job at McGinn, Smith working in the mail room.

Q. What does that mean, working in the mail room?

A. I sorted the mail, delivered it to various employees, kind of learned the business a little bit in the back office capacity just by watching, and I had some -- a chance to perform some of those duties like entering order tickets and reconciling confirmations and things like that. And I spent nights that summer studying for the Series 7 exam.

Q. Okay.

A. I had the same job my sophomore year in college. And then after my junior year, I had an opportunity to have an internship in New York City working at a larger brokerage firm by the name of Tucker Anthony. I believe they have since been bought by Royal Bank of Canada.

Q. What did you do there?

A. Sat in a room with a phonebook and made cold calls.

Q. And following that internship?

A. Following the internship, I graduated trying to find a job in finance in New York. Struggled for a little while so I found myself in the mail room again at McGinn, Smith.

Q. Okay. Not to interrupt you, but do you have a relationship to David Smith?

A. Yes, I am his son.

Q. I am sorry. Go ahead.

A. In October of 2012, I was hired by a company by the name of Berstein, Greenberg Trading.

Q. I am sorry, 2012?

A. 2002, I am sorry. They were a commodities trading firm. I was hired as a clerk or assistant trader, and worked on the floor of the New York Board of Trade.

Q. This is on Wall Street?

A. Well, at the time it was in Queens.

Q. Oh, that is right.

A. Because the trading floor was blown up in 9/11. Eventually we were relocated back to the financial district.

Q. Okay, and for how long did you work at Berstein, Greenberg?

A. I believe I finished there in December of 2007, so just about five years.

Q. And what did you trade?

A. Eventually I traded cocoa options.

Q. And then following Berstein, Greenberg, did you have any other employment?

A. Yes, when I first began trading, because I didn't have a salary, and I had very unknown income based on whether or not I was going to make money trading or lose money trading, I had the opportunity to work at the McGinn, Smith New York office part-time in the afternoons. The reason for that is the cocoa market is only open from eight to twelve.

So I felt like a twenty-five year old should probably work more than four hours a day. And I tried to help out at McGinn, Smith doing just back office type stuff, filing, that sort of thing. And I also attempted to assist a new business that they were trying to start, which was just an equity trading business that never really took off, but that was sort of the job that we thought I was going to do when I first got there.

Q. Did you have a specific title?

A. At that time, no, but shortly afterwards, when I decided that I wasn't performing well enough on the trading floor, I decided to move full-time to McGinn, Smith.

Q. In the New York City office?

A. That's right, yes.

Q. What did you do there when you moved over to

McGinn, Smith full-time?

A. Well, I did a lot of things. Sort of the first position that I had was -- I think I had the title of vice-president of institutional sales.

Q. What did that entail?

A. Essentially calling a number of broker-dealers, smaller broker-dealers and investment advisories, and introducing the business of alarm trusts and cable trusts to those various sales teams and trying to sort of grow our sales network and grow our business that way.

Q. And did you transition to a different role at McGinn, Smith?

A. I did. I am not exactly sure of the timeframe, but I think probably in late 2008 I began -- we were introduced to a new product. It was a structured product that a lot of big banks were doing, and I began to sort of develop relationships with the department heads that were creating those products at bigger banks and basically negotiating deals to sell through the McGinn, Smith sales force.

Q. Okay, and any other positions?

A. Yes. Eventually McGinn, Smith had hired a woman by the name of Theresa Walsh. She was an investment banker for Merrill Lynch, and she had her own business. She was raising capital and doing financial advisory for small

startup tech companies, and I worked as her assistant basically creating financial models and putting documents together to raise capital for those companies.

Q. What is a financial model?

A. It is basically a set of financial statements that are forward looking. So you generally use a couple of years of past data. And then through analysis of the market or that specific company, you try to forecast what is going to happen in the future, and then you use that to come up with a valuation for that company.

Q. Does that coincide with your designation as a CFA?

A. Absolutely.

Q. So you had positions at McGinn, Smith while you were at the New York City office. Did you sell any of the various private placements that are outlined in this particular indictment?

A. I did. Because I was a registered broker I was allowed to sell.

Q. From your Series 7?

A. From my Series 7, that's right. So when I was there part-time in October of 2006, TDM Cable Trust was being contemplated and eventually offered to customers, and I took a look at the private placement memorandum, read it through. It seemed like the type of deal that I wanted to

do myself, and I was still working on the trading floor at the time. So lot of the time when you are trading, there is nothing going on. You are just sitting there, you know, chatting it up. So a couple of guys next to me started to ask me about what sort of investment opportunities were out there. We started to talk about TDM Cable Trust 06.

Q. Okay.

A. Eventually I delivered the PPM to my first customer, and we both took it home at night, read it through, analyzed the deal, and met in the morning and discussed it and both decided to invest in that deal.

Q. All right, and did you sell a private placement called Firstline Trust?

A. I did, yes.

Q. And did you come to learn that you had sold some of those Firstline sales after the bankruptcy in January of 2008?

A. I did.

Q. And were you an investor in Firstline as well?

A. I was an investor in the May deal.

Q. All right. So there was some analysis that you did for some of the various private placements allegedly or within the indictment. What did you do when you reviewed the private placements when you were going through your analysis?

A. I essentially looked at three things. First and foremost, I looked at the private placement memoranda for each deal. And that is basically the framework for the structure of how the operating companies will relate and interact with each trust. So I used the PPM.

And then for my analysis of what took place, I used the bank statements from each trust and also the bank statements from the related operating company.

Q. Okay. What sorts of information would you find in the various PPMs for the private placements?

A. In most cases, I was able to find information in the exhibits that spelled out the exact cash flows that were expected to come into the operating company and then also the exact cash flows that would pass from the operating company back to the investors through the trust.

Q. Okay, and have you read -- have you reviewed anything else when you were reviewing each of those deals?

A. Yes, I had reviewed the QuickBooks files that were prepared by the prior McGinn, Smith accountants.

Q. How did you obtain those?

A. In May of 2010, I either called or sent an e-mail to Brian Shea.

Q. Who is he?

A. He was the CFO at McGinn, Smith at the time. And I requested the accounting records from him. He asked

Mr. Brown, the receiver, for approval on that and was granted it. And then I am pretty sure that he delivered the files on like a little thumb drive in an envelope to me.

Q. Okay, and was there anything else that you reviewed in preparing the analysis for the deals?

A. Not in preparing my exhibits, but I have reviewed virtually every piece of paper that has been provided by the government in discovery.

Q. How much time would you say you spent on reviewing each one of the deals?

A. You know, I don't know how much time I spent on each one, but I spent probably close to three or four thousand hours doing this analysis.

Q. Okay. All right.

MS. OWENS: At this time the defense would like to move the admission of Defense Exhibit 153.

MS. COOMBE: No objection.

THE COURT: Defendants' 153 is received.

MS. OWENS: I am sorry. That is the wrong exhibit. 153A. Defendants move for the admission of Defendant's Exhibit 153A.

THE COURT: Any objection to 153A?

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 153A, received.)

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, can you tell us what this is?

A. Yes. This is the general framework for one of the trust deals and how the money is supposed to flow, and I can go through the boxes. So on the left is the group of investors, and they invest into the trust.

Q. I am sorry. It says escrow account?

A. Yes. So each trust had two checking accounts. The account into which the investor money would be deposited had an escrow agreement that went along with it. And basically the condition that had to be met in order to break escrow was that the minimum amount of the trust was raised.

So the investor money would be deposited into that account until which point the minimum raise was met. And at that point, the escrow agreement is broken and that just becomes a checking account. Each of the trusts in the PPM spell out the fact that once the minimum raise is met, proceeds would be lent to the operating company in order to purchase an asset or make another loan.

Q. So that's that purple box?

A. Yes. Once the minimum raise has been met and the escrow agreement has been broken, money is then lent to the operating company, and would move into that bank

account.

Q. And just in your review of the various bank records of all the deals, was there a distinction between the operating -- that the bank used for the operating company and, say, the trust account?

A. It wasn't a hard and fast rule, but oftentimes the bank that held the escrow checking account was Mercantile Bank and the bank account for the operating company was M&T Bank.

Q. Okay, and what is this orange box asset/borrowing company, what does that represent?

A. So once the operating company has borrowed the money from the trust, it would use that to do one of two things, either make a loan to a company that was either providing alarm or cable or triple play services or it would purchase an asset from that company, and the asset was generally the actual contracts, people's monthly payments in whatever it is that company was providing.

Q. Can you give us an example of one of the asset or borrowing companies that you reviewed in the various PPM?

A. Sure. One of the borrowing companies would be Verifier Capital, LLC, and they provided alarm services.

Q. Okay, and if I could just show you the next page on this exhibit. And does this represent what you were

just describing that once the minimum was met, escrow is broken?

A. That's right, and at which point the flow of funds when the asset or the borrowing company was making its interest payments back to the operating company, the operating company then had debt service or interest that is owed to the trust. So that money would then flow down to the second checking account that the trust owned. And that's the trust operating account.

Q. So it is a little confusing because it says operating company, operating company. Can you make a further distinction for the jury?

A. Sure. They are two separate entities. So the operating company is a completely different company. It has its own bank account. The trust operating account is a checking account that is owned by the trust, and it basically had the function of receiving interest payments from the operating company and immediately passing them through to the investors that owned the trust.

So from the structure that is spelled out in the PPMs, the trust operating account really should always have a zero balance because the trust has already lent all of its money to the operating company, and as interest payments come in, they should be immediately passed out to the investors.

Q. Okay. So based on this chart that you prepared, after escrow was broken, the operating company is an obligor of the assets or borrowing company, and then the trust is the obligor of the operating company. Did I describe that correctly?

A. No. Once escrow is broken and -- well, once escrow is broken, the operating company is the obligor to the trust. They have received the loan from the trust.

Q. Okay.

A. They then do something with that money, whether it is to purchase an asset and then collect on that asset in order to service their obligation to the trust or they lend that money to another company, the borrowing company.

Q. Okay.

A. The example I gave you was Verifier. And that company is the obligor to the operating company.

Q. Okay. But then the operating company is the obligor to the trust?

A. Correct.

Q. Okay, and did you say that when you were reviewing, you reviewed a bunch of payment schedules and amortization schedules?

A. Yes, in a number of cases. The actual amortization schedules or payment schedules are fully laid out as exhibits in the PPMs. I believe -- and I think we

are going to go through them, but I believe that a payment schedule or an amortization schedule is only provided in the case that the payments actually did amortize or pay back principal or a portion of principal in each monthly payment.

Q. And I am sorry. Just for vocabulary, can you just explain what you mean by amortize and amortization schedule?

A. Yes. So there is essentially two types of loans. One would be a loan that was not amortized. So if you lend a hundred dollars and you get interest payments, you get interest on your hundred dollars, and then at the end of your loan you get your hundred dollars back.

An amortizing loan is a loan where with each monthly payment, you get some portion of your hundred dollars back. So you might get a payment of five dollars every month and three of those dollars are considered interest and two of those dollars are considered return of your principal. And as the loan processes or operates, you are slowly getting back your investment until your final payment and you have received all of your money back.

Q. Can you give the jury an example of something that might have an amortization schedule besides these alarm deals?

A. Yes. If you have like a car loan that you have

taken from a bank and you make the same monthly payment every month, you are -- some portion of your payment is interest on the loan and some portion of your payment is basically paying off your car loan. So if you have a five year loan, and you make a three hundred dollar payment every single month, at the end of five years you own your car. You don't have to pay back your loan. You have paid back your loan over time.

Q. Is a balloon payment a type of loan payment?

A. Yes, and a balloon payment can describe a loan in one of two ways. The first way is, as I described before, where you lend one hundred dollars and you earn interest every month on it and then you get your hundred dollars back. And the second example would be if you lent a hundred dollars and you did not get any money for a period of time and then you got your hundred dollars plus something extra back on top of it. So you are receiving one payment at the end of the term.

Q. If I can clarify maybe, a balloon payment is basically interest is only paid throughout the length of the loan and then at the end a large amount of the principal is paid?

A. All of the principal is paid.

Q. All of the principal is paid. Okay. So just going back to Exhibit 153A, this relationship between the

operating company and the asset or borrowing company. So what you just described as far as the loan repayment schedule, that would be when the operating company makes a loan to finance a particular investment with the borrowing company; is that correct?

A. Yes.

Q. Okay. Then what would occur when the operating company was investing in some sort of assets, how is that different?

A. That's different because rather than making a loan where the borrowing company has an obligation to make certain payments back to the operating company, instead they would, the operating company would buy a certain number of contracts or a stream of monthly payments.

So they may buy, you know, if the asset or borrowing company had ten thousand cable customers, the operating company might buy two thousand of those contracts. And when the cable customers pay their monthly bills, two thousand of those bills get paid to the operating company. And they own those assets forever. There is no term on the loan.

Q. Okay. So if an operating company has a relationship with an asset company where they are purchasing the cash stream, what would happen once the deal matured to investors, what would happen to that asset

stream?

A. Because that is a cash flow stream that would sort of continue into perpetuity, there would have to be an exit strategy to retire the trust data.

Q. I am sorry. What do you mean retire the trust data?

A. Pay back the obligation to the trust, so pay back the principal.

Q. And how would that occur?

A. Generally there is several ways for it to occur. The first and sort of most common that you see in business every day would be a debt refinance or like a rollover. So when the trust bond came due to maturity, the operating company would offer a new debt offering at whatever the market terms were at that time. And they would use those proceeds to retire the bond before that, the bond that was maturing.

The second way would be to sell the assets. And there is a market for that clearly by the fact that the operating company was able to go out and buy those assets. So the second way to raise the money to retire the debt would be to go out to the marketplace and say, you know, we have two thousand contracts to sell, sort of negotiate a price on what that pool of assets would sell for.

Q. So when the operating company is purchasing the

actual assets so purchasing the cash flow stream, basically what you just described as some sort of exit strategy is kind of built into the deal as far as either rolling it over or selling the asset on the market?

A. Yes. It is assumed. What I mean by that is that if you view the operating company as a normal business like any business that has revenues and expenses, when they purchase the cash flow stream, that is their source of revenue. And most businesses have some sort of debt financing that they manage and deal with. And when that debt comes due, they find a way to either refinance that debt to continue to finance their operation or their revenue stream or they sell their business to retire their debt. And that would be an example of selling the assets. It is almost as if somebody has decided to sell their business.

Q. So it is rolling the investment over or putting it back on market at the end of the maturity date, is that essentially something very common in investment banking?

A. Yes.

Q. Now, is there any relationship to risk between the three different payment schedules or asset purchasing that you just described?

A. Yes, I would say that a payment schedule that amortizes has a little bit less risk because you are

receiving your investment back over time instead of in one lump sum payment, you know, several years down the line. But along with that, you get slightly less return because you are only earning your interest rate on a smaller amount of money as time goes on.

Q. And then in your review of the PPMs for various deals, did you see a debt service reserve fund built into some of the deals?

A. Yes. Some of the deals had a specific number of what would be considered a debt service reserve fund.

Q. Was this in the PPM?

A. Yes.

Q. Okay.

A. But my analysis is that every deal had an implied debt service reserve, and that's because there was a spread or essentially more money was raised from the trust than was used to make a loan by the operating company.

Q. Okay, and just a very plain definition because not everybody speaks finance. How would you describe a debt service reserve fund?

A. It is basically money that is set aside to make interest payments or cover shortfalls. It is essentially a safety measure or a safety net. Provides more coverage in case the collateral that backs up that loan is faltering or

the cash flow stream that was purchased, you know, has swings and goes up and down and isn't a steady payment every single month. It is sort of a buffer.

Q. Okay. Is that because -- is there a timing issue between the time that a borrowing company provides its loan to the operating company and the operating company pays the trust account to the investors, is that a timing thing?

A. Yes. There could be timing issues where the asset of the borrowing company is making a payment on a day that is different from when the interest or debt service payment is due to the trust operating account. So the debt service reserve fund might help in smoothing out those timing issues.

Q. And in reviewing the internal accounting records from McGinn, Smith in relation to the various deals, was there a specific accounting system that was used?

A. In terms of software?

Q. Software, just -- I mean, how the accounting was documented?

A. Poorly.

Q. Okay.

A. They used QuickBooks. And the best that I could tell, it seemed like the accounting was sort of done ad hoc, like the bank statements would come in, and they would

use the bank statements to try to figure out where everything went.

Q. And were the books, were the internal accounting records on an accrual basis?

A. Yes.

Q. And what is an accrual basis?

A. Accrual accounting is basically double entry accounting. So any time that there is a cash transaction, there has to be an offsetting record to that in the accounting books that is basically the reason for that transaction.

And the nature of double entry accounting or accrual accounting also allows for accurate record keeping to be made when there is no cash involved in a transaction. So, for example, if the operating company had its obligation to a trust met by another operating company, the obligor operating company would still have to record an expense that it incurred and the offsetting entry to that would be, you know, a loan made to the other operating company. Something like that.

So there -- even in the case where there is no actual cash, accrual accounting calls for accurate recordkeeping to be made based on the structure and, you know, generally accepted accounting principles.

Q. Okay. So in accrual accounting when are income

items reported on the books?

A. Income items are reported when income is earned, not when cash is received.

Q. Okay, and when are expenses recorded?

A. Expenses are recorded when expenses are incurred, not when cash is physically transferred. So an example of that is if you received a loan and you owe interest expense and you pay, and you pay that interest expense on a quarterly basis, you still incurred interest expense in the first two months even though you paid three months worth of interest expense in the third month. So you still have to record every single month, a month's worth of interest expense.

Q. Okay. So what about an example of earning a salary, but you get paid on the fifteenth or thirtieth of the month, would that be -- how does that relate to accrual accounting versus a cash basis accounting?

A. Yes. So if you are a company and you have sales income that is coming in from a customer, maybe they are paying you thirty days later than you earned the income, you still have to record that you have earned the income when you earn it, and you record being paid for that income at some later date.

Q. Okay, and in your review of the books and records of the McGinn, Smith internal accounting staff, did

you see any instances of third-party payments or agency payments?

A. No.

Q. Okay, and can you explain what an agency payment is just very generally?

A. Yes. I just alluded to it a little bit, but an agency payment may be, you know, if I have borrowed a hundred dollars from my sister, which would never happen. If I borrowed a hundred dollars from my sister, and I owed that money back to her, and she then had a cell phone bill for one hundred dollars, I could pay her cell phone bill, and I would no longer owe her a hundred dollars, and she would no longer owe her cell phone bill. So I paid that as agent for her.

Q. Okay. I would like to show you Defense Exhibit 228, which I believe was admitted yesterday. Does this describe what you were saying about your sister and the cell phone bill, Mr. Dreyer and Mr. Jones and an electric bill?

A. Yes, exactly. This is the exact same relationship. So in this example, Mr. Jones owes Mr. Dreyer a hundred dollars and Mr. Dreyer owes one hundred dollars to National Grid to pay for his power.

Q. If we could just go to page two, please.

A. And so this shows that Mr. Jones pays a hundred

dollars to National Grid on behalf of Mr. Dreyer and both of those liabilities are satisfied by the one payment.

Q. Okay. So the payment on behalf of Mr. Jones cancels out both debts; is that correct?

A. That's correct, yes.

Q. And I believe you started talking to this before when you were talking about the debt service reserve fund, but in review of the various deals within the private placement memoranda, did you see something within there known as a spread?

A. Yes. And the definition of a spread is nothing more than the difference between what you paid for something and what you sell it for. You could compare it to like Home Depot selling hammers. They sell them for more than they buy them for, and there is a spread there.

MS. OWENS: At this time the defense would like to move the admission of Defense Exhibit 152.

THE COURT: 152.

MS. COOMBE: No objection.

THE COURT: Received. (exhibit)

(Exhibit No. 152, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Mr. Smith, can you tell us what this is?

A. Yes, this is just an example that I created to sort of demonstrate how a spread is created in the

financial world by borrowing money at a rate that's lower than what you are lending the money at.

So on the top is a typical local bank that offers one year CDs to its customers and also lends money to home buyers on their thirty year mortgage. So this essentially shows that the bank can borrow three hundred thousand dollars on a one percent CD, and they will owe three thousand dollars in interest on that CD.

And similarly, they can offer a sixty thousand dollar mortgage at five percent to a home borrower, and that mortgage will pay them interest of three thousand dollars, which is enough to service the interest payment on the one year CD. And that essentially creates a two hundred and forty thousand dollar spread that can be used by the bank any way that they wish.

They can pay expenses or salaries or rent. They can invest it in other businesses. They can use the spread to lend to other home buyers that are seeking a mortgage. They manage that money, and they use it to make a profit.

Q. Okay, and then the -- right on the bottom section, I guess it looks like a parallel model. Can you explain how that relates to the Adirondack Trust example?

A. Yes. So this is sort of a mirror image of TDM Cable Funding Company, which would be the operating company, and if they were to borrow from the trust, TDM

Verifier Trust 07, at a rate of 9.15 percent and they borrowed 3.475 million dollars, they would owe interest every year of four hundred and twenty-four thousand.

And if they lent a portion of those proceeds to Verifier Capital at a rate of twelve percent, they would only have to lend two million, six hundred and fifty thousand dollars in order for Verifier Capital to pay them the exact amount of interest that they then owed to the trust. So that creates a spread at the outset of the deal of, in this example, eight hundred and twenty-five thousand dollars.

And TDM Cable Funding, again, did manage that spread in number of different ways. They can use a portion of it as a debt service reserve fund. They can pay salaries. They can pay expenses. They can invest in other entities and try to grow that money from the spread into more money. That spread is the operating company's money to manage.

Q. Okay, and so in your example the, I guess, TDM Cable Funding, its agreement with Verifier Capital, they have a twelve percent interest rate agreement, but then the agreement or the obligation to the trust from TDM Cable Funding at a 9.15 percent interest rate as promised. So this spread is created because TDM Cable Funding is getting a higher interest rate based upon its agreement with

Verifier Capital; isn't that correct?

A. That's right. TDM Cable Funding is borrowing that at a rate that is lower than it is lending at. So because those two rates are different, there is a spread created.

Q. Okay, and that is the same as the trust model, a thirty year mortgage at five percent, and then it has an obligation on a one year CD for a one year --

A. Yes, it is similar.

Q. Okay. Can we take a look at Government's Exhibit GA2, please? Mr. Smith, was this one of the PPMs that you reviewed in your analysis of all the deals?

A. Yes.

Q. And the section that's highlighted, it is for TDM Cable Trust 06. What's the significance of the maximum and minimum and the other things in that block?

A. So obviously TDM Cable Trust 06 is the name of the entity. And the language underneath it states that the trust can raise no more than three million, five hundred and fifty thousand dollars in this offering and has to raise at least five hundred thousand dollars in order to be able to perform its duties that are spelled out later on in the document.

Q. And so if it doesn't raise the five hundred thousand, the minimum, what would happen?

A. Then the escrow condition is not met and the money is returned to investors.

Q. Okay.

A. This deal had offered two different maturities. One was a two-year maturity with an interest rate of 7.75 percent. And it also offered a four-year maturity with an interest rate of 9.25 percent.

Q. Can you just tell us a little bit from your review of the PPM, what did this offering entail, what type of asset?

A. From reading the PPM I know that the asset that was supposed to collateralize and provide support to this trust was a company called Prime Vision Communications, and they offered triple play contracts in a couple of communities in Florida.

Q. I am sorry. Triple play is phone, Internet, and TV?

A. It is phone, Internet, and cable TV as a package or a bundle.

Q. Okay. If we could please go to page four, and then the top paragraph. I am sorry. The top section. Summary of the offering and is this something that you reviewed in your analysis?

A. Yes. So this, the language here, really is the basis for the structure of how this company will interact

with the operating company.

Q. And I am sorry, the exhibit that we looked at I think two exhibits before with the investors, the trust, and the operating company, the asset?

A. Yes, it says here in, I think the -- this, starting at the single paragraph under the bold print, the trust fund. It says the trust fund will advance funds to TDM Cable Funding. And then it says TDM has advanced certain funds to PrimeVision Funding of Cutler Cay; PrimeVision Funding of Keys Cove and ADT.

Q. Okay, and I am sorry to interrupt you there. TDM has advanced certain funds to PrimeVision Funding. What do you understand that to mean?

A. That indicates that TDM Cable Funding has other sources of capital besides the trust and it basically used those resources to provide sort of a bridge loan to purchase the assets from PrimeVision.

Q. In advance of this actual trust offering?

A. That's right.

Q. All right, and what is this section down at the bottom: The mechanics of such purchases are more fully described in the amended and restated operating agreement of PrimeVision Management of Keys Cove, LLC and the amended and restated operating agreement of PrimeVision Management of Culter Cay?

A. Yes. Those are both exhibits that were part of the PPM and found later on in the document. In conjunction with other language in this document, you can use those operating agreements to analyze or get an idea of the expected cash flows these assets would produce in order to pay the debt to the trust.

Q. Okay. So was there somewhere in this PPM, is there a return stated for the agreement between the operating company and the purchase for the PrimeVision contracts? It might be down --

A. I think it is down on the page just a touch. So it says: Each homeowners association will be required to pay for services for a period of approximately one hundred and twenty-two months. A preferred return equal to 29.15 percent of the gross revenue will be afforded to PrimeVision Management of Keys Cove and Cutler Cay.

Q. Okay, and this relates to the initial funding that was already provided?

A. Yes. And if we go to those actual operating agreements, it spells out what the initial funding and the terms for buying those cash flow streams from PrimeVision actually are.

Q. Okay. I am sorry. PrimeVision, is that a company similar to like Time Warner Cable or -- that's the only cable company I know.

A. I believe so, but quite a bit smaller.

Q. Okay. Is there any other significance to this other paragraph? It starts: Additionally, TDM has acquired a preferred position in a note owned by ADT Services, Inc.?

A. Yes. It is another asset that TDM Cable Funding purchased as -- to be used as collateral in order to service the debt to the trust. And it was an assignment of a note that PrimeVision had to ADT, which is a large security company.

And this summarizes the terms of the note. And it says: Upon payment thereof, TDM will receive one million, three sixty-six, eight thirty-one, plus twenty percent of any money realized in excess of that. And the terms of that note are also much more fully described in that exhibit.

Q. So this summary is a saying that TDM Cable Funding is going to purchase an asset stream from PrimeVision from these two homeowners associations, Keys Cove and Cutler Cay. And additionally that TDM Cable Funding is purchasing a position of a note that ADT has between PrimeVision. Does that summarize what you said?

A. That's exactly right, yes.

Q. Okay. If we could go to page thirty-five, please. And what is this, Mr. Smith?

A. This is the operating agreement for PrimeVision Management of Keys Cove, which is one of the two homeowners associations.

Q. And this was referenced in the summary of the offering that we just looked at?

A. Yes.

Q. Okay. If you could just go to I believe it is page forty-two. And this is still within this operating agreement?

A. That's right, and we want to look at Article VI.

Q. Okay. I am sorry.

A. Or -- oh, no, no. You are right. Article IV.

Q. Okay. Is that Section 4.2?

A. Yes. If could you zoom in on that.

Q. Yes, Section 4.2 in the middle?

A. So Section 4.2A states that the preferred member, which is TDM Cable Funding, LLC, will contribute three hundred and sixty-four thousand, six hundred and ninety-five dollars as its initial capital contribution to purchase those cash flows from this homeowners association.

Q. Okay. So the TDM Cable Funding, based upon this funding agreement with PrimeVision, is going to purchase this specific amount, three hundred and sixty-four thousand, six hundred and ninety-five dollars and fifty-four cents?

A. Yes.

Q. Okay, and is there another agreement between PrimeVision and Cutler Cay, the other homeowners association?

A. There is, but I also wanted to point out here in Section 4.3, there is language that indicates that TDM Cable Funding will make additional capital contributions, and as time goes on, buy more contracts from the homeowners association.

Q. Okay. Is that because it is says upon delivery of new homes in the homeowners association?

A. That's right.

Q. So theoretically if they built more condos or whatever they are and TDM Cable Funding will have an interest in those?

A. I am not exactly sure if it had to do with the development and building more condos, but certainly more people moving into them.

Q. Okay. If we could please go to page sixty-six. And this is similar to what we just looked at, but it is for the other entity, Cutler Cay?

A. Yes, this is the agreement between TDM Cable Funding and PrimeVision Management of Cutler Cay, which is another neighborhood development.

Q. Okay. Does this also have a funding amount

section?

A. It does.

MS. COOMBE: Objection. Relevance.

THE COURT: Overruled.

BY MS. OWENS, CONTINUED:

Q. I think it is on the next page.

A. Yes, I think it is Section 4 again.

Q. I am sorry. One more, please.

A. It is further.

Q. Okay. One more?

A. No. It is Section 4, so it is further.

Q. Keep going?

A. Yes.

Q. Oh, we are still in the terminology. Okay. Go a little bit more. So in that Section 4.2, does this describe the amount that's going to be used from TDM Cable Funding to purchase these PrimeVision contracts for Cutler Cay?

A. Yes. So the initial funding here is -- it is hard to read.

MS. OWENS: Can we zoom in a little bit on 4.2?

A. It is six hundred and twenty-nine thousand, eight thirty-nine and forty-nine cents. And again, this Section 4.3 has a provision for additional capital

contributions to buy more contracts and increase the cash flow stream.

BY MS. OWENS, CONTINUED:

Q. So this agreement is saying it is going to purchase approximately six hundred and twenty-nine thousand dollars worth of the contracts, and then the agreement with PrimeVision and Keys Cove that we looked at before, that was approximately three hundred and sixty-four thousand dollars?

A. Yes.

Q. So between those two funding agreements, approximately nine hundred and ninety-four thousand dollars is being used from the funding company or from TDM Cable Funding to purchase these contracts; is that correct?

A. Yes, from PrimeVision, yes.

Q. And you talked about the ADT note that TDM Cable Funding was interested in a little bit before. I believe that those terms are on page ninety-seven. What is this, Mr. Smith?

A. This is the actual promissory note between ADT and PrimeVision. It is for a larger amount than what was assigned to TDM Cable Funding, and I believe it says in here, I'm searching for it, but this note had a thirty percent return associated with it.

Q. Okay, and if we could go to page one hundred,

please. And what is this, assignment agreement?

A. Yes. If you look under Section 3 in there, closer to the bottom, it says purchase price. And this basically spells out the terms of the assignment that was purchased by TDM Cable Funding. So it says that the assignee shall pay the assignor five hundred thousand dollars. And in exchange for that, it will earn a thirty percent return when the balloon payment is made.

Q. And then, I am sorry. This principal is paid all at the end?

A. Principal and interest together, so this particular loan did not receive monthly or quarterly interest payments. It just received its thirty percent return in one payment at the end of the term.

Q. Okay. So this is -- we see at the top assignment agreement between ADT and TDM Cable Funding, LLC, and this is in reference to that promissory note, that three million dollar promissory note that we just saw between PrimeVision and ADT, correct?

A. Correct.

Q. And then down at the bottom, that section towards the bottom, is that where you got that thirty percent interest rate that you referenced before?

A. Yes, and it says the assignee will allow the assignors to receive an internal rate of return of thirty

percent on the cash payment.

Q. Okay. So within this particular PPM is outlining the contracts, these triple play contracts, that the operating company is going to purchase from these two homeowners associations, Keys Cove and Cutler Cay, and it is also purchasing a five hundred thousand dollar interest in this ADT note with a thirty percent interest rate?

A. That is right.

Q. Was there -- you talked a little bit about it before. I believe because this is an asset based purchase, would there be any amortization associated with this?

A. There wouldn't. And I think it specifically states that. Certainly the assets that were purchased wouldn't amortize because in the case of the cable contracts, they are just cash flows. There is no term to the loan or any pay back of the loan.

In terms of the actual investment that's spelled out in the trust, it also says that there is no amortization of the principal.

Q. Okay. So that goes back to what you were saying before, that because there is an amortization, this deal would be dependent on some sort of rollover or resale of the assets on the market once there is -- once the deal matured; is that correct?

A. That's right, yes.

Q. Okay.

MS. OWENS: Defendants move for the admission of Defendant's Exhibit 159?

THE COURT: Any objection?

MS. COOMBE: Just a moment, Your Honor. No objection.

THE COURT: Received.

(Exhibit No. 159, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and, Mr. Smith, can you tell us what this is?

A. Yes. This is a schedule that I prepared that basically puts into table format the expected cash flows from the assets that were purchased as described in the PPM. So on the left-hand side, I sort of separated it, just shows how the ADT note would actually function. And so I put October of 2006.

Q. Why do you use the October 2006 date?

A. That's when the money was advanced to purchase that assignment.

Q. Okay, and you said before this was a balloon payment so there wasn't any interest or principal paid until that particular agreement matured?

A. Correct. So as you go down through the months, there is nothing there because they are not making any

payments.

MS. OWENS: Just scroll down a little bit, please.

BY MS. OWENS, CONTINUED:

Q. So 2006, 2007, 2008, 2009?

A. Yes.

Q. There is no payments?

A. Right. And if we go to page two real quick, it will just show the balloon payment. So in August of 2010, it is expected that the ADT note will pay a million three hundred and sixty-seven thousand, seven fifty, and that is a thirty percent return.

Q. And that is based upon that assignment agreement that we looked at in the PPM?

A. That's right.

MS. OWENS: If we could just go back to page one again, please. And then just scroll over a little bit because we already talked about the ADT note.

BY MS. OWENS, CONTINUED:

Q. All right. So this cash flow is from PrimeVision asset and debt service through TDM Cable Trust 06. What does this represent, Mr. Smith?

A. Okay. So this is --

MS. OWENS: I am sorry. Can you just scroll -- we don't need to look at the ADT note anymore.

A. So using the initial funding numbers that are described in those operating agreements and the 29.15 percent preferred return, that basically equates to a monthly cash flow, an estimated monthly cash flow of twenty-five thousand, one hundred and two dollars.

BY MS. OWENS, CONTINUED:

Q. And then it starts in October 2006 again because that's when the asset was initially purchased from TDM Cable Funding?

A. That's right.

Q. Okay.

A. And then the next column is the beginning balance of the investor's debt or the amount of money that the trust raised. And that is three million, five hundred and fifty thousand.

Q. And was that the maximum offering?

A. It was.

Q. And the next section, interest?

A. The next section is interest. And using the bank statements and knowing how much of each of the two maturities were purchased, remember there was a 7.75 percent maturity and a 9.25 percent maturity.

Q. It is a blended interest?

A. It is a blended interest rate. I just used the weighted average of those two interest rates to come up

with 8.68 percent. And so this column is interest of 8.68 percent on a monthly basis based on that principal of three million, five hundred and fifty thousand dollars.

Q. And at least the section that we are looking at right now, it looks like the date range October 2006 to March 2009, there is no principal paid. Is there anything unique about that or is that just the terms of the deal?

A. The terms of the deal are that this deal did not amortize. That's why we see only interest payments. The other thing that's interesting is that the initial cash flow is just about five hundred and seventy dollars short of what is necessary to pay the interest.

Q. Okay. That's on the surplus and deficit column on the right?

A. Right. And so this is a great example of the function and purpose of the operating company because the operating company is the actual obligor and owes the debt to the trust.

So in the first year the cash flows are just about five hundred dollars short of what is necessary, and so the operating company uses its own resources to make up that shortfall. And it basically smooths out the timing. As we go down, and the operating company purchased more contracts and increased the cash flow.

Q. So, and I am sorry --

THE COURT: Wait a minute.

MS. OWENS: I am sorry, Judge?

THE COURT: Don't interrupt him all the time.

BY MS. OWENS, CONTINUED:

Q. I am sorry, Mr. Smith. Go ahead.

A. So as the operating company made those additional contributions that were referenced in the operating agreements with PrimeVision, their cash flows would increase, and that shortfall that they funded in the first year would be recovered. And that's indicated in the last column which says surplus deficit.

You can see that in the second year, the expected cash flow is sufficient to meet the interest payments by about fifty dollars. And then the third year, it is up to about seven hundred dollars a month, and it grows from there.

Q. Okay.

MS. OWENS: Just go to the next page, please. And scroll over again.

BY MS. OWENS, CONTINUED:

Q. So this is a continuation now. I thought that from the PPM it said it was a four-year and two-year deal, but you have payments going to 2011 and 2012. Why is that?

A. That is because without the knowledge, you know,

four years ahead of time, would this deal be able to be -- would the cash flows be able to be sold on the market? And since the cash flows are owned by the operating company into perpetuity, I just extended this to be a six-year deal.

And you can see that in August of 2010 when the ADT note pays off, I have used those proceeds to pay down some portion of the principal. It could be to pay off the forty-eight month portion of that trust debt. We do know that there was actually one rollover that did happen in 2008. The two-year deal matured and did actually roll over. So this just indicates that this debt could continue to be refinanced for another two years beyond what the four-year deal is on the PPM.

Q. Okay, and that's again just because there was no amortization; is that correct?

A. Correct.

Q. Required EBITDA, what is EBITDA.

A. That's an acronym that stands for earnings before interest, taxes, depreciation, amortization. And it is just -- it basically means available cash flow. And so EBITDA is essentially one year's worth of this cash flow stream, monthly cash flow payments that are on the left column.

And so what I have done here is that in the

sixtieth month I have said, well, if this deal did need to sell those assets in the market, what would be the price of those assets? And so the very bottom, there is still a principal balance on the loan of two million, one hundred and eighty-two thousand, two fifty. So I have taken the last year of cash flows and added them together and divided that number into the principal balance.

So long story short is that you would have to sell a year's worth of cash flows at 5.5 times that cash flow number in order to retire the debt through a sale of the assets. And another way to put that is sort to think of it in terms of time.

So if you were somebody that was going buy this asset stream, you could think of the 5.5 multiple as kind of like five and a half years. So if you want to buy this business and you knew that the cash flows were going to continue every year, it would take you roughly five and a half years to recover your investment. And then beyond that time, you would be making a profit.

Q. Okay. So EBITDA, and you described it as basically cash flow, would be a five and a half for the -- your last twelve months earnings to retire the debt; is that correct?

MS. COOMBE: Objection, form.

THE COURT: Overruled.

A. It would be the last twelve months of cash flow or earnings before paying interest and taxes and depreciation.

BY MS. OWENS, CONTINUED:

Q. Okay. So in summary of this very detailed chart, can you just tell me overall, you get to an end point of September 2012. What is this representing?

A. Really this is representing the expected cash inflows from these assets and, side by side with that, the known cash requirements to pay the trust investors back their full investment plus interest.

Q. Okay, and this is all based upon those contracts and agreements that we viewed in the PPMs, and we know that the interest rates to the two tranches of investors had a blended interest rate of 8.68. So that's where you get all this information from when you structured this model?

A. Yes, that is right. This model comes from only information that was in the document.

Q. Okay.

MS. OWENS: At this time defendants move the admission of --

THE COURT: Let's take a break now, members of the jury. Be back in fifteen minutes for the morning break. Don't discuss the case.

Mr. Minor.

COURT CLERK: Court stands for the morning recess.

(Whereupon, the proceedings were held in open court out of the presence of the Jury.)

THE COURT: Don't discuss your testimony over the break, Mr. Smith.

Mr. Minor.

COURT CLERK: Court stands for the morning recess.

(Whereupon, a brief recess was taken.)

THE COURT: Ms. Owens.

MS. OWENS: At this time the defendants move for admission of Defendant's Exhibit 154A.

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 154A, received.)

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, did you prepare this exhibit?

A. I did, yes.

Q. And what does it represent?

A. This is just a summary of the table that we were just previously looking at. And each of the numbers in these red boxes are the sum of all of the monthly cash flows that were spelled out in that table. And also there is some larger numbers that we already previously

discussed.

Q. So if we could just go through the -- what the tables of numbers represent at the top?

A. So the 25,102 is the initial monthly cash flow that was in the beginning of that table. And due to the additional funding, that monthly cash flow eventually grew to about twenty-eight thousand, four hundred. This number of two and a half percent annual increase in cash flow is just the representation of how much those cash flows grew on an annual basis over the five years of debt table.

And the number one million, nine hundred and twenty-four thousand, one forty-five is the total of all of the monthly cash flows. The one million, three sixty-seven, seven fifty is the expected balloon payment from the ADT note. And the two million, one eighty-two, two fifty is the sale of the monthly cash flows at 5.5 or 5.45 times EBITDA. So that's a number that we had just previously discussed.

And finally, in reviewing other documents related to the case and reviewing the bank statements from TDM Cable Funding, there were three loans to partners of that company that were associated with this deal. And so if those loans were repaid at the end of this deal with three percent interest, that would equate to one million two hundred and twenty-one thousand, five sixty-one.

When you add all those cash flows together, the total available cash to repay the investors with interest comes to six million, six hundred and ninety-five thousand, seven hundred and six dollars. If we look at the bottom of this flow chart, I have sort of a summary of that number, the six million, six ninety-five.

Underneath that is the total necessary cash to pay the principal of the trust investors' debt back, plus all of their interest over this time period. That number is five million, one hundred and thirty-two thousand, seven thirteen and one penny.

And so the difference in those two numbers is basically the expected profit that TDM Cable Funding will have realized after they have repaid the debt capital that they had raised from the trust. And that number is one million, five hundred and sixty-two thousand nine ninety-two.

Another way to look at that is that's the amount of coverage that was expected above and beyond the repaying the debt to the investors that was available.

Q. Okay, and in the top summary box where it says sale of the RMR, is that recurring monthly revenue?

A. Yes, that's sort of an alarm industry acronym. It's sort of self-explanatory. It is just a monthly payment that comes in each and every month. So recurring

monthly revenue.

Q. Okay, and that 5.45 EBITDA number or cash flow number, is that -- I understand that before break you described how you got to that number. Is that number -- would that be considered fair market value at the time of the sale or is it a more modest number?

A. Tough to say. I mean, an EBITDA multiple is an industry standard for valuating the price of a sale. The industry standard for, you know, what a year's worth of EBITDA actually sells for really depends on the industry and the company, itself, but, you know, EBITDA multiples on asset sales range anywhere from three to thirty times. So I would say it is on the lower end.

Q. Okay, and if I could just point out a couple of things here. For all of the, basically the investments, the ADT note, the cable contracts, and then I see you have the loans in here as well, all of the inflows from this TDM Cable Trust raise was supposed to be basically 6.6 million dollars or actually closer to 6.7 million dollars?

A. That's right.

Q. And then total necessary cash to retire investor debt, does this mean when, according to the model, investors would be paid their principal and modest interest back was 5.1 million?

A. That's right, yes.

Q. Okay. So resulting equity after investors are fully paid, 1.5 million, just an estimation, that is more than the partner loan repayment; is that correct?

A. Yes, that's right.

Q. So in summary underneath the model that you have prepared, the deal would have taken in 6.6 or 6.7 million dollars, and the amount that was owed to investors at the date of maturity was 5.1 million?

A. Yes, that's right.

Q. Okay. You mentioned before that when you were reviewing a bunch of the documents in relationship to your analysis of the particular deals, you reviewed a number of bank statements?

A. Yes.

Q. And specifically for TDM Cable Trust?

A. TDM Cable Trust, I reviewed the bank statements from the two checking accounts associated with that trust, and I also reviewed the bank statements for TDM Cable Funding, LLC.

Q. All right. Did you review anything else in relationship to any records related to the trust besides what we just talked about?

A. I did review the existing McGinn, Smith QuickBooks files to some extent.

MS. OWENS: And at this time the defendant

moves the admission for Exhibit 160.

MS. COOMBE: The government objects. There are a bunch of comments in here. The witness has not been qualified as an expert witness, and there is no foundation or basis for him to be rendering his opinion in this fashion.

MS. OWENS: Your Honor, this --

THE COURT: Okay. So see if you can establish a foundation. There is nothing before me to rule on at this point. The government objects. So you see if you can establish a foundation, and then I will rule on it.

MS. OWENS: Sure.

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, Ms. Coombe just indicated you prepared a number of comments in this particular exhibit. What are your comments based on?

THE COURT: Well, why don't you show him the exhibit that we are talking about. Have him look at the exhibit and see what it is, and then he can...

BY MS. OWENS, CONTINUED:

Q. I am showing you Defense Exhibit 160.

A. Okay.

Q. What do you recognize it to be?

A. This is an Excel spreadsheet that I created by looking at only the bank statements for TDM Cable Trust 06.

It organizes every transaction that actually took place into those bank statements into certain sections. And the one, two, three, four -- well, the second column from the right says as accounted for.

And as I mentioned, I had reviewed the McGinn, Smith QuickBooks records and found these specific transactions recorded there. And I simply transferred that information for what account those accountants recorded that specific transaction for.

The final column to the right is the actual -- which account I was looking at. And then finally in the middle where it says comments, I believe that's what they are asking me about.

Q. Are those comments based upon your review of any of the other documents that we have previously discussed?

A. Yes, they are based upon the review of the private placement memoranda and the structure of the relationship between the operating company, TDM Cable Funding and TDM Cable Trust and also just using the general rules of accounting.

So I made a comment on whether or not the way the McGinn, Smith accountants actually labeled that particular transaction, whether it was accepted under the rules of accounting or not.

Q. Okay, and just -- what you just said before

based upon the structure laid out in the private placement memorandum for TDM Cable Trust 06?

A. That's correct.

MS. OWENS: Defendants move the admission of --

THE COURT: Does the government still object?

MS. COOMBE: Yes, Your Honor.

THE COURT: Overruled. Defense Exhibit 160 is received. It is up to the jury to decide whether or not it is accurate and whether or not the comments are appropriate, but this witness is a CPA qualified to make those comments.

(Exhibit No. 160, received.)

THE COURT: Proceed.

BY MS. OWENS, CONTINUED:

Q. So this was the chart you were just talking about?

A. That's correct.

MS. OWENS: If you could zoom in a little bit, please.

BY MS. OWENS, CONTINUED:

Q. So this top where it says TDM Cable Trust 06 and then you reference some bank account numbers here?

A. Yes, those are the two bank accounts associated

with TDM Cable Trust 06.

Q. Okay, and then do you want to talk about some of the columns I see of dates, debits and credits, amounts?

A. Sure. So the Mercantile account ending in 9573, this was the checking account that had the escrow agreement tied to it until the minimum raise was reached. And so this is the account that investor deposits would be made into.

So the first blue section just lists all of the investor deposits into that account. And as you move across the columns, the McGinn, Smith accountants designated whether or not this was for the nine and quarter, four-year deal or the seven and three quarters, two-year deal. And so my comment says that those were correctly notated.

Q. Okay.

A. And so as you move down the blue section, it goes chronologically as to the investor deposits when they came in. And finally we reach a total of three million, five fifty, which is the maximum raise stated on the PPM.

Q. Thank you. And then I see over for the light blue column, all the way over to the right, it says account escrow, MERC, is that for the Mercantile Bank?

A. Yes, that is right. So that just indicates that all these transactions took place in that Mercantile

account.

Q. Okay, and do you recall what the minimum raise was for TDM Cable Trust 06?

A. It was five hundred thousand.

Q. Okay.

MS. OWENS: If we can scroll over to the left a little bit.

BY MS. OWENS, CONTINUED:

Q. Okay, and then it looks like it starts with a date of November 30, 2006, and an amount of one million, one hundred and forty thousand dollars?

A. Yes. So that just means that by 11/30/06, the condition for the escrow agreement to be broken had already been met. And so even though we labeled this an escrow account ongoing, it is really just a checking account at that point.

Q. Okay. So the light blue section is based upon the review of each month's bank statements for the Mercantile escrow account, escrow is broken on November 30th, and then there is the total raise number of three million, five fifty?

A. That is right, yes.

Q. Okay, and the next section it is like a peachy color. Can you describe to us what that reflects?

A. Sure. So after the money has been raised, we

know from the PPM that it is to be loaned to TDM Cable Funding, the operating company.

And so the next few sections show the disbursements of the money that was raised. And I have tried to just organize it in into approximate sections. So reading the PPM through the initial funding of about nine hundred and ninety thousand dollars and then through the additional funding, which I determined from looking at all of the bank statements all the way through April of 2010, it turned out that the additional funding grew to about one million, one hundred and eighty thousand dollars. And then there was the five hundred thousand dollar ADT note.

That was roughly a million -- one million, eight hundred thousand that was used by TDM Cable Funding to purchase those cash flows. So I have just organized the disbursements from the Mercantile account to show that this is roughly the amount of disbursements that were used to purchase the assets.

Q. Okay. Just sticking on the peach section, you have a comment indicating should be due from TDM Cable Funding, and did you get that from the private placement memoranda?

A. Yes, because the proceeds were intended to be loaned to TDM Cable Funding. So in this case, like the first transaction says loan to FIIN, this one million,

thirty actually was transferred directly from the trust to FIIN, which was one of the Four Funds.

And that was actually a repayment of the bridge loan we had talked about before where TDM Cable Funding had secured other sources in order to advance the money for the purchase of the asset.

So what I am saying here is that even though the money went directly to repay that bridge loan, instead of passing through the operating company, it still needs to be recorded that the operating company has a liability or an obligation of the operating company to pay back to the trust. And so that's what my comment is. It should be due from the operating company, TDM Cable Funding.

Q. Okay, and is there significance between the difference between the blue total, the three five fifty and the peach total of a million, eight thirty, eight hundred?

A. Yes, the difference of those two numbers is the spread that we talked about before because the peach section is an approximation of the actual asset purchase. And the blue section is the amount of money that was actually raised. So in this deal, there was a spread of roughly about a million, one million, seven hundred thousand dollars.

Q. Okay, and then if we could just go to the next page, please. And what does the black numbers represent?

A. Okay. So because of that spread of one million, seven hundred thousand dollars, that is still money that is, based on the language in the PPM, is still owed in the form of a loan to TDM Cable Funding, the operating company.

And so the operating company has a number of expenses that it needs to pay in order to -- for this deal to function. So the black section is the underwriting spread that is listed on the cover of the PPM. And this is money that was paid as commissions to brokers who sold the deal, and that total is one hundred and two thousand, eight hundred.

But it is important to note that that expense is actually an expense that's incurred by the operating company and not by the trust. And we know that because it comes out of the spread, which is money that is owed to the operating company. And also we know that because the trust, itself, doesn't actually have any fees or expenses because it gets paid back the full amount that it lends.

So because three million, five hundred and fifty thousand dollars was raised and that full amount of principal is eventually repaid, they really have -- the trust, itself, has no expenses associated with it. All of the expenses that are paid are actually incurred by the operating company.

Q. Okay. So based upon what you just said, the

trust, which is what the investors invest in, they don't incur any fees because it all comes out of the spread from the operating company?

A. That's right.

Q. Okay, and then moving on to this light green section, what does this represent, Mr. Smith?

A. Again, these are other transactions that took place physically in the Mercantile account of the trust but really were functions of the operating company on an agency basis.

So again, because the trust doesn't pay any fees or expenses, all of these bank charges and wire fees of like twenty dollars and sixty dollars and the copying fees, etcetera, those are all expenses that are incurred by the operating company.

And so the trust simply doesn't lend that money to the operating company and then have the operating company go back and pay the expense. They just pay the expense on behalf of that spread money. And there is some other transactions there that are fairly large. And again, those are loans that come out of the spread. And the operating company either pays expenses with that money or makes other loans to other entities.

Q. Okay, and I see you have some entries here. If you scroll over to the right, not recorded by Dave Rees.

Who is Dave Rees?

A. Dave Rees at one point was the CFO of McGinn, Smith. And when I was reviewing the bank records and comparing them to the internal McGinn, Smith QuickBooks files, I found all of these transactions there with the exception of these three, which are transactions that clearly happened because they are found on the bank statement, but they weren't found anywhere in the actual books and records. They total about seven hundred thousand dollars.

Q. Okay. And so just to summarize what you said, correct me if I am wrong, but these green expenses are really part of the spread, and according to the McGinn, Smith accounting records, these were fees or expenses, excuse me, expenses charged to the trust, but they are really supposed to be charged to the operating company; is that correct?

A. That's right.

MS. OWENS: And then if we could move to the left a little bit on the exhibit. Scroll down a little bit.

BY MS. OWENS, CONTINUED:

Q. And then I see a section where it says escrow account balance after first raise, and then it is a little dash meaning nothing?

A. Yes. So that just shows -- it is sort of a check of the accuracy of this. The bank statement after whatever the last date here is, I think it is probably September of have 2007, had a zero balance.

And so this is just a check because it shows that if you add up the totals of the four sections above here, which include the raise of three million five fifty, and then all the money that is loaned to TDM Cable Funding, it comes out to a zero balance. So the source is equal to uses.

Q. Okay, and the blue section, what does this represent?

A. So we alluded to it before, but there is -- the two-year deal, the seven and three quarters deal, actually matured in November of 2008. And so there was a refinancing or a rollover of that note, and it was done through a second raise in TDM Cable Trust 06. And this just shows how that money was raised.

And so again, I have investors, which is investor deposits. And that is actually new money, new investors that are coming into that deal. The second line says rollover investors. It is one million, forty-five thousand. So that's the amount of money that was in the original two-year deal that decided that they wanted to continue to receive interest payments from this particular

cash flow stream. And so they, rather than taking a redemption and taking their principal back, they rolled it into the next deal. And so that is just the total of the second raise or the rollover, which is a million, three ninety.

Q. Okay. So in the initial raise for TDM Cable Trust 06, there were some people who subscribed to a two-year maturity date, and this is just reflecting some of the people that elected to continue receiving their monthly interest payments and continue on with the deal; is that correct?

A. The line that says rollover investors reflects that. The other lines reflect new investors that basically bought the new deal and that money was used to pay the principal back to the investors that did not elect to roll over.

Q. And for the rollover investors, was there a separate private placement memorandum for the rollover that was issued to them?

A. There was.

Q. And did it have the same interest rate?

A. No, the second private placement memorandum had a ten percent interest rate and a maturity of two years.

Q. Okay, and if we could just go on, there is another peach section. It is in category of redemption.

Does this piggyback on what you were just talking about, the rollovers and --

A. Yes. This shows the retirement of the original two-year trust.

Q. Okay, and the black section again, what does that represent?

A. Again, that's an underwriting fee that is paid on behalf of TDM Cable Funding to the brokers.

Q. Is there another underwriting fee because there was another raise for the rollover?

A. That's right, yes.

Q. Okay, and moving on to the green section, it is similar to the green section that we looked at. I guess the first page or the second page. Can you just remind us what this represents?

A. Yes. Again, that -- if you notice this acts just like what we looked at before. So the blue section on this second raise was money coming in of one million, three ninety, and that amount of money retired only one million, three hundred and forty-five thousand dollars worth of debt. So there is another spread there. And the spread is forty-five thousand.

So Out of that spread, twenty thousand dollars is paid to McGinn, Smith as underwriting fees. And then there is another twenty-five thousand dollars of spread

that is money that belongs to the operating company, and it is used in, again, a number of different ways. In fact, there is a transaction on 2/1/09 that says transfer to trust operating account fourteen thousand, five hundred dollars, and that is a perfect example of the debt service reserve that we spoke about before. It is just money out of the spread that's transferred into the checking account of the trust and used to pay back interest.

Q. Okay. So just like the -- we are talking about the rollover now, but just like the initial raise, these are fees that are supposed to be incurred by the operating company, TDM Cable Funding, because investors get their principal, their full amount of principal and interest back under your model?

A. That's correct.

Q. Okay, and then we see another section, escrow account after second raise now zero?

A. Yes. Again, this is a check that I did just by looking at the final bank account for that Mercantile account, and it shows a zero balance, and the sum of all those columns on my sheet also had a zero balance.

Q. Okay. Now, this lavender section, a lot of the descriptions are listed as interest income. How do you know it is interest income?

A. So these are all transactions that now take

place in the M&T account. And as we discussed before, I think, this is the operating checking account of the trust, and so the function of this bank account is really to receive payments from the operating company and pay those payments back out to investors.

And so the transactions that are labeled interest income are actually payments that came from the operating company, and I have labeled them as such. In some cases that interest income maybe came from another operating company. And so in my comments section I don't say that it is necessarily correct, but I know that it is interest income to service the interest expense of the trust.

Q. That's because TDM Cable Funding has agreements with the assets of PrimeVision, PrimeVision contracts, so those interest income should be flowing through TDM Cable Funding first?

A. That's right. And you can see there is some transactions where PrimeVision sent their payment directly to the trust and sort of skipped over the operating company. The reason for that, I don't know, but it is indicated by reading the bank statements.

So rather than the operating company, TDM Cable Funding, receiving its cash flow payment for the assets that it purchased and then taking the necessary portion of

services, its interest expense to the trust, and passing that through, instead the money just jumps over the operating company and goes right into the trust.

Q. Okay, and do you recall from looking at that model with the EBITDA and the ADT balloon payment that the cash flows from PrimeVision to TDM Cable Funding weren't necessarily, at least in the beginning, equal amounts that were due to investors; is that correct?

A. That's right. And then later on the cash flows amounts were expected to be more than what was due to investors.

Q. Okay. So if PrimeVision is depositing its the interest income from its relationship under the agreement with TDM Cable Funding right into the M&T accounts, which is the checking account for the trust, what effect would that have, if any?

A. Well, it would create a surplus in the operating account or rather in the operating account of the trust. So as we discussed before, because this operating account is supposed to act as just a mechanism to pay interest to the investors, once those payments are made, there should really be a zero balance there every time. The money should just come in and then be paid out because the amounts should be equal.

Because a lot of these amounts are coming

directly from the cash flow stream of the asset, there is a surplus created, and it begins to build up an account balance in the trust that is money that really belongs to the operating company.

Q. Okay. If we could just scroll down a little bit and see what the total is on this purple section. So a million, one?

A. A million, ten thousand.

Q. I am sorry. A million ten thousand in interest income. Okay, and if we could go to left a little bit. We are now in the blue section. It is not labeled interest income. It is labeled interest expense. Why is that?

A. So these are checks and wires from the bank account that went out to investors. So this is the money that has passed through the trust and been paid out to the investors that invested in the trust.

Q. Okay.

MS. OWENS: If we could just scroll down.

BY MS. OWENS, CONTINUED:

Q. So the total interest expense paid to investors is nine hundred, eleven thousand, one seventy-seven dollars and forty-three cents until, it looks like, November of 2009?

A. Yes.

Q. Okay, and then you have it labeled here

operating account surplus due to TDM Cable Funding of ninety-nine thousand, seven hundred and eighty-eight dollars and twenty-six cents. Does that relate back to the fact that the interest income was going into the M&T account in error?

A. Correct. And I don't know if I would use the word "error" in the sense that the money was physically transferred in that way. But it wasn't properly recorded as money that belonged to the operating company.

Q. Okay. So it essentially results in a surplus within the trust account, but it is really owed to the operating company, it is actually operating company money?

A. That's right.

Q. Okay. So it is about ninety-nine, one hundred thousand dollars (sic)?

A. I think.

Q. So this next orange section, what exactly does this represent? You have a number of different entries here.

A. Yes. These are payments that either came out of the trust or came into the trust from other entities. And again, these were all -- should have been recorded as a function of the operating company even though the actual cash transactions are taking place in the trust account.

And if you just scroll down a little bit, you

see that the total sum of all those transactions is an amount that's less than that surplus that's created. It is eighty-three thousand, nine thirty-five.

Q. Okay, and then the yellow section I see starting on the next page?

A. Again, these are expenses that were paid for by the trust, but were actually incurred by the operating company. So McBee I think is a service that provides checks, printing of checks. There is a number of bank charges. There is legal expenses on here, accounting expenses, etcetera. These all expenses that are actually incurred and are paid out of that excess money that is residing in the trust. So I think that total is about fifteen thousand dollars.

And so that eventually I have gone through every single transaction that took place at the trust. And if you just scroll down a little bit, there is -- it leaves you with an ending balance in that operating M&T account of one hundred forty dollars and thirty-three cents. And again, that's what is left over of the excess money. That is really money that belongs to the operating company. And it is a small amount, but it should be recorded on the operating company's balance sheet.

MS. OWENS: Okay. At this time the defendants move the admission of Exhibit 160A. I think it

is actually stipulated to.

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 160A, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Mr. Smith, can you tell us what this is?

A. This is just the April 2010 bank statement for that operating account that we were just looking at. And it just shows, for accuracy sake, that the ending balance here is the same, one hundred and forty dollars and thirty-three cents that shows on the table that I created.

Q. Why did you use the April 2010 statement?

A. Mr. Brown, the receiver, came in and took control on April 20th, so it seems like the last relevant date to what we are doing here.

Q. Okay. I notice on this bank statement it says TDM Cable Funding, LLC, Trust 06 account, aren't those two different entities?

A. They are. I don't know who set up the bank account for the trust, but whoever it was maybe did not know that those were two different entities.

Q. Okay.

A. Maybe the person at the bank didn't realize that either. I don't know.

Q. Mr. Smith, now I am going to show you what has

been marked as Defendants' Exhibit 161. What do you recognize that to be?

A. This is just a summary.

THE COURT: Is this admitted.

MS. OWENS: No.

THE COURT: All right.

A. This is just a summary of the table we were just looking at. It just is a little bit easier to look at. It takes the totals of each of those sections and just displays it without every single transaction.

MS. OWENS: Okay. At this time the defense moves the admission of Defendants' 161.

MS. COOMBE: Your Honor, I have the same objection. A lack of foundation, a lack of qualifications. He is not a CPA or an accountant.

THE COURT: So noted. 161 is received.

(Exhibit No. 161, received.)

BY MS. OWENS, CONTINUED:

Q. So this looks somewhat similar to the other chart, the spreadsheet with all the colors we were looking at. And you said that this was the totals from each colored section; is that correct?

A. That's right.

Q. If you can scroll down, investor deposits, loans underwriting fees, spread, the rollover that we discussed,

redemptions, and then the one hundred and forty dollars and thirty-three cents that's left over?

A. Yes.

Q. And based upon your review of the private placement memorandums and various bank statements, did you prepare anything that related to this trust relationship with TDM Cable Funding?

A. Yes. In conjunction with the work that I did here looking at the bank statements of the trust, I also looked at the bank statements of the operating account. And using the two together, I have organized the transactions of the operating account into a balance sheet and a profit and loss statement. Essentially just took all of the transactions that dealt with the operating company and put them into a category much like I did here.

Q. Okay, and I am going to show you Defense Exhibit 158. Is this the document that you prepared?

A. Yes.

Q. And is it demonstrative of the transactions that would be properly recorded under the business models, the business model of the trust and operating company that we discussed when going over the private placement memorandum?

A. Yes, this is a balance sheet for the operating company, and it is just used as a snapshot to accurately reflect numbers that I reviewed in bank statements, and

also numbers that are on these tables that we just looked at, like the ending bank balance for the trust. And it just reflects that those numbers match and are the same.

Q. Okay. So is it demonstrative of the principles of this particular deal structure and generally accepted accounting principles?

A. Yes.

Q. Okay.

MS. OWENS: At this time defense moves for the admission of Defense Exhibit 158.

MS. COOMBE: Your Honor, the government objects. Again, he is not an accountant. He has made up his own balance sheet, and that's what they are seeking to admit. It is not relevant. There is no foundation.

THE COURT: Overruled. 168 received.

COURT CLERK: 158.

MS. OWENS: I am sorry. It was 158.

THE COURT: You said 168.

MS. OWENS: Oh, I am sorry, Your Honor.

THE COURT: What is it, 158 now?

MS. OWENS: Yes.

THE COURT: Okay. 158 is received.

(Exhibit No. 158, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Is this the document that you were just

talking about?

A. Yes.

Q. It has a January 3rd date in the corner. Is that the date that it was printed?

A. Yes.

Q. Okay. So the balance sheet as of April 30, 2010?

A. Correct.

Q. And that was the last date according to your analysis of this deal?

A. Yes.

Q. Okay. So we looked at the bank statement. It said one hundred and thirty -- I am sorry. I forgot what it said. One hundred and forty dollars?

A. Yes, one hundred and forty dollars and thirty-three cents. We just reviewed that that is the leftover of the excess money in the trust account that belongs to the operating account.

So just near the top here under current -- other current assets and trust accounts receivables, there is a small typo. It says AP instead of AR. It should be AR TDM Cable Trust 06. And it shows that one hundred and forty dollars and thirty-three cents reflected there.

Q. Okay. So that matches. And then if we could go to page two. This shows, I guess, liabilities. Is there

one here for TDM Cable Trust 06?

A. Yes. So under trust liabilities due to TDM Cable Trust 06, this reflects the principal amount that is still owed back to the investors of the trust. And if you remember, the initial raise was three million, five hundred and fifty thousand dollars. And then on the subsequent rollover, there was a new spread created of forty-five thousand dollars. So essentially an extra forty-five thousand dollars in principal was raised in the second raise. So this shows that the operating company owes that liability back to the trust of three million, five hundred and ninety-five thousand dollars.

Q. Okay. So that's the three million, five hundred fifty thousand dollar initial raise and the forty-five thousand from the rollover?

A. That's correct.

Q. Okay, and if you could go back to, I believe, page one and then go down, it looks like a section called other assets?

A. Yes. This reflects the assets that the operating company purchases with the proceeds from the capital raise that they get from the trust. So there is three sections here that relate to TDM Cable Trust 06.

The first one is at the very top. It says Cutler Cay Security Alarm Repo, one hundred and twenty

thousand dollars. That's a cash transaction that took place from the operating company and went to Cutler Cay for one hundred and twenty thousand.

The next line is due from ADT, five hundred thousand. That reflects the assignment of the ADT note that we reviewed earlier.

And then finally, PrimeVision cash flow, which is the second from the bottom in that section, indicates that one million, one hundred and eighty-one thousand, nine thirty-four was actually received in exchange for those cash flow streams. That money was received by PrimeVision and is an asset of the operating company.

Q. All right. So the assets from Cutler Cay were one hundred and twenty thousand dollars, the ADT note of five hundred thousand dollars, and the PrimeVision cash flow was roughly one million, one hundred and eighty-one thousand dollars. Does that add up to approximately 1.8 million?

A. Yes. It is just about 1.8 million, which on the trust summary sheet that we reviewed just before this, I have indicated that that's roughly the amount of the proceeds to the operating company that were used to purchase the assets.

MS. OWENS: If we could just go back to Defendants' Exhibit 161, please.

BY MS. OWENS, CONTINUED:

Q. Okay, and if we -- and is it that peach section?

A. Yes, it is one million, eight thirty, eight hundred.

Q. Okay. So it is slightly different. Is there any reason for that?

A. Only that the number on the balance sheet is the actual amount that was received for the purchase of assets by the operating company. Because the trust engaging in these agency payments, the number is not exact because, you know, some money was lent directly to the operating company and then a smaller amount may have been forwarded to purchase the assets. It is just a matter of me not actually splitting one transaction into two different amounts on this sheet. I wanted to use the actual numbers from the bank statements.

Q. Okay. So the balance sheet that we previously looked at showed roughly a million, eight in assets, and then this amount, lends to the operating company for purchase of asset, is roughly the same?

A. Correct.

Q. Okay. At this time I would like to show you Government's Exhibit GA7. TDM Luxury Cruise Trust 07. Can you tell us a little bit about this deal, did you review this deal and its PPM?

A. I did, yes.

Q. And can you tell us a little bit about it, please?

A. This another trust. Essentially a vehicle for investors to invest in or lend money to TDM Cable Funding. And this trust is collateralized or secured by a different asset. In this case, it was the receivables from cruise bookings from a company called Luxury Cruise Receivable. The offering is for three million, six hundred and thirty thousand dollars, and it pays ten percent interest, has a term of, I believe, three years -- or four years, rather.

Q. Okay, and I see there is a maximum offering and there is a minimum offering of five hundred thousand, it says right there?

A. Yes.

Q. Okay, and If we go to page four, please. And then if we could go to --

A. Just the page before.

Q. Page three, I am sorry. Summary of the offering. And this was one of the sections that you reviewed when you were analyzing this particular deal?

A. Yes. Again, the second paragraph down, it says: The trust funds will advance funds to TDM Cable Funding, and TDM has purchased a portion of its preferred interest in Luxury Receivables.

MS. OWENS: I am sorry. Can we just zoom in a little bit on that paragraph, the trust funds?

BY MS. OWENS, CONTINUED:

Q. The trust funds will advance funds to TDM. Do you understand that when we see in the paragraph, TDM means TDM Cable Funding?

A. Yes, that's right. And then further in that paragraph it says that up to three million dollars will be lent to this company, Luxury Receivables.

Q. Okay. Is that where it says in exchange for capital contributions to Luxury Receivables in an amount of up to three million dollars or is that a different sentence?

A. Yes, well, I was actually looking at the next paragraph, but they say the same thing.

Q. Okay, and when it says it will advance up to three million dollars to Luxury Cruise Receivables, do you understand that to be the assets that the operating company is entering into some sort of agreement with?

A. Yes.

Q. So it is saying right here it will advance up to three million dollars. And what was the total max of the raise again?

A. I think it was three million, six hundred and thirty thousand.

Q. Okay. So does that create a spread?

A. Yes. That creates a spread of at least six hundred and thirty thousand dollars.

Q. Okay. So it says on the front page of the PPM the maximum raise is going to be about three million, six, and then right here in the summary of the offering it says it is going to lend three million?

A. Correct.

Q. Okay, and it says up to three million?

A. That's right.

Q. All right. So what if they lent less than that, what would be the result?

A. That is acceptable, and it would create a larger spread. I just took it to mean that this was sort of a line of credit.

Q. Okay, and then on that same paragraph the trust funnel will advance funds to TDM. The next sentence says: TDM has purchased a portion of its preferred interest in Luxury Receivables in the amount of one million, four hundred and fifty thousand dollars. It says TDM has purchased. Does that mean that it has already went out and purchased the asset prior to the raise?

A. Yes, again, this is indicative of a bridge facility being used. So TDM Cable has secured another source of funding in order to close the deal and be able to

even provide this offering to investors.

Q. Okay.

MS. OWENS: If we could go to page eighteen, please -- or seventeen.

BY MS. OWENS, CONTINUED:

Q. Okay, and down at the bottom it says additional information?

A. Yes. So it says that additional information is available upon request to the trust fund and that investors can request that information from whoever their sales agent might be.

So in this particular case, we know that up to three million dollars is going to be lent, but in the PPM, itself, there is really not any indication of what the rate of that loan is going to be between the Luxury Cruise Receivables company and TDM Cable Funding. So in my review of this, I looked for the operating agreement between those two companies, which we did find, and I can't remember where we got it.

Q. Just backing up two sentences. The additional information section, did you see this section in a majority, if not all, of the PPMs that you reviewed?

A. Every one I think.

Q. Okay, and so if an investor sees this, what is it telling the investor?

A. If you have more questions and you want answers, you can -- you are entitled to them.

Q. At this point, I would like to show you Defense Exhibit 232.

MS. OWENS: I believe the government did not have an objection to that.

THE COURT: 232 is received.

(Exhibit No. 232, received.)

MS. OWENS: It is going to be on the Elmo. And if you could zoom in a little bit. It is a little blurry.

BY MS. OWENS, CONTINUED:

Q. So is this the operating agreement between TDM Cable Funding and Luxury Cruise Receivable?

A. Yes.

MS. OWENS: And if you could just push the paper down so we can see the title.

BY MS. OWENS, CONTINUED:

Q. Okay. So this is the operating agreement. And do you recall back when you were working at McGinn, Smith a discussion of this particular agreement because it wasn't like we just saw, it wasn't in the PPM?

A. Right, but the terms of the assets were generally discussed on the sales calls, the conference calls that introduced each of these deals before the

offering was made. So the deal was generally presented by Mr. McGinn, and he would often disseminate that information, and the brokers would take notes and have it at their disposal if investors had questions.

Q. Okay, and what type of information would Mr. McGinn disseminate on these conference calls?

A. Oftentimes he would talk about the multiple of RMR that they purchased the contracts for, or the equivalent of that if it was a loan.

In the case of Luxury Cruise, he talked about the actual loan that TDM Cable Funding was making to Luxury Cruise Receivables in terms of that loan. And those terms are spelled out in this document.

Q. Okay.

MS. OWENS: If we could go up to page seven of the agreement, please.

BY MS. OWENS, CONTINUED:

Q. And I believe it is Section 6.3, guaranteed payments?

A. Yes, this just shows that the interest on this line of credit or loan of up to three million dollars comes along with an annual interest rate of thirteen percent.

Q. Okay.

MS. OWENS: And if we could go to page eight, please.

BY MS. OWENS, CONTINUED:

Q. And then right there, Section C: The preferred interest holder shall be entitled to receive additional guaranteed payments, the kicker sufficient to increase its annual internal rate of return, which shall be calculated using the XIRR function within the Microsoft Excel.

What does this mean?

A. This is just a provision in the loan that increases the return to TDM Cable Funding, and it actually acts as sort of a sword hanging over Luxury Cruise Receivable's head enticing them or incentivise them to pay back their full loan sooner rather than later.

So as we go down to the small i, Roman Numeral II, III, and IV, the longer they take to repay the principal, the more money they actually owe. And so that's what the kicker describes.

Q. Okay. So in Subsection I, if the redemption occurs on or before the end of the three-year period beginning on the effective date, then the kicker shall be an amount necessary to increase the annual internal rate of return to twenty-one percent.

So is this I guess best case scenario for Luxury Cruise, worst case scenario for -- or the opposite?

A. No, that is right. That is the kicker amount that I used in creating my model, so to speak, because it

is the most conservative estimate.

Q. Okay, and then just very briefly the other two subsections, I see it goes down subsection two, if it occurs after the three-year period but before the five-year period, the kicker shall be an amount that increases the rate of return to twenty percent. Subsection three, essentially the same thing, eighteen percent.

So this is just saying the longer you wait to repay us, the more the interest rate is going to be?

A. Well, it is not actually the interest rate because you will notice that the longer they wait, the rate actually goes down, but because the time of the repayment is increased, they actually owe more real dollars. So it is detrimental to them.

Q. Okay. So based upon this operating agreement between TDM Cable Funding and Luxury Cruise Receivables, LLC and the PPM for TDM Luxury Cruise, did you create some sort of model demonstrating the expected rate of return based upon those two documents?

A. Yes.

Q. Okay.

MS. OWENS: At this time, defendants move the admission of Defense Exhibit 166B.

MS. COOMBE: Your Honor, I have an ongoing objection.

THE COURT: All right. So noted. Received.

(Exhibit No. 166B, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. So this is the document that we were just describing?

A. That's right.

Q. Okay, and it is similar to the one that we looked at for TDM Cable Trust; is that correct?

A. Somewhat, yes.

Q. Well, a similar concept?

A. Yes.

Q. Okay. If you just want to briefly -- we don't want to spend as much as time as we spent on the first one, but briefly just want to describe what this is showing?

A. So this first page shows the loan that we just discussed between TDM Cable Funding and Luxury Cruise Center. It shows that it pays thirteen percent interest. The beginning balance column actually starts at one million, two seventeen and increases up to the final amount that was lent to the cruise company.

And then the thirteen percent interest is calculated off of whatever the balance of that loan was at that particular month or point in time. And because this loan didn't have any amortization, you will notice that there is no principal payments, just the interest portion

of the loan makes up the total debt service.

And then if we can scroll down on that a little bit. As the agreement described using the XIRR function of Microsoft Excel, I calculated a kicker amount under that conservative scenario of twenty-one percent to be equal to eight hundred and fifty-two thousand dollars, $852,033. So that's an additional amount that will be tacked on to this final principal payment in the forty-eighth month of about 2.9 million dollars.

Q. Okay, and it shows forty-eight, it looks like on the left, forty-eight month term?

A. That's right.

Q. That is under the terms of the private placement memorandum for Luxury Cruise Trust 07?

A. Correct.

Q. Okay, and I have just a quick question on the kicker amount. Did you say that you calculated that based upon the thirteen percent conservative amount in the operating agreement?

A. The twenty-one percent.

Q. I am sorry. The twenty-one percent. So can you just explain how you got to that number again, just a little bit?

A. The operating agreement says to, in order to calculate that number, to use a function or a formula in

Microsoft Excel called XIRR, and that stands for internal rate of return. So I used an internal rate of return of twenty-one percent. And based on the terms of this loan, the function spits out this number, eight hundred and fifty-two thousand, thirty-three.

Q. Okay, and below the kicker amount you have a section called partner loan repayments?

A. Yes. Similar to what we looked at in TDM Cable Trust 06, in my review of the bank statements for TDM Cable Funding, there were loans to the three partners that seem to relate to -- around the time period of this deal and come out of the spread that was created by this deal. So this shows that if those loans were repaid with three percent interest, it would equate to two hundred and ninety-seven thousand, one thirty-four.

Q. Okay, and did you prepare a summary of this model just kind of summarizing the total forty-eight month term and the kicker amount and the repayment?

A. Yes.

Q. Okay.

MS. OWENS: And at this time defendants move to admit Defense Exhibit 166C, like Charlie?

MS. COOMBE: Same objection.

THE COURT: So noted. Received.

(Exhibit No. 166C, received.)

BY MS. OWENS, CONTINUED:

Q. So this is the summary that we just talked about based upon the model?

A. That's right.

Q. Do you just want to very briefly go through that little summary box on the top?

A. So the two million, eight ninety-seven, eighty-eight is the total amount of money that was advanced from TDM Cable Funding to Luxury Cruise Receivables, so that is the amount of the loan. And four million, two sixty-three, seven hundred and one is the sum of the thirteen percent interest payments for four years plus the repayment of that principal amount of two million, eight ninety-seven.

And then the eight fifty-two, thirty-three is the kicker provision that we just discussed. And finally, the two ninety-seven, one thirty-four is the repayment of the partner loans associated with this trust. So that -- when you total all of those sources of cash, the total cash inflow is five million, five forty-three, five ninety-five.

Q. Okay, and that's between Luxury Cruise Receivables and TDM Cable Funding; is that correct?

A. Yes, it looks like there is a typo here and it says MS Funding in that little summary box. But the operating company is TDM Cable Funding.

Q. Okay, and you had a section towards the bottom saying total cash flow necessary to retire debt with interest. Is this related to the operating company debt to the trust?

A. That's right, yes.

Q. Okay. So we have five million, and a little bit less than the expected cash flows. So you have a resulting equity of three hundred and sixty-nine thousand dollars?

A. Right. So this says again, that at the inception of the deal, it was expected that by the time the debt was retired with interest, there would be a profit to TDM Cable Funding of three hundred and sixty-nine thousand, two eighty-five.

Q. Okay, and then just on the summary box, you mentioned partner loan repayment at three percent, approximately two hundred and ninety-seven thousand dollars?

A. Yes, again, that number is less than the expected equity.

Q. Okay. Thank you. And similarly like you reviewed for TDM Cable Trust 06, did you review the numerous bank statements and internal accounting records for TDM Luxury Cruise Trust?

A. I did.

MS. OWENS: At this time defendants move for

the admission of Defendants' Exhibit 166.

MS. COOMBE: Same objection.

THE COURT: So noted. Received.

(Exhibit No. 166, received.)

BY MS. OWENS, CONTINUED:

Q. We won't go through this chart in the same amount of detail as we did with TDM Trust 06, but this follows the same general format; is that correct?

A. Yes.

Q. Okay. So it is TDM Luxury Cruise. You have both the escrow and operating account activity referenced here in the M&T account section?

A. Right. And the blue section, again, shows the investor deposits. The maximum raise was three million, six thirty. And the trust only raised three million six, twenty-five. So that's reflected there.

Q. Okay, and just going back quickly on the escrow and operating account, the operating account, that doesn't mean operating company?

A. Correct. It is the operating or it is the account owned by the trust that is used to take in payments and pay to investors.

Q. Okay, and does it serve as a checking account basically?

A. Yes.

Q. Okay.

MS. OWENS: If we could just scroll down a little bit on this first page.

BY MS. OWENS, CONTINUED:

Q. The September 27, 2007, entry, the last entry on the first page, it says, McGinn, Smith & Company, one hundred ninety-one thousand, nine hundred dollars. There is a comment here, thirteen thousand, five hundred should be underwriting fees.

A. Yes.

Q. Could you explain what you mean by that?

A. Sure. So, again, the money in the green is the spread money and that's the leftover between what was raised and what was used to make the loan to Luxury Cruise Receivables. And that money can be used by TDM Cable Funding for a number of different things, bank fees, and etcetera.

And as we discussed before, that spread is also used to pay the underwriting fees, which are listed on the cover of all the private placement memorandums. This transaction of 9/27 also included another fee to McGinn, Smith that was over and above the underwriting fee on the cover. So this is a case where one lump sum was transferred, but of that one ninety-one, nine hundred, only thirteen thousand, five hundred can be attributable to the

underwriting fee as dictated on the cover.

Q. Okay, and then I also see you said should be advisory. Why should it be an advisory fee?

A. It is just a fee that McGinn, Smith received for providing the personnel to structure the deal and manage this deal as it goes on, etcetera.

Q. Are you familiar with the Four Funds?

A. Yes.

Q. Now, are you familiar with an entity called McGinn, Smith Advisors?

A. Yes.

Q. Were you aware that Funds had an advisory fee that was written in the PPM?

A. Yes. Sort of different than what I have labeled here. That was a management fee that was earned every year. This structure of the Funds are different than the trusts in the sense that it is like a blind investment pool. So there isn't any like -- when the money is raised in the Funds, there isn't an advisory fee in the same sense of advising the people involved in this transaction on how to structure it.

Q. Okay. So here when you say should be advisory fee, what do you really mean by that because it is confusing, the two differences?

A. It is. What I mean by that is that McGinn,

Smith & Company provided the personnel or the human capital, so to speak, to put this deal together. They had personnel that managed the income of or the receipt of payments, of payments to investors. And essentially this is a four-year deal, and the salaries of those people need to be paid for the life of this deal, about four years.

Q. Okay.

A. So that's what I take it to mean.

Q. All right.

MS. OWENS: If we could just scroll over a little bit to the right a little bit.

BY MS. OWENS, CONTINUED:

Q. Okay. So there it just says underwriting. This is in column where what the McGinn, Smith internal accounting staff notated --

A. Yes. They notated the entire amount that's underwriting, which wouldn't be allowed under the language on the PPM because it is specifically states the amount that would be paid as underwriting to brokers.

Q. Okay.

MS. OWENS: And then if we could just scroll down a little bit on the chart.

BY MS. OWENS, CONTINUED:

Q. Again, we are not going to go through every single item. I see a couple of things here. I am sorry.

Right in the purple, it says, should have gone to TDM Cable Funding. Now, what does -- this purple section, what is this supposed to represent again?

A. Again, this is the income generated by the loan from TDM Cable Funding to Luxury Cruise Receivables. And I think if we go to the left a little bit, you can see where these amounts came into the trust from. And in a lot of cases, they came from directly from Luxury Cruise Receivables.

So, again, this is money that sort of skipped over or jumped over the operating company and flowed directly into the trust. And as we discussed on the last one, that would create an excess of funds that are sitting in the operating account.

Q. Okay.

MS. OWENS: And then just continue to scroll down some.

BY MS. OWENS, CONTINUED:

Q. There is a total nine hundred forty thousand dollars.

A. That's right.

Q. And then again, like we discussed in TDM Cable, this represents the interest expensed to investors under the terms that is between TDM Luxury Cruise and TDM Cable Funding; is that correct?

A. That's right.

MS. OWENS: Just continue to scroll down. So here up until -- I am sorry, Leslie.

BY MS. OWENS, CONTINUED:

Q. Up until September 3, 2009, we have a total paid to investors seven hundred and twelve thousand dollars?

A. Right, and, again, I have just pulled out what that excess is. It is two hundred and twenty-eight thousand, four seventeen.

Q. All right.

MS. OWENS: Continue to scroll down some.

BY MS. OWENS, CONTINUED:

Q. So the green section, these are -- what are those again?

A. The orange and the green are, again, just agency transactions that should have been recorded at the operating company, but the physical money actually flowed through the Luxury Cruise Trust account.

So again, this is money that because of the terms of the trust loaning its funds to the operating company, this is money that really belongs to the operating company and is used in a number of different ways that are spelled out in both the orange and the green section.

Q. Okay. So we see in between the orange and green section, there is a reference here, operating account due

to TDM Cable Funding and MS Funding, five hundred and twenty-two thousand dollars?

A. Yes. So this is a surplus that is really owed to TDM Cable Funding. I have indicated that MS Funding was involved there because there is actually, through some of these transfers, there becomes, through the agency relationship, a loan between the two operating companies, TDM Cable Funding and MS Funding. But the five twenty-two is really money that belongs to TDM Cable Funding.

Q. Okay. So any agreement, any obligations between MS Funding and TDM Cable Funding, it is not an obligation to the trust investors. It is just an agreement between the two of them?

A. That's right.

Q. Okay, and if we can just finish this chart up?

A. That's fine.

Q. All right. So right here we have an operating account. Due to TDM Cable Funding four hundred dollars, fifty-three cents, and you get that after deducting all the various expenses in the yellow?

A. Right. So that's the balance that's created from this table, and we will see that that is the same balance on the final bank statement for TDM Cable -- or sorry, TDM Luxury Cruise Trust.

Q. Okay. So four hundred dollars and fifty-three

cents. I would like to show you Exhibit 166D.

MS. OWENS: I believe it is stipulated.

MS. COOMBE: Yes.

THE COURT: Received, 166D.

(Exhibit No. 166D, received.)

BY MS. OWENS, CONTINUED:

Q. Was this one of the bank statements that you reviewed in your analysis?

A. Yes.

Q. And this is, it looks like, in April of 2010 M&T Bank statement?

A. Yes.

Q. For the same TDM Luxury Cruise Trust 07?

A. Yes.

Q. And has the same ending balance of four hundred dollars and fifty-three cents?

A. Correct.

Q. All right, and then that spreadsheet that we just reviewed, did you also make another summary of that spreadsheet?

A. I did.

Q. Okay.

MS. OWENS: At this time the defendants would like to move the admission of Defense Exhibit 166A.

MS. COOMBE: Same objection.

THE COURT: So noted. Received.

(Exhibit No. 166A, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and this is just the same where you just take the totals from each of the colored sections from the spreadsheet that we looked at before. I just want to go through a couple of things on this. Investor deposits, what does that show again?

A. Again, that is the total amount raised by the trust.

Q. Okay, and then the peach color, the two million, nine hundred?

A. Again, that's approximately the amount of the loan proceeds that were used to eventually be loaned to Luxury Cruise Receivables. The actual number I believe was two million, eight ninety-seven, so this is an approximation again, and it is fairly close.

Q. Okay, and I would like to just pull up again Defense Exhibit 158 that we looked at before. So this is this balance sheet that you prepared based upon your review of the bank statements and the private placement memorandum?

A. Right. And again, under accounts receivable for TDM Luxury Cruise Trust 07, you see the ending bank balance for the trust account, which is four hundred dollars and

fifty-three cents.

Q. Okay, and under the other asset section right in the middle of the page, is there an asset from Luxury Cruise here?

A. Yes, that shows the loan from TDM Cable Funding to Luxury Cruise Center Receivables for a total of two million, eight ninety-seven, eighty-eight.

Q. Okay, and I think on page two, there is a liability section that we looked at for the TDM Cable Trust. Is there a section here to locate this as well?

A. There is, and it shows the appropriate amount three million, six, twenty-five.

Q. That's for investor deposits?

A. That's for liability that the operating company owes back to the trust.

Q. Okay. Thank you, Mr. Smith. I would like to show you Government's Exhibit GA4.

THE COURT: We will break for lunch now, members of the jury. Be back at two o'clock. Don't discuss the case among yourselves or anyone else. We will see you back here at two o'clock.

Mr. Minor.

COURT CLERK: Court stands in recess until two o'clock.

(Whereupon, the luncheon recess was taken.)

(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Ms. Owens, you may continue with your direct examination of Mr. Smith.

MS. OWENS: Thank you, Your Honor.

BY MS. OWENS, CONTINUED:

Q. Good afternoon, Mr. Smith.

A. Good afternoon.

Q. I would like to show you previously admitted Exhibit GA4. Are you familiar with this PPM?

A. Yes.

Q. It is for TDM Verifier Trust 07?

A. That's right.

Q. Can you just describe to us generally what this offering is about?

A. It is an offering of three million, four hundred and seventy-five thousand dollars in a trust called TDM Verifier Trust 07. It had two maturities, a one-year and a two-year maturity at eight and a quarter percent interest and nine percent interest. And the proceeds were to be lent to TDM Cable Funding for the subsequent loan from TDM Cable Funding to a company called Verifier Capital, LLC, which was secured by some number of guaranteed payment units, which were essentially commercial alarm contracts.

Q. Okay, and then on that same page we see -- do

you see an underwriting discount of 9.5 percent. Could you just remind us what an underwriting discount is?

A. It is a commission that is paid to the sales representatives that placed this deal with their clients.

Q. Thank you.

MS. OWENS: And if we could go to page four of the PPM, and then highlight that section under trust fund under summary of the offering.

BY MS. OWENS, CONTINUED:

Q. Okay.

A. Okay. So there is some important information here. It says the trust fund will advance funds to TDM Cable Funding, LLC. TDM has in turn purchased two and a half million dollars of face value guaranteed payment units from Verifier Capital, LLC.

And above that, it says that the two and a half million dollar assignment of guaranteed payment units by Verifier Capital when discounted to a present value at the blended interest rates contemplated by this offering will have a value of three million, four hundred and seventy-five thousand dollars. That is important to know basically to calculate the rate of the loan that TDM Cable Funding makes to Verifier. And when you do that calculation, it comes out to a loan of sixteen percent.

Q. Okay. So right here in the summary of the

offering it says the trust fund will advance funds to TDM Cable Funding, and then TDM Cable Funding in turn, again, it uses that word purchased, as in past tense 2.5 million of face value of guaranteed payment units from Verifier Capital. So similar to the other deals, do you understand that to mean that TDM Cable Funding has purchased the assets in advance or before this particular raise?

A. Yes, it is the conclusion of that.

Q. Okay, and can you just remind us what the maximum raise on this deal was?

A. Three million, four hundred and seventy-five thousand.

Q. Okay, and you said based upon that, this paragraph regarding the blended interest rate, you said that maximum raise is discounted at a blended rate to the present value of 2.65 million dollars, is that what you said?

A. The actual -- well, the PPM says that 2.5 million dollars will be purchased, and that indicates a spread of nine hundred and seventy-five thousand dollars. When I reviewed the bank statements, TDM Cable Funding actually purchased two million, six hundred and fifty thousand in GPUs. So that created a spread of eight hundred and twenty-five thousand dollars instead, and it provided a higher monthly cash flow to service the trust

debt.

Q. Okay. So there is a spread between the raise and the GPU purchase outlined in the summary of the offering of approximately eight hundred and twenty-five thousand dollars?

A. That's right.

Q. Okay.

MS. OWENS: And if we could go to page five, please.

BY MS. OWENS, CONTINUED:

Q. And in the risk factors section towards the bottom. I am sorry. Is there any significance there would be no monthly amortization schedule?

A. Yes, that just indicates that TDM Cable Funding will pay interest only on its debt service to the trust until the trust debt matures. So that is important in creating the model because I know that I will only be calculating the monthly interest rate.

Q. Okay. So based on this information, you created a model outlining the loan to Verifier Capital from TDM Cable Funding?

A. That's right.

MS. OWENS: At this time the defendants moves to admit Exhibit No. 164.

MS. COOMBE: Same objection.

THE COURT: So noted. Received.

(Exhibit No. 164, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Is this the model that you prepared based upon the terms outlined in the private placement memorandum?

A. Yes.

Q. Can you just briefly describe -- this one is different from the other two that we looked at. It has a twelve percent annual and accrued income of four percent annual. Why is that?

A. The sixteen percent loan from TDM Cable Funding to Verifier was actually broken down in two different rates. It paid a twelve percent current income, which was cash payments. And then it accrued the interest on that principal balance at a rate of four percent.

So essentially what that means is that the accrued income portion will actually be added to the principal payment, and that's the amount that Verifier will eventually have to pay back to the operating company.

So if you look at month one, that shows the purchase of the two million, six hundred and fifty thousand GPUs. The four percent annual accrual number of eight thousand, eight thirty-three then gets added to that two million six fifty. So as you move down through the term of

the loan, the amount of principal that Verifier has to pay back to the operating company increases by that four percent amount.

The twelve percent portion is the actual monthly cash payment that they make. And that is important to note that twelve percent cash on the principal balance is in every single month sufficient to cover the monthly payment that's due in interest to the trust investors.

Q. Okay, and if we could just go back to the top briefly. So because the PPM said there is no amortization, there is nothing in the principal payment section or that column and that at least initially the twelve percent annual income matches the total debt service to TDM Cable Funding?

A. That's right.

Q. And then I see somewhere around one thirteen on the surplus column, I am seeing a surplus of about a thousand dollars?

A. Yes, that's generated on the -- you are actually looking at the second page of this. This shows the loan from the trust to the operating company of three million, four and seventy-five and the blended interest rate between the two maturities was 8.68 percent. So on a monthly basis they required cash of twenty-five thousand, one twenty-nine. So the payment made by Verifier each month is

sufficient to cover that.

Q. Okay. So this page two is the, I guess, debt service from TDM Cable Funding to investors. Page one is the debt service from Verifier Capital to TDM Cable Funding?

A. That's right.

Q. And then back on page one the surplus is the surplus from the -- I am sorry. Can you just explain that again?

A. Yes.

Q. On the right-hand side of the screen?

A. We have to move over a little bit. After the first year, it just shows that surplus is generated because the cash flow is increased over and above the required debt service to the investors.

Q. Okay, and did you prepare a summary of this model?

A. I did.

MS. OWENS: Okay. At this time the defendants move to admit Defendants Exhibit 164C.

MS. COOMBE: Same objection, Your Honor.

THE COURT: Same ruling. Received. 164C?

MS. OWENS: Yes, Your Honor. I am sorry, Leslie. My apologies. I think it is 164A.

THE COURT: 164A received.

(Exhibit No. 164A, received.)

BY MS. OWENS, CONTINUED:

Q. Is this the model summary that you prepared, Mr. Smith?

A. I think so, yes.

Q. And if you could just briefly describe this model summary?

A. Sure. It is -- in the box at the top, the number two million, one thirteen, one hundred and one is just the sum of those cash, monthly cash payments that are generated by the twelve percent current interest.

The seven hundred and six thousand, two seventy-eight is the amount of accrued interest from the four percent portion of the loan. And that gets added to the principal amount of the initial loan of two million, six hundred and fifty thousand.

So that generates a total cash flow available to service the debt to the trust of five million, four thirty-seven, twenty-three. The boxes just sort of show the flow of funds into TDM Cable Funding.

And at the bottom, the second line down shows the total cash necessary to service the TDM Verifier Trust 07 debt with interest. And that number is the sum of the monthly payments at the blended interest rate over the period of the loan, plus the principal repayment. That's

five million, two eighty-four, three thirty-seven. And again, we are left with about one hundred and fifty thousand dollars in expected profit at the operating company after the debt has been retired.

Q. Okay. But there is no -- on this one, there is no partner loans taken out of the operating company for TDM Cable Funding, is that accurate?

A. It is. The loans all were transferred out of the operating company. So to be able to specifically trace it to any one deal is difficult. This deal was offered sort of around the same time as the Luxury Cruise deal. There were loans taken out around the time of both of these offerings. And in my analysis, there really was no use for the repayment of loans to service the debt. So it is not on here.

Q. Okay, and did you undertake a similar review of the bank statements related to Verifier Trust 07?

A. I did.

Q. And did you enter them into some sort of spreadsheets to TDM Cable Funding -- I am sorry, TDM Cable Trust and Luxury Cruise?

A. Yes.

Q. Okay.

MS. OWENS: And at this time the defendants move to admit Defendant's 165.

MS. COOMBE: Same objection.

THE COURT: Received.

(Exhibit No. 165, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and is this transaction spreadsheet detailing the transactions from the bank statements for TDM Verifier Trust 07, is formatted in a similar matter as TDM Cable Trust and Luxury Cruise Trust?

A. Yes.

Q. Okay. So we won't go through everything in detail, but it looks like the investor rate is in blue.

MS. OWENS: Scroll down. Keep scrolling down.

BY MS. OWENS, CONTINUED:

Q. It outline the funds to be loaned to Verifier Capital, LLC, the spread, so on and so forth that we reviewed in the other two examples?

A. That's correct.

Q. All right.

MS. OWENS: If we could just go all the way down to the last page. And then all the way to the bottom, please.

BY MS. OWENS, CONTINUED:

Q. Okay. So you show an ending operating account balance of seven thousand, six hundred and seventy-five

dollars and sixty-one cents?

A. Yes, again that belongs to operating company. It is the excess that's left over.

Q. Due to that surplus?

A. That's right.

Q. Okay. At this time I would like to show you Defense Exhibit 165B, and I believe this has been stipulated to. It is a bank statement?

MS. COOMBE: That's correct, Your Honor, assuming it is a bank statement.

THE COURT: Received.

(Exhibit No. 165B, received.)

MS. OWENS: We are just going to throw it on the Elmo.

BY MS. OWENS, CONTINUED:

Q. Is this one of the banks statements that you reviewed for Verifier Trust 07?

A. Yes.

Q. It is a little blurry, but does it look like it is April 2010?

A. April 2010.

Q. Okay, and do you find the ending bank balance on here?

A. Yes, seven thousand, six seventy-five, and I think sixty-one cents.

Q. Okay, and that matched that same seven thousand, six hundred and seventy-five dollars and sixty-one cents that we saw on that transaction spreadsheet; is that correct?

A. Yes.

MS. OWENS: At this time the defendants moves the admission of Exhibit 165A.

MS. COOMBE: Continue to object. Lack of qualification, etcetera.

THE COURT: 165A received.

(Exhibit No. 165A, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Mr. Smith, this is that summary that we talked about. And it just has the totals from each of the sections from the larger spreadsheet; is that correct?

A. Yes.

Q. Okay. So we have the investor deposits and that three million, four hundred and seventy-five thousand. What does that reflect again?

A. That's the amount of the money raised in the trust.

Q. Okay.

MS. OWENS: If we could just go down a little bit.

BY MS. OWENS, CONTINUED:

Q. That peach color, can you just remind the ladies and gentlemen of the jury what that reflects?

A. Yes, again, that's the approximation out of the funds that are loaned to the operating company for the purchase of the asset, which in this case was a purchase of GPUs for Verifier Capital of two million, six fifty. So that's just the closest approximation from those actual transfers.

Q. Okay.

MS. OWENS: Scroll down a little bit more.

BY MS. OWENS, CONTINUED:

Q. It looks like there is a section for new investor deposits and rollovers for TDM Verifier Trust 07, and it is similar to what we saw in the TDM Cable Trust deal?

A. Yes, this is actually TDM Verifier Trust 07 R.

Q. Okay.

A. And this is a rollover of, I believe, the one-year maturity on this deal.

Q. Okay, and were there some redemptions paid out to investors for this trust?

A. I believe so.

MS. OWENS: Scroll down.

A. Yes. So the redemptions are a million five fifty-eight, which is a couple hundred thousand dollars

more than the amount of money that came into the rollover deal. So this indicates that TDM Cable Funding actually paid back some portion of principal on the original loan.

BY MS. OWENS, CONTINUED:

Q. Okay, and I am going to show you Defense Exhibit 158 again. This is the same balance sheet that we were looking at before we took our break?

A. Yes.

Q. For Verifier Trust 07 under current assets we see that seven thousand, six hundred and seventy-five dollars and sixty-one cents number?

A. Yes, that matches the balance in the trust account.

Q. Okay, and under assets, the asset section, it looks like there is a due from Verifier Capital, LLC for 2.65 million dollars?

A. Two million, six hundred and fifty thousand, yes.

Q. Okay, and does that reflect anything that we were just looking at in the prior chart?

A. Yes. That reflects the approximation of the loan proceeds that were used to purchase the asset. It is also the amount of GPUs purchased from Verifier Capital by the operating company.

Q. Okay.

MS. OWENS: And if we could go to page two.

BY MS. OWENS, CONTINUED:

Q. And under trust liability for TDM Cable Funding, and the due to TDM Verifier Trust 07, is that three million two hundred eighty thousand, five hundred number the amount of the raise?

A. It is the amount of the raise less the amount of redemptions in the Verifier Trust 07 R that was paid back.

Q. Thank you, Mr. Smith. I would like to show you Government's Exhibit GA16. And was this one of the PPMs that you reviewed?

A. Yes.

Q. Okay, and this is TDMM Cable Junior Trust 09?

A. Correct.

Q. It is not TDM Cable, right?

A. Right.

Q. Just a similar name?

A. Yes.

Q. Okay, and can you please give some brief background on this deal?

A. This was a trust raise that was going lend money to TDM Cable Funding, one M, and the operating company was going to use those proceeds to purchase triple play assets from two companies. One was called Broadband. I can't remember the full name. I think it is in here somewhere.

And the other company was a company called HipNET.

And this is just a junior portion of this trust that are actually -- rather than just two maturities and two different interest rates, this offering actually had also two levels of seniority. So the senior trust was actually -- had a preferred capital position to the junior trust, basically meaning that if anything should go wrong, the senior trust would get all of their money back before the junior trust. This indicates that it is an eleven percent debt instrument, and it expires in August of 2014.

Q. Okay, and there is a maximum offering, a minimum offering. It looks like the minimum offering is two hundred and fifty thousand dollars?

A. Right.

Q. Okay.

MS. OWENS: If we could go to page four, please. Or page five. Okay. Under summary of the offering, can we make that a little bit larger, please?

BY MS. OWENS, CONTINUED:

Q. Okay. Was this section something that you reviewed?

A. Yes. Again, this says that the trust will make a loan to TDM, which is defined above this as TDM Cable Funding, the operating company. And TDM will purchase the operating assets of Broadband Solutions, and I believe also

this company called HipNET, which a couple of paragraphs down it says additionally TDM will acquire the operating assets and customer contracts of HipNET, LLC.

Q. Okay, and then there is that other paragraph underneath the highlighted paragraph. Was that what you were talking about before, the trust loan to TDM will be subordinate?

A. Yes, and this language is specific to the junior offering and just says that the junior debt position will be subordinate to the senior.

Q. Okay.

MS. OWENS: And if we could go like to the next page, please. If we could just -- there is a -- a couple paragraphs in, the paragraph. It says TDM will enter into an agreement.

BY MS. OWENS, CONTINUED:

Q. Okay, and what is your understanding of this section of the PPM?

A. This is really describing where the cable contracts were coming from geographically. In fact, if we just scroll up a little bit and look at the table, it gives an idea of the total amount of contracts that are being purchased. Fifty-four hundred from Broadband and another two hundred from HipNET. So that information is somewhat useful in estimating the cash flow streams that were

purchased.

Q. Okay.

MS. OWENS: And if we could go to page, I believe it is forty-one. Or forty-two.

BY MS. OWENS, CONTINUED:

Q. Okay, and what --

MS. OWENS: If we could just make that a little bit larger, please.

BY MS. OWENS, CONTINUED:

Q. Was this something else that you reviewed in the PPM?

A. Yes. This is the amortization schedule for the junior portion of the trust debt, and this was used in creating the payment schedules that I created.

Q. Okay. So somewhat similar to what we have looked at before in the other PPMs?

A. Yes.

Q. As far as the format?

A. Yes.

Q. Did you prepare a model based upon the information that we just looked at in this private placement memorandum?

A. Yes.

Q. Okay, and did you also prepare a summary of the model?

A. I did.

Q. Okay.

MS. OWENS: At this time the defendants move to admit Exhibits 167 and 168B.

MS. COOMBE: Your Honor, the government has the same objections.

THE COURT: Same ruling, received.

(Exhibit No. 167, 168B, received.)

MS. OWENS: And if we could just go to the summary to try and keep things moving here. It is Exhibit 168B.

BY MS. OWENS, CONTINUED:

Q. Okay. Does this describe the information from the PPM, and I guess in an easier format to view?

A. Yes, it also describes the top line here on the flow chart, the one million, three fifty-six, six forty is actually a number that's described in the bank statements from review of the bank statements of TDM Cable Funding. It is money that was transferred to either HipNET or Broadband Solutions.

And the total expected cash flow from those assets was three million, nine hundred and sixty thousand dollars over the term of the loan. That was over sixty-six months. So the total cash flow necessary to retire the debt with interest is three million, eight hundred eight,

seven thirty-five. And again, there is a resultant equity after the investment is paid off with interest of one hundred and fifty-one thousand, two sixty-five for TDM Cable Funding.

Q. Okay, and just to clarify, you mentioned that for this particular deal there was a junior and a senior. We were looking at the junior PPM. Does this model also incorporate the senior?

A. Yes. The cash flow necessary to retire the debt is both the junior and the senior combined at a blended interest rate.

Q. Okay, and the senior PPM was substantially similar to the junior trust PPM?

A. With the exception of the language about subordination.

Q. Okay.

MS. OWENS: The defendants move to admit Exhibit 168.

MS. COOMBE: Same objection.

THE COURT: Same ruling. Received.

(Exhibit No. 168, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. This is another one of the junior spreadsheets that you created?

A. Yes.

Q. From the bank statements?
A. Yes.
Q. Okay, and again, this is for both the junior and senior trusts; is that correct?
A. That's right.
Q. Do you recall what the minimum was for the junior trust?
A. You know, I just looked at it, and I don't, but I think that -- well, we better look at it again.
Q. Okay. I believe it is GA16 or it is Government's Exhibit 16. I am sorry. This is the junior trust. What is the minimum offering?
A. The minimum was two hundred and fifty thousand dollars.
Q. Okay.
MS. OWENS: If we could just bounce back to Defense Exhibit 168.
BY MS. OWENS, CONTINUED:
Q. Okay. So in the blue section that we talked about before, these are investor deposits to the escrow account for the trust; is that correct?
A. Yes.
Q. And when was the minimum met?
MS. OWENS: If we can scroll over to the right a little bit.

BY MS. OWENS, CONTINUED:

Q. I think it breaks it down between junior and senior?

A. The junior is actually just the second blue section, so if we could just go down just a touch.

Q. So the second blue section --

MS. OWENS: Just scroll back over.

BY MS. OWENS, CONTINUED:

Q. So the minimum was two hundred and fifty thousand dollars.

MS. OWENS: Keep scrolling over.

A. Yes. Two hundred and fifty is raised by --

MS. OWENS: A little bit more just looking for the date.

A. By March 31, 2009, two hundred and sixty-five thousand has been raised in the junior. So escrow is broken at that point.

BY MS. OWENS, CONTINUED:

Q. March 31st, 2009?

A. Correct.

Q. Okay, and so -- and we are not going to spend a ton of time on this transaction spreadsheet.

MS. OWENS: But if we can scroll down here.

BY MS. OWENS, CONTINUED:

Q. Was there some partner loans associated with the

operating company or, I am sorry, with this particular trust?

A. There were. And the loans were -- again, once the escrow is broken, these funds have effectively been loaned to the operating company. And so in the green section, which indicates the spread after the purchase of the assets and the underwriting fees, there is one particular transaction, which is a loan to Timothy McGinn of thirty thousand dollars on April 30, 2009.

Q. Okay.

A. And so this just shows that that transfer is made after the escrow condition has been met.

Q. And because the escrow condition is met on March 31st and the loan to Timothy McGinn is on April 30, 2009?

A. Correct.

Q. Okay.

MS. OWENS: And if we could just go to the last page, please. And then scroll all the way down.

BY MS. OWENS, CONTINUED:

Q. Okay. So it says TDMM Cable trust account balance twelve dollars and seventy-one cents. Is this the same situation as in the other instances that we looked at, there a surplus at the trust level?

A. That's right.

Q. Okay, and it is really operating company money?
A. Correct.
Q. Okay.
MS. OWENS: And if we could just pull up Defense Exhibit 168C, like Charlie. I move to admit Defense Exhibit 168C, like Charlie?
THE COURT: Received over objection.
(Exhibit No. 168C, received.)
BY MS. OWENS, CONTINUED:
Q. Okay. Is this one of the bank statements that you reviewed, Mr. Smith?
A. Yes.
Q. Okay, and it looks like it is April 2010. This looks like it is a zero balance, but if you go to the next page, there is an ending balance of twelve dollars and seventy-one cents?
A. Yes. So the first page was the bank account for the junior trust. It had a balance of zero. And the second page is the balance in April of 2010 of the senior trust and has a balance of twelve dollars and seventy-one cents.
Q. And is that because on that transaction spreadsheet you included both trusts in the same spreadsheet?
A. Correct.

Q. Okay. And then --

MS. OWENS: Defendants move to admit Defendant's Exhibit 168A. I believe it is just a summary of that same transaction spreadsheet that we were looking at.

MS. COOMBE: Same objection.

THE COURT: Received.

(Exhibit No. 168A, received.)

MS. COOMBE: What is the number?

MS. OWENS: Oh, I am sorry 168A.

BY MS. OWENS, CONTINUED:

Q. Okay. So this just has the totals in each of the sections?

A. Yes.

Q. Okay, and we see the investor deposits, loaned to operating company for the purchase of assets. And then you go all the way to the end, it has that same ending bank balance of twelve dollars and seventy-one cents?

A. Correct.

Q. Okay, and I am just going to show you Defense Exhibit 158 again. And under assets we see accounts receivable from TDMM Cable Trust?

A. Twelve dollars and seventy-one cents.

Q. Okay, and what about in the asset section, you said that this TDMM Cable deal involved purchases from

HipNET and Broadband cash flows?

A. Yes. The purchase of the assets are actually combined on this sheet. It says HipNET and Broadband cash flows. It shows a value of one million, three hundred and fifty-six thousand, six forty.

Q. Okay.

MS. OWENS: And if we could go to second page, please.

BY MS. OWENS, CONTINUED:

Q. And then at the trust liability section we had a due to TDMM Cable Trust 09?

A. Yes. That reads two million, five ninety-four, five eighty. And if we go back to the summary we can show how that number is calculated.

Q. Sure.

MS. OWENS: Leslie, it is Exhibit 168A.

A. So we will start with the investor deposits of two million, eight fifty, and then there is some portion of principal repaid to the senior trust. If we scroll down just a little bit, we will see that. So two hundred and fifty-six thousand, nine nineteen was repaid in principal to the senior trust investors. So that gets into that liability number on the balance sheet.

BY MS. OWENS, CONTINUED:

Q. Okay.

MS. OWENS: And if we could just go back to Defense Exhibit 158. And if we could just go to the first page.

BY MS. OWENS, CONTINUED:

Q. And underneath checking, the top section assets, checking, there is seven thousand, two hundred and seventy-six dollars and thirty-three cents. And what was that calculation from, Mr. Smith?

A. So when I prepared these statements I also had to look at the checking accounts and I looked at the statements from the actual operating company. Obviously the operating company was conducting cash transactions as well. So we just wanted to check that this number is -- matches the ending back balance for TDM Cable Funding, LLC.

Q. Okay. If we could -- I am going show you --

MS. OWENS: I move to admit Defense Exhibit 158C, the bank statement?

MS. COOMBE: Your Honor, I am not going object. There is a stipulation for those. No objection.

THE COURT: Received.

(Exhibit No. 158C, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. It says Mercantile Bank, that is the bank account for TDM Cable Funding?

A. That's right.

Q. Okay, and this has an ending balance of -- is that same amount?

A. Seven thousand, two seventy-six, thirty-three, I believe.

Q. Okay. Does that match the balance sheet that we were just looking at?

A. It does.

Q. Okay.

MS. OWENS: If we could just go back to that balance sheet. It is 158.

BY MS. OWENS, CONTINUED:

Q. Okay. So under current assets it has accounts receivable, and it is -- it has TDM Cable Trust 06, TDM Luxury Cruise Trust 07, TDM Verifier Trust 07, and TDMM Cable Trust, I believe it is 09. Were those the four associated trusts to this operating company?

A. Yes.

Q. Were there any others?

A. No.

Q. Okay. So based upon the accounting review and review of each of the PPMs for the particular trusts, would you say that a review of the PPMs was necessary for you to apply the business model to the accounting records?

A. Yes, definitely.

Q. Okay. Do you have any personal knowledge of

whether any of the McGinn, Smith internal accounting staff reviewed the PPMs?

A. No, I don't.

Q. And did you -- in part of your review for this analysis, did you review any of the binders that the accounting staff maintained?

A. I did, yes.

Q. Were there any PPMs within those binders?

A. There were PPMs in the binders.

Q. Okay, and I am going to show you Defense Exhibit 224. I am just going to show you a hard copy of it. And do you recognize that document, Mr. Smith?

A. Yes.

Q. What do you recognize it to be?

A. This is the general ledger of TDM Cable Funding that was created internally by the McGinn, Smith accounting department.

Q. Is a general ledger something that is kept in the regular course of business?

A. Yes, essentially every transaction that has been recorded. It is kind of like a balance sheet and profit and loss statement combined into one file.

Q. Okay, and were the records contained in that document, are they usually made at or near the time of the event in the records?

A. Yes.
Q. And are those records made by a person of knowledge that usually keeps those records?
A. Generally, yes.
Q. Like someone in the accounting staff?
A. Well, yes.
Q. Okay, and are you in possession of any of those records?
A. Yes, I am.
Q. And how did you obtain them?
A. In May of 2010 after the SEC filed their civil complaint, I requested from Brian Shea the QuickBooks files for all the McGinn, Smith entities. And he requested permission from Mr. Brown whether or not he could release those to me, and he was given permission, and then he delivered them to me on like a thumb drive.
Q. Did you have an opportunity to offer those files to the government?
A. I did.
Q. Did they accept your offer of the files?
A. No. They said they already had them.

MS. OWENS: At this time defense moves the admission of Defendant's Exhibit 224.

THE COURT: Any objection?

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 224, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. This is the same document that you have up front there?

A. Yes.

MS. OWENS: If we could go to page six, please. And scroll down a little bit.

A. No, I don't believe this is the right page.

MS. OWENS: Leslie, if you can go to page five. Scroll down a little bit. We are just looking for the liability section.

A. It is actually higher up. Yes. This is the right page.

MS. OWENS: Okay. So If we could just go over to the left a little bit, please. Okay. So it is unclear if this is the liability section or not.

BY MS. OWENS, CONTINUED:

Q. Can you tell from that?

A. You can't -- you would have to scroll up to know that this is the liability section. I am actually looking at this. It doesn't indicate that there is a liability section or an asset section.

Q. Okay. So we should just go back to page four?

A. Yes.

Q. So this is the general ledger for the operating company, TDM Cable Funding, LLC. And we see a section for TDM Cable Trust 06; is that correct?

A. Yes. That is the account that would indicate the liability that's due back to the trust.

Q. Okay.

MS. OWENS: And if we could scroll down a little bit more and then go back a little bit.

BY MS. OWENS, CONTINUED:

Q. So we have TDM Cable Trust 06, TDM Luxury Cruise Trust, TDM Verifier Trust 07, TDMM Cable Senior and Junior Trust 09. So those are the four deals that we just reviewed?

A. That is right.

Q. Okay, and this is on the internal accounting staff of McGinn, Smith.

MS. OWENS: If we could just scroll over to the right a little bit. That's good.

BY MS. OWENS, CONTINUED:

Q. Okay. So TDM Cable Trust 06, these books show a liability of eight hundred, six thousand dollars. Why is that, do you know why that is?

A. I do. Because we know that three million, five ninety-five was raised from the trust. And so that should be the liability that is reflected here, but whoever

created these books did not record any agency transactions or repayments of bridge loans as -- in the liability account for that trust. So according to these records, the operating company only owes eight hundred thousand dollars back to trust investors instead of three and a half million.

Q. Okay, and you know that from the PPM because there was the three and a half million dollar raise?

A. Correct, and all the proceeds would be going to the operating company.

Q. Okay, and let's look at the Luxury Cruise. It says liabilities of a million six. Do you recall what the total raise was for Luxury Cruise?

A. Yes, I believe it was three million. It was either three million six -- I think it was three million, six twenty five.

Q. But these internal books are only showing a liability of a million six?

A. Correct.

Q. It appears to be for the same reason for the TDM Cable Trust?

A. Yes. The only transactions recorded here are the actual cash transactions from the trust to the operating company. It doesn't take any of the other agency transactions into account.

Q. Okay, and that's the same thing for Verifier Trust 07?

A. Yes.

Q. And TDMM Cable Senior Trust. I think it is junior and senior trust?

A. That is right.

Q. So these liabilities from the operating company to each one of these trusts is showing a number that is significantly less than what the operating company actually owes investors?

A. Correct.

Q. And that's based upon reading of the private placement memorandums for each of these trusts?

A. Yes.

MS. OWENS: I am sorry. Is Defense Exhibit 210 -- I think it is already in evidence. If not, I will move it. I think it got introduced when Mr. Cooper testified.

THE COURT: Are you offering 210? Any objection?

MS. COOMBE: No, Your Honor.

THE COURT: Received.

(Exhibit No. 210, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and, Mr. Smith, do you recognize this?

A. Yes.
Q. And what is it?
A. This is the general ledger that was prepared for TDM Cable Trust 06 by the McGinn, Smith accounting staff.
Q. Okay.
MS. OWENS: And we can temporarily minimize this a little bit.
BY MS. OWENS, CONTINUED:
Q. So this is for the trust. We just looked at the operating company. Those names are similar?
A. Yes.
MS. OWENS: So if we can scroll down. Can you go to the left a little bit, Leslie? Okay, and then scroll down.
BY MS. OWENS, CONTINUED:
Q. And you reviewed this ledger, did you find anything out of the ordinary or unusual?
A. Yes.
Q. Okay, and what was that?
A. Well, I think it is a few pages down. Bring this down a little bit. Down a little further. You can stop there. So this is the general ledger for the TDM Cable Trust 06 account. But under the assets section, starting in January of 2008, cash transactions that took place at the operating company, which is the Mercantile

Bank account ending in 9507, started being posted into the trust books and records.

And so essentially the cash transactions of the operating company are being posted on two sets of books because -- well, it seems as though there is no distinction between the two separate entities here.

MS. OWENS: And, Leslie, can you just enlarge that, please?

BY MS. OWENS, CONTINUED:

Q. Okay. So it says Mercantile, TDM Funding, LLC, and then within the books for the trusts, it lists a number entries beginning from January 10, 2008.

MS. OWENS: And if you would scroll down.

BY MS. OWENS, CONTINUED:

Q. Okay. So until February 1st of 2010, records for the operating company are being recorded in the trust books?

A. Right.

Q. And this just appears to be a mistake?

A. Yes, and the effect that this would have is to basically render the books and records of the trust account completely useless because the associated income, expenses, assets and liabilities for each of these cash transfers is now being recorded at the trust entity rather than the operating company.

Q. Okay, and that would -- at least on the books, it would appear to have an effect on investors?

A. Hard to say. It is hard to say because I don't think that the books of the trust, itself, are useful in any way to the investors. They are getting their payments based on a schedule, and I don't think that that schedule is affected by these entries. It is just wrong.

Q. Okay. Thank you, Mr. Smith. And if we could take a look at, it is Government's Exhibit GA10. And just to summarize, it states that there is no more trusts associated with TDM Cable Funding; is that correct?

A. Correct.

Q. Okay. So this one starts with the same name, TDM Verifier Trust 08. Can you give us some brief information on this offering?

MS. OWENS: And can you make it a little bit larger, please?

A. So this is at raise of -- a maximum raise of three million, eight fifty, a minimum raise of two hundred and fifty thousand dollars. Again, there is two maturities. There is an eighteen-month maturity at eight and a half percent and a three-year maturity at ten percent. And again, this was a trust that was going to lend its proceeds to an operating company to, again, make a loan to Verifier Capital, LLC.

BY MS. OWENS, CONTINUED:

Q. And that's an asset based company?

A. No. That's the commercial security alarm company that pledges guaranteed payment units in exchange for those loans.

Q. Okay.

MS. OWENS: Can you go to page four, please. Okay, and then just under summary of the offering, if you just could enlarge that.

BY MS. OWENS, CONTINUED:

Q. And did you read this section?

A. I did.

Q. Okay, and do you see the sentence: The trust fund will advance funds to McGinn, Smith Funding, LLC. What is your understanding of that sentence?

A. Again, the trust fund will loan its proceeds to McGinn, Smith Funding. And then the next sentence says: McGinn, Smith Funding will in turn purchase three million dollars of face value GPUs from the company, which is Verifier Capital.

In the paragraph previous to that, again, it says that the assignment of three million dollars of face value of guaranteed payment units issued by Verifier Capital when discounted to the present value at the blended interest rates contemplated by this offering will have a

value of three million, eight hundred and fifty thousand dollars.

Again, we use that information to generate an internal rate of return. Again, it comes out to sixteen percent, which is the same rate as the loan from the Verifier Trust 07 offering.

Q. Okay.

MS. OWENS: And if we could just go to page five and it is down towards the bottom.

BY MS. OWENS, CONTINUED:

Q. Where it says no monthly amortization schedules, is that similar to the Verifier 07 deal?

A. Yes, same language. Just indicates that the trust will receive interest only for the period of the loan, and then get their principal back in one payment.

Q. So it sounds like this deal, Verifier 08, is substantially similar to the Verifier 07 deal except Verifier 08 has a different operating company?

A. That's right.

Q. Okay, and the operating company for Verifier 08 is?

A. MS Funding or McGinn, Smith Funding.

Q. All right. Did you prepare a model based upon the information in the summary of the offering section?

A. Yes, I did.

MS. OWENS: The defendants move the admission of Exhibit 172.

MS. COOMBE: Your Honor, I am not going to keep objecting. I think my position is very clear at this point.

THE COURT: Received.

(Exhibit No. 172, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. So just in this Verifier 07 deal has this twelve percent interest rate and then an accrued interest rate of four percent?

A. Yes. Same terms.

Q. Okay, and just because we looked at this and a similar model with the Verifier 07 deal, can you just briefly summarize this model for us?

A. Yes, the current interest is a cash payment on the three million dollar loan to Verifier. So that's thirty thousand dollars a month, and then the four percent accrual will be added to the original principal balance. So that at the end of the loan, Verifier will have to pay back principal plus that four percent accrued interest.

And then on the second page, we see that once the trust is fully funded, which happens in the sixth month, three million, eight fifty, at the blended interest rates of two maturities paying twenty-nine thousand, five

eighty-three per month in order to service their interest expense. And that number is less than the thirty thousand dollars that is produced by the loan to Verifier.

Q. Okay.

MS. OWENS: And just go down all the way to the bottom.

BY MS. OWENS, CONTINUED:

Q. Okay, and then this is your ending calculations based upon the sixty months?

A. Yes. So the total cash available from the loan to Verifier Capital is 5,707,770, and the total cash necessary to retire the Verifier Trust 08 debt with interest is 5,571,376. So again, there is about one hundred and thirty-six thousand dollars of equity contemplated by the offering and that would be profit to MS Funding in this case.

Q. Okay, and did you prepare a summary of this model?

A. I did.

MS. OWENS: Defendants move for the admission of Defendant's Exhibit 173B.

THE COURT: Received over objection.

(Exhibit No. 173B, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and then just briefly, this piggybacks on

the model that you just talked about. So just very briefly for the jury, can you describe what you prepared here?

A. Sure. So in the box at the top, 1.8 million is generated from the interest payments, the cash interest payments of twelve percent. Six hundred and sixty-two thousand, nine eighty-nine is the accrued interest over the period of the loan with Verifier. So that gets added to the original three million dollar principal balance.

And then once again, there were loans to the partners of MS Funding that seemed to be around the time of this offering, and so I have included those with a repayment of three percent. And that would be -- that would make another two hundred and forty-four thousand, seven eighty available to the Verifier Trust 08 investors if they needed to -- if they needed it. So it is sort of a safety net.

Q. Okay, and it has that resulting equity after the deal matures of one hundred and thirty-six thousand?

A. One hundred and thirty-six thousand, three ninety-four.

Q. I am sorry.

A. That is okay.

Q. Okay, and did you review a number of bank statements related to TDM Verifier 08 Trust?

A. Yes.

MS. OWENS: At this time the defendants move for the admission of Defense Exhibits 173 and 173A.

THE COURT: Received over objection.

(Exhibit No. 173, 173A, received.)

BY MS. OWENS, CONTINUED:

Q. If we could take a look at the summary, which is Exhibit 173A. Okay. I just want you to describe some of the entries here briefly?

A. Once again, the maximum raise is achieved. So three million, eight hundred and fifty thousand dollars was deposited into the trust for investors. And once escrow was broken, that money is effectively loaned to MS Funding.

So out of that loan, this is an approximation of three million dollars that was actually loaned to Verifier Capital. That's the peach section. And so that creates a spread of about eight hundred and fifty thousand dollars, of which two hundred and fifteen thousand is paid as an underwriting fee to the broker-dealer. And if we scroll down a little bit, there is the green section that indicates the rest of the spread that resides at MS Funding to be used as they see fit.

Q. Okay, and I want to show --

MS. OWENS: I am going to move the admission of Exhibit 173C. It has been stipulated. It is a bank statement.

THE COURT: Received over objection.

(Exhibit No. 173C, received.)

BY MS. OWENS, CONTINUED:

Q. Okay, and this is one of the bank statements that you reviewed in your analysis?

A. Yes.

Q. Okay, and it is for Verifier Trust 08?

A. Yes. The April 2010 statement has an ending balance of nine thousand, four seventy-nine point zero six.

Q. Okay, and then does that match what is on the transaction summary, Exhibit 173A?

A. We haven't seen that number yet.

Q. I am sorry.

MS. OWENS: Can we go back to that?

A. This is it. Just scroll to the bottom. And that's the number there, which matches the bank statement. Again, this is excess funds that are -- that belong to the operating company, in this case, MS Funding.

BY MS. OWENS, CONTINUED:

Q. Okay, and did you prepare a balance sheet reflecting the -- this summary and a review of the bank statements and the PPM and the internal accounting records?

A. And the bank statements of MS Funding, yes.

Q. And --

MS. OWENS: The Defendants move the

admission of Exhibit 171A.

THE COURT: Received, same objection.

(Exhibit No. 171A, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Similar to the TDM Cable Funding balance sheet, this shows an asset line for Verifier 08 of that same number that we looked at on the bank statement?

A. It is actually different. I believe that the accounts receivable for Verifier 08 on this sheet is through March of 2010. When it was prepared, the April statement was available to me.

Q. Okay.

MS. OWENS: And then if we could just go down to the assets section.

BY MS. OWENS, CONTINUED:

Q. Okay. Is that the due from Verifier Capital, LLC?

A. That's right.

Q. And that has a four million dollar number. Is there a reason for that?

A. Yes. We are going to get to it, but MS Funding was also the operating company for the TDM Verifier Trust 09 deal. And that deal purchased another one million fifty in guaranteed payment units to secure the debt raised by that trust.

And in addition to that, MS Funding acting in its own capacity, made a small loan of about one hundred and thirty thousand dollars to Verifier Capital. So all three of those purchases are reflected in the same line.

Q. Okay, and you mentioned Verifier 09. I am just going to show you the PPM for that deal. It is Government's GA15. It is Verifier Trust 09.

Mr. Smith, can you just give us a briefly summary of this deal?

A. Very similar to the Verifier Trust 08 deal. This only has one maturity. It is thirty-six months at ten percent. Minimum offering is two hundred and fifty thousand. A maximum offering of a million three. Again, the funds are to be lent to MS Funding, which is then going to purchase these guaranteed payment units from Verifier Capital. I believe on page four it will show us that amount.

MS. OWENS: Go to page four, please. And then just top half section.

BY MS. OWENS, CONTINUED:

Q. Is this what you are referring to?

A. Yes. So this says the proceeds from the loan from the trust to MS Funding will be used to purchase one million fifty of face value GPUs from Verifier Capital. It says that when that amount is discounted to present value

contemplated by the rates in this offering, it will have a present value of one million, three hundred thousand. Again, that calculation works out to a sixteen percent loan.

And additionally here, there is sort of like an equity bonus for the investors of this deal. It says: Additionally the company shall directly convey seventy-five thousand warrants to purchase it common units to the certificate holders. So that was just sort of if things went fantastically, Verifier Capital would have a nice little reward for that.

Q. Okay. What is seventy-five thousand warrants, what does that mean?

A. Warrants are like options to buy a unit of stock at a price below where it is actually trading.

Q. Okay, and did you --

MS. OWENS: I am sorry. Can we just go to page five, please?

A. It is actually written at the top. It says no amortization of principal. So again, similar terms of the loan. It will pay the trust -- MS Funding will pay interest to the trust only and then principal at the end of the term.

BY MS. OWENS, CONTINUED:

Q. Okay, it is that top section where the bullets

are?

A. Yes, the last bullet point.

MS. OWENS: If we can enlarge that quickly.

BY MS. OWENS, CONTINUED:

Q. Okay. No amortization of principal. And did you -- based upon that information in the PPM, did you prepare a model?

A. Yes.

Q. Okay.

MS. OWENS: Defendants move the admission of Defense Exhibit 177.

THE COURT: Received over objection.

(Exhibit No. 177, received.)

MS. OWENS: Okay. Can we make that a little bit larger?

BY MS. OWENS, CONTINUED:

Q. And we already look at Verifier 07 and Verifier 08. Can you just tell us how this deal for Verifier 09 is different, if at all?

A. It is slightly different. The loan amount to Verifier is obviously somewhat smaller. It is a million fifty at the beginning balance. And the other difference here is that the sixteen percent loan came along with a 12.5 percent current income payment and accrued interest at three and a half percent. In the other two deals, it was

twelve percent and four percent.

And so again, the monthly interest that's paid in cash is enough to cover the monthly interest that's due to the trust investors.

Q. Okay.

MS. OWENS: And I just want to scroll down to the bottom of this exhibit.

BY MS. OWENS, CONTINUED:

Q. Seventy-two month term, and then you say total cash flow generated from Verifier Capital and the total cash flow necessary to retire debt plus interest, those are just totals from the above calculations?

A. That is right.

Q. Okay, and did you prepare a summary of this model?

A. I did.

MS. OWENS: And at this time the defendants move the admission of Defense Exhibit 177A.

THE COURT: Received over objection.

(Exhibit No. 177A, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. Is this the summary?

A. Yes.

Q. And then just briefly, Mr. Smith, can you just go ahead and describe what that reflects?

A. Sure. So in the box at the top, the twelve and a half percent interest on the one million fifty loan comes to a total of seven hundred and eighty-seven thousand, five hundred. The three and a half percent accrued interest comes to total of two hundred and forty-four thousand, nine sixty-six. And the principal repaid is one million fifty. And that generates a total cash available of two million, seventy-one thousand, five twenty-eight.

In order to repay the debt to investors, with interest, there was cash necessary of two million sixty, two ninety-one. So here there is resultant profit for equity after retiring the debt of eleven thousand, two thirty-six ninety-two. And that is a profit for MS Funding.

Q. Okay. So the two interest rates reflected in that model that we just looked at and the retirement of the guaranteed payment units comes to a total cash generated of over two million dollars to McGinn, Smith Funding, LLC?

A. That's right.

Q. And then McGinn, Smith Funding, LLC had an obligation to TDM Verifier Trust 09 of slightly less than that?

A. That's correct.

Q. Okay, and then, Mr. Smith, did you review a number of the bank statements related to the TDM Verifier

Trust 09 and MS Funding?

A. Yes, I did.

Q. Okay.

MS. OWENS: At this time the defendants move the admission of Defense Exhibits 178 and 178A.

THE COURT: Received over objection.

(Exhibit No. 178, 178A, received.)

BY MS. OWENS, CONTINUED:

Q. I am just going to show you Defense Exhibit 178A. Okay, and this is a summary of the spreadsheets that we have looked at before?

A. Yes.

Q. And this is specific to Verifier Trust 09?

A. Yes.

Q. Okay, and do you just want to walk us through the totals?

A. So there was a maximum raise on the offering of one million, three hundred thousand. The trust actually raised one million, two ninety. One million fifty of the loans proceeds to MS Funding were used to purchase the asset. And that created a spread of two hundred and forty thousand dollars.

Q. Okay.

MS. OWENS: And keep going down a little bit.

A. The contracts brought income into the trust of one hundred and twenty-seven thousand, two twenty-seven. And there is interest paid out of one twenty-five, fifty-two. So again, that left an excess that there is money belonging to the operating company. And that number is two thousand, one seventy-four point seventy-six.

BY MS. OWENS, CONTINUED:

Q. Okay.

MS. OWENS: Defendants move the admission of Exhibit 178B. I believe it is under stipulation.

THE COURT: Received.

(Exhibit No. 178B, received.)

BY MS. OWENS, CONTINUED:

Q. All right, and is this one of the statements that you looked at during your analysis?

A. Yes.

Q. For TDM Verifier Trust 09?

A. Correct.

Q. And it has this -- it looks like it is actually a May 2010 statement. It has an ending balance of that same number that we just looked at in the summary?

A. Actually it is a May statement. It has a beginning balance of two thousand, one seventy-four ninety-six. And then it shows that that money has been removed.

Q. Okay.

A. And there is a zero balance, but I was using the April statements, so...

Q. Okay.

MS. OWENS: Scroll down, please.

BY MS. OWENS, CONTINUED:

Q. So miscellaneous debt in the account, again, it is a zero?

A. Correct.

Q. Okay.

MS. OWENS: If we could go back and look at Defense Exhibit 171A.

BY MS. OWENS, CONTINUED:

Q. Okay, and just based upon the balance sheet for McGinn, Smith Funding, is there an account receivable for that amount that we just looked at on the bank statements?

A. Yes. It is the last line of TDM Verifier 09, two thousand, one seventy-four point ninety-six.

Q. Okay, and just to review the assets due from Verifier Capital, LLC, we talked about that 4.1 million dollar number?

A. Yes. The million fifty is part of that number.

Q. Okay.

MS. OWENS: And if we could go to page two. And then down a little bit more.

BY MS. OWENS, CONTINUED:

Q. The trust liability section for TDM Verifier 09 and Verifier 08 that we looked at before, does that reflect the amount owed by the operating company to the trusts?

A. Yes, I believe there was another ten thousand dollars that came into the operating account sometime after the loan had been made from the escrow account. So the liability is actually a million three, which is the maximum raise.

Q. Okay, and that ten thousand dollars, did it have anything to do with the trusts as far as you could tell?

A. No, other than it was another investor deposit that came into the trust later.

Q. Okay. Thank you, Mr. Smith. I am going to show you Government's Exhibit 5 -- I am sorry. GA5, my apologies. Okay, and Mr. Smith, can you just briefly tell us what this is?

A. Sure. This is the PPM for the Firstline Trust 07. It has a maximum raise of one million, eight sixty-seven, a minimum raise of five hundred thousand. This is the junior subordinate piece of this offering, and it is a five-year deal at eleven percent.

Q. Okay.

MS. OWENS: And if you just want to go to page four of the PPM.

BY MS. OWENS, CONTINUED:

Q. And under summary of the offering there is a description in the top half. Did you review this in part of your analysis?

A. Yes.

Q. Okay, and what is significant in the summary of the offering?

A. It says that the trust fund will enter into a monitoring receivable financing participation agreement with the senior participant relative to the financing.

Q. Okay, and --

MS. OWENS: I am sorry. That's on the bottom half of the page. Can you just make that a little bit bigger?

A. Yes. It is about in the middle just above that actually.

MS. OWENS: Up a little bit.

A. Right there.

BY MS. OWENS, CONTINUED:

Q. Okay. So the monitoring receivable financing participation, was that contained within this PPM?

A. Yes, it was contained as an exhibit.

Q. All right.

MS. OWENS: If we could go to page forty-eight, please. Go one page up. There is a cover

page. One more, okay.

BY MS. OWENS, CONTINUED:

Q. So this is the cover page to the monitoring agreement?

A. Yes, this shows that McGinn, Smith Funding entered into an agreement with Firstline Security. This is the actual monitoring receivable agreement. The first page says that the trust will enter into a participation agreement with the senior participant from this agreement. So there is actually two --

Q. Oh, okay.

A. There is two agreements, and they are back to back. So in order to analyze this, you have got to look at this one first.

Q. The participation agreement?

A. Well, first you need to look at the agreement we are looking at now, the receivable financing agreement.

Q. Okay.

MS. OWENS: And then if we can just go to the next page, please, of that.

BY MS. OWENS, CONTINUED:

Q. And you reviewed this agreement and in summary, what did it say?

A. If we go maybe one or two pages further, it really summarizes it. This is a lot of definitions and

stuff, but there is some numbers indicated on maybe the next page or two pages from here. Further. Next page, please. Next, next, next, next.

THE COURT: Okay. We will take the afternoon break now. We will get it straightened out. We will be back in fifteen minutes.

Mr. Minor.

COURT CLERK: Court stands for the afternoon recess.

(Whereupon, a brief recess was taken.)

THE COURT: Ms. Owens, you may continue with your direct.

MS. OWENS: Thank you, Your Honor.

BY MS. OWENS, CONTINUED:

Q. Okay, and I think before the break we were looking at Exhibit GA5. I think it is actually a sub-agreement to this agreement.

MS. OWENS: So if you could just keep going. It is spaced out differently.

BY MS. OWENS, CONTINUED:

Q. Is that it?

A. Yes. This is it.

Q. Okay.

MS. OWENS: If we can just enlarge that, please.

BY MS. OWENS, CONTINUED:

Q. All right. Mr. Smith, what do these funding price, net funding price, additional expenses, what does this represent?

A. The funding price is the amount of the loan that MS Funding will make to Firstline Security. And there are some fees that will be paid by Firstline Security in relation to this loan.

So the net funding price is the actual cash amount that MS Funding will transfer to Firstline Security, but they still owe -- the liability on their loan is still the funding price in section one. So they actually owe in principal two million, seven eighty-one, two fifty.

Q. Okay, and was there a debt service schedule that was part of the PPM?

A. Yes. The debt service schedule from the Firstline loan to MS Funding is maybe on the next page.

Q. I think it is page sixty-three?

A. This is it. So this just stipulates the exact payments that Firstline will have to make in relation to that loan of two million, seven eighty-one, two fifty. So I used this to create my model of the expected cash flows.

Q. Okay.

MS. OWENS: And if we could just go to the next page.

BY MS. OWENS, CONTINUED:

Q. Is there -- what does this, any debt --

MS. OWENS: If we could just enlarge that sentence.

BY MS. OWENS, CONTINUED:

Q. -- any debt service amounts not received by the agent in the month when due shall bear interest at a rate of 21.5 percent annum until paid. What does that mean?

A. It is just a penalty for late payments. It is a penalty of 21.5 percent. The payments, themselves, based on the loan amount actually generate what the actual interest rate is on that loan, and that is a calculation that we will see in the model that I created. It is just a function of the formula.

Q. Okay, and before you referenced the monitoring participation agreement.

MS. OWENS: I believe it is on page ninety-one or ninety-two.

A. This is the actual debt service -- yes. This is basically the full model. This shows both the monthly debt service that Firstline will pay to MS Funding, and it also shows the payment schedule that will be paid to the senior portion of the trust debt from MS Funding.

So in this case, the beginning balance of the senior debt was one million, eight fifty. And this is an

example of an amortizing loan. And you will notice that the -- it is not typical in that the sense that the same total payments made every month. The total payment sort of varies along with the payments that Firstline will make to MS Funding. But in any event, it is a debt service schedule that does fully amortize the principal by the end of the loan. So the payments are made up of both interest and principal.

BY MS. OWENS, CONTINUED:

Q. Okay, and based upon these documents that we just reviewed in this PPM, did you make a model reflecting the information?

A. I did.

Q. Was there anything else in the PPM that you relied on?

A. I did not need anything else, but this.

Q. Okay.

MS. OWENS: Defendants move the admission of Exhibits 174, and the summary, it is 174A.

THE COURT: Received over objection.

(Exhibit No. 174, 174A, received.)

THE COURT: To move it long, are you also going to move 175, 175A, and 176 and 176A?

MS. OWENS: That is correct, Your Honor.

THE COURT: All received.

(Exhibit No. 175, 175A, 176, 176A, received.)

MS. OWENS: Okay, and we just want to take a look at -- we will just look at the summary that you did. It is Exhibit 174A.

BY MS. OWENS, CONTINUED:

Q. Okay. Did you say earlier this morning that you, yourself, were personally an investor in the May Firstline deal?

A. That's correct.

Q. Okay, and if you could just briefly describe what this model summary represents?

A. Sure. The Firstline in the box at the top is the funding price, two million, seven eighty-one, two fifty. And the sum of the payments that are spelled out in that debt service schedule in the same exhibit add up to four million, eight twenty, seven fifty. And they were also part of the loans associated with -- that came out of MS Funding that seem to be associated with this transaction.

So I have included that as an available asset to the trust investors. And at the end of the term with three percent interest, those loans go seven hundred and eighteen thousand, seven forty-nine. So the expected total cash flow from the deal, including the Firstline payments and

the loan repayment, totals five million, five thirty-nine, four ninety-nine. And the total cash flow necessary to retire both the senior and the junior trust debt with interest is four million, nine sixteen, eight eighty-eight. And that results in a profit to MS Funding of six hundred and twenty-two thousand, six eleven.

Q. Okay. So based upon the model, which is based upon the information in the private placement memorandum, the expected cash flow to this deal to MS Funding is over 5.5 million dollars and the cash flow necessary to retire the debt or essentially pay off investors is roughly 4.9 million dollars?

A. That's right.

Q. And that's where we get that equity of over six hundred and twenty thousand dollars?

A. Yes.

Q. Okay, and was there a second Firstline offering?

A. There was.

Q. Okay.

MS. OWENS: If you would just go to -- it is Government's Exhibit 8 -- I am sorry. GA8.

BY MS. OWENS, CONTINUED:

Q. Okay, and this is the PPM for Firstline Trust 07 Series B?

A. Yes. Again, this is the junior tranche or

portion of this offering. So it is fairly similar in terms to the May deal, sixty months, eleven percent. There is a maximum raise of two million, one fifteen. A minimum raise of five hundred thousand. And the language is in terms of how the proceeds will be used. It is identical. It says that the trust will engage in the monitoring participation agreement with the senior participant. I believe that's on page four.

Q. Okay, and did you sell some of this offering while you were working at McGinn, Smith & Company?

A. I did, yes.

Q. And was it -- were you aware that -- well, are you currently aware that Firstline Security, Incorporated declared bankruptcy in January of 2008?

A. I am.

Q. Did you sell this deal after the bankruptcy?

A. I did.

Q. Were you aware of the bankruptcy when you sold it?

A. No.

MS. OWENS: And if we could just go to page three of the PPM -- or page four. I am sorry.

BY MS. OWENS, CONTINUED:

Q. Okay, and this is the summary of the offering. Is this something that you reviewed?

A. Yes.

Q. Okay, and if we just want to look at the top section where it says trust fund. Okay, and what was significant to you when reviewing this summary of the offering?

A. Just down a little actually, underneath the yellow highlight. The trust fund will enter into a monitoring receivable financing participation agreement with the senior participant. And who the senior participant is and what that agreement is, is actually attached to the PPM as an exhibit.

Q. Okay, and is that -- is this the monitoring agreement, I believe it is on page forty-six or forty-seven?

A. Yes, this is.

Q. This is it. Okay, and then you reviewed that section that we looked at in the May deal, is that that sub-exhibit to it?

A. Yes, this agreement indicates that McGinn, Smith Funding will enter into this agreement with Firstline Security. And as a sub-exhibit to this, again, there is a funding price. It is a few pages down.

Q. So according to this financing agreement, McGinn, Smith Funding is entering into an agreement with Firstline Security, not the trust?

A. Correct.

Q. Okay.

MS. OWENS: And if we can just go down to that. It will be a few pages.

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, you just explained what that exhibit is reflecting?

A. Yes. Again, there is a funding price of two million, four ten, and that's the principal amount of the loan to Firstline that they are required to pay back to MS Funding. And there is -- again, there is some fees that are imbedded in the deal, which are paid by Firstline to McGinn, Smith Funding.

And really, all that means is that they will have to pay back a larger liability than the actual cash they receive. So the net funding price is the actual cash amount that is lent to them, but their liability is greater. It is two million, four ten.

Q. Okay, and is there also a debt service schedule in this PPM that you reviewed?

A. Yes.

Q. I believe it is on page sixty or sixty-one. Is this it?

A. Yes.

Q. Okay.

MS. OWENS: Just make this a little bit larger.

BY MS. OWENS, CONTINUED:

Q. Summarize what this debt service schedule reflects?

A. Yes. Again, these are the scheduled payments Firstline Security is supposed to make to MS Funding in exchange for a loan. And, again, on the second page I think there is language about penalty for late payments, but this is just the payment schedule for a loan.

Q. Okay, and was there anything else that you -- did you create a model based upon the information in the PPM?

A. I did.

Q. Was there any other specific sections of the PPM that you relied on?

A. Yes. Just the next exhibit, which is the monitoring receivable participation agreement. And that's between the Firstline Trusts Series B and McGinn, Smith Funding.

Q. Okay.

MS. OWENS: If we could just go to the next page or the next two pages.

BY MS. OWENS, CONTINUED:

Q. Do you think it is after this?

A. Yes.
Q. Okay.
A. This is it.
Q. Monitoring receivable financing participation agreement and then --
MS. OWENS: Could we just go to the next page?
A. So it states in here that this is between the trust and -- Firstline Trust and McGinn, Smith Funding. And then there is -- as an exhibit to, as a sub-exhibit to this, there is an amortization schedule for the payments that are due to the trust similar to what we saw in the May Firstline deal.
BY MS. OWENS, CONTINUED:
Q. All right, and I think that's somewhere around page ninety-four or ninety-five. Is this one of them?
A. Yes, it looks like that. The page after this would be the scheduled payments to the junior participant.
Q. Okay.
A. And a few pages prior to this is the scheduled payments to the senior.
Q. Okay, and I am going to show you exhibit, Defense Exhibit 175A. Mr. Smith, is this a model summary that you prepared from the detail that you just reviewed in the private placement memorandum?

A. Yes.

Q. Okay, and could you just briefly describe what this exhibit represents?

A. Sure. Two million, four ten is the funding price that we saw in the monitoring receivable agreement exhibit. And based on that payment schedule, if you add up all of those payments, you come to five million, two twenty-four, seven fifty.

And, again, there were some partner loans from MS Funding that seemed to be around the same time of this offering. So I have included those as an asset that might be available if needed to the trust investors. So when you add up those cash flows, you come with the total cash available of five million, one forty, six seventy-seven.

And in order to pay the investors back their principal and interest, you needed cash of five million eighty-five, five seventy-six. So this indicates that there is an expected profit for McGinn, Smith Funding at the end of this term of fifty-five thousand, one hundred dollars.

Q. Okay. So just based upon what you said, you are saying that the expected cash flows from the assets that MS Funding invested in is expected to have a total of approximately 5.1 million dollars, and then the obligation MS Funding has to trust investors is slightly less than

that, the second number, the five million eighty-five number?

A. That's right.

Q. Okay, and related to the November deal, the Firstline Trust 07 Series B, and the May deal, both senior and junior trusts for both, did you review a number of bank statements?

A. I did.

Q. Okay, and did you prepare a spreadsheet like you did for the other trusts that we have reviewed?

A. Yes.

Q. Okay. I am going to show you Defense Exhibit 176.

MS. OWENS: Okay. Please make it a little bit bigger.

BY MS. OWENS, CONTINUED:

Q. It says at the top Firstline Trusts, Firstline Senior Trust 07, Firstline Trust 07 Series B, and Firstline Senior Trust 07 Series B, so all four deals?

A. Yes.

Q. Okay, and this appears to be an extremely long exhibit with each one of the individual trusts. So we won't go through it in great detail.

A. Okay.

Q. But if we just want to go down, it looks like --

as we have seen, there is investor raise, the funds to be loaned, underwriting fees.

MS. OWENS: And then we want to go to page five.

BY MS. OWENS, CONTINUED:

Q. Okay. This blue section, this is for interest income, it looks like?

A. Right. And just the reason we are focusing on this is obviously there is a number of payments that come into the trust to be paid to investors following the bankruptcy of Firstline. So, again, since MS Funding is the obligor and is required to make those payments, MS Funding has arranged for those payments to be made either by themself or through an agent.

And we just wanted to focus on the fact there is a number of payments here that are going to the Firstline Trusts that come from MSTF and other sources. And it just needs to be pointed out that those payments will then become a loan between the entity that makes the payment and MS Funding who is the obligor.

So that is to say that MS Funding on its books and records still needs to record interest expense for each one of these payments because -- just because they have the obligation to the trust, itself. They are incurring that expense.

Q. Okay, and did you create a summary of this so we don't have to go through all fourteen pages?

A. Yes.

Q. I am going to show you Defense Exhibit 176A. So this is only two pages. Go down, the blue, is that the investor raises for each of the four individual trusts?

A. That's right.

Q. Okay, and the peach belonging to the operating company?

MS. OWENS: Go down a little bit more.

A. Again, those are approximations based on the funding amount from MS Funding to Firstline and both for the May and November loans.

MS. OWENS: Okay, and then if we can just go down a little bit more.

BY MS. OWENS, CONTINUED:

Q. It shows a million six for the spread. Okay, and then all those dark blue sections?

A. These are all the payments to investors. Eight hundred, eighty-two thousand was the principal return to the Firstline Senior Trust. And they also got paid two hundred and ninety-four thousand in interest from the junior trust. Those May deals paid four, thirty-one interest. And the November deal, the senior tranche received a little over ten thousand dollars in principal

return. And if we keep scrolling down it also shows the interest paid to both the senior and junior of the Series B deal or the November deal.

And finally, there is, again, an ending bank balance. And this is actually the addition of -- there is four different bank accounts, one for each of the four trusts. And so we just added them together to come up with this ending bank balance of three forty-five, twenty-seven.

Q. Okay.

MS. OWENS: Defendants move for the admission of Exhibit 176B. I think it is stipulated to. It is a bunch of bank statements.

THE COURT: Received.

(Exhibit No. 176B, received.)

BY MS. OWENS, CONTINUED:

Q. And, Mr. Smith, it looks like one of the bank statements, it looks like the senior -- I am sorry. The junior for Series B for April 2010?

A. Yes.

Q. And this is something that you reviewed?

A. Yes.

Q. And it has an ending balance of three hundred and twenty-eight dollars and eighty-three cents?

A. Yes.

Q. Okay.

MS. OWENS: Go to the next page, please.
BY MS. OWENS, CONTINUED:
Q. Okay, and this is another bank statement that you reviewed?
A. Yes. This is the November deal, the senior trust ending bank balance, forty cents.
Q. Okay. What is this, the junior May raise?
A. Yes. And there is a balance of zero.
Q. Okay.
MS. OWENS: And the next page.
BY MS. OWENS, CONTINUED:
Q. The May senior raise?
A. Yes, and there is a balance of zero. This is actually through July of 2010. So prior to that, there was a balance of two seventy-six, fifty-six.
Q. Okay, and in fact does the total of these bank statements match the number that we were just looking at in the summary?
A. Yes.
Q. Okay.
MS. OWENS: If we could go back to previously admitted Exhibit 171A.
BY MS. OWENS, CONTINUED:
Q. And then under the accounts receivable, does that reflect that same number?

A. Yes, the forty cents. And then the seven ninety-five, eighty-three actually reflects the balance that we just looked at. And there was also about four hundred dollars left over in the -- what was previously the escrow account for the Junior Series B deal. So that was both of those accounts combined.

Q. Okay, and just when you were reviewing the entries from the McGinn, Smith internal accounting staff, did you have any difficulties with tracing the funds for any particular reason?

A. I did because all of it seemed to be, all four trusts seemed to be accounted for in only the books of the May senior deal. It just made it kind of difficult.

Q. So --

A. I honestly don't know how to explain it.

Q. Okay. All right.

MS. OWENS: And we just want to go to the second page, the liability section, trust liabilities. Down a little bit more.

BY MS. OWENS, CONTINUED:

Q. Due to Firstline Series B Junior and due to Firstline -- or it has all four trusts there?

A. Yes, and those are equal to the full amount of the raise, minus any principal repaid. So the most noticeable one is the Firstline Senior Trust May deal has

had close to nine hundred thousand dollars in principal repaid. So the liability there is lower than the rest. It is nine hundred and fifteen thousand.

Q. Okay.

MS. OWENS: And if we can go back to the first page, please.

BY MS. OWENS, CONTINUED:

Q. So for the books for MS Funding, it says, total checking/saving amount is about sixty-seven thousand dollars?

A. Correct.

Q. Okay.

MS. OWENS: Defendants move for the admission of Defendant's Exhibit 171D. It is a bank account statement. I believe it is stipulated to.

THE COURT: No objection. Received.

(Exhibit No. 171D, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. So this looks like a Mercantile Bank statement for MS Funding?

A. Yes. And this is just, again, a check that I incorporated all of the cash transactions from MS Funding in my preparation of that balance sheet. On this piece of paper, the new balance number seems to be redacted, but if you scroll down a couple of pages, it is found in another

spot. So on 4/19 under daily balances summary, you will find that same number, sixty-seven thousand, seventy, and sixty-four cents.

Q. Okay.

MS. OWENS: And if we could just go back to the balance sheet, Exhibit 171A.

BY MS. OWENS, CONTINUED:

Q. Is that that same number?

A. Yes.

Q. Okay, and were there any other trusts related to McGinn, Smith Funding, LLC?

A. No.

Q. Okay, and are you familiar with the deal called Fortress Trust 08?

A. Yes.

MS. OWENS: If we could just pull up Government's Exhibit GA13.

BY MS. OWENS, CONTINUED:

Q. Did you review the private placement memorandum for Fortress Trust 08?

A. I did.

Q. Okay.

MS. OWENS: And if we could just zoom in on the top section.

BY MS. OWENS, CONTINUED:

Q. Can you just provide a brief summary of this private placement?

A. Yes. It is a maximum raise of three million, sixty. A minimum offering of two hundred and fifty thousand. And it was a three year deal paying thirteen percent interest.

Q. Okay. What was -- the ultimate was for cable contracts?

A. These were alarm contracts that were eventually purchased from, I think, a hedge fund called Fortress Capital or something like that.

Q. Okay.

A. It says it in the document several places.

Q. Okay.

MS. OWENS: And if we could go to page three, please.

BY MS. OWENS, CONTINUED:

Q. Okay. Under summary of the offering, we just want to go to that highlighted section. We can start there.

A. So this is from a standpoint of analyzing this deal is fairly complex, but there was actually the creation of a joint venture between the operating company, NEI Capital, and a company called Full Circle Partners. That joint venture was called MSFC Security Holdings, and that

is the entity that ultimately bought the alarm contracts from Fortress.

The trust deal says that the business of the trust would be to lend all of its proceeds to NEI Capital, which is the operating company. And NEI will use that money to acquire a 48.98 interest in a one million, nine hundred and sixty thousand dollar note from the joint venture MSFC Security. And also a 74.5 percent equity interest in that same company. And then there is, again, some sort of bonus stuff if all goes well, with one hundred percent interest in this Class B capital contribution. And that carried this fifteen percent dividend. So --

Q. Okay. Is there any way you can explain that in plain speak?

A. It is quite difficult to do, but we can maybe look at the model and get a better idea of how the cash flows are supposed to flow through to everybody.

Q. Okay, and was there a debt schedule associated or within this private placement memorandum?

A. I believe so.

Q. Okay. I believe it is on page forty. Is this the schedule?

A. Yes. This shows the scheduled repayments to the trust investors from NEI Capital. And I used this in my creation of preparing the model.

Q. Okay, and related to Fortress Trust 08, did you also review a number of bank statements related to this, related transactions?

A. Yes, I did.

Q. Okay.

MS. OWENS: At this time defendants move for Exhibits D184, 184A, 185A, and 182.

THE COURT: Received over objection.

(Exhibit No. 184, 184A, 185A, 182, received.)

MS. OWENS: If we could pull up Defense Exhibit 184.

BY MS. OWENS, CONTINUED:

Q. And, Mr. Smith, is this the model that you created based upon the information that was in the private placement memorandum?

A. Yes.

Q. And this is similar to the ones that we looked at before. It has a little bit more information in it. Can you just briefly -- you don't have to go through every detail, but just briefly describe what that model represents?

A. Yes. So this shows the loan from NEI Capital to the join venture, which was MSFC Security Holdings. And it also shows a portion of that loan was from Full Circle

Partners. They actually had a senior interest in that loan. So they were to be paid back their principal first.

So as you go through these payments, it was a loan that was made at twelve percent. And then there were stipulations for all of the excess cash flow that was coming into the joint venture to the first fund, that debt service reserve fund, for the trust investors. And once that debt service reserve fund was fully funded, then Full Circle Partners would start receiving payback on their portion of the loan. Once they were repaid, all of the money was available to NEI Capital to service their debt to Fortress Trust.

Q. Okay.

A. I am sorry.

Q. That's okay. Just because we have a lot of entities here. NEI Capital, LLC is the operating company for Fortress Trust 08?

A. That's right.

Q. Okay, and then Full Circle Partners, that is just a related -- I guess it is not related --

A. It is an unrelated third-party.

Q. -- to this particular deal with NEI Capital?

A. Correct.

Q. Okay, and let me show you Defense Exhibit 185A. We will just go to the summary in the interest of time.

Fortress Trust 08. Mr. Smith, do you want to walk us through this briefly?

A. Sure. So again, the investor deposits came in in a total three million, sixty. And the loan to the joint venture, which was MSFC Security Holdings. Was roughly one million eight hundred and seven. It was actually about one hundred thousand dollars more than that.

And then the resultant spread is somewhere around 1.1 million dollars. So from that spread, one hundred and eighty-three thousand, six hundred is paid to McGinn, Smith, the broker-dealer, for commissions to sales reps.

And then further down, the green section is the rest of the spread that resultant from this deal. And then there was some small redemptions on this deal. So I just reflected that there.

Q. Okay, and the six hundred and eleven thousand cash inflows from Fortress, what is that, the interest income?

A. It is both interest and principal returned in conjunction with the terms set out in that loan from NEI to MSFC Security Holdings.

Q. Okay.

MS. OWENS: Could you scroll down just a little bit more, please.

BY MS. OWENS, CONTINUED:

Q. So this deal, based upon review of the model, there was a certain amount of principal and interest paid under the schedule, and it is reflected in the blue, back to investors?

A. Yes. This is sort of interesting, but the amount of principal that was returned is far more than what was scheduled. And that's because the assets that were producing the cash flows began to experience some difficulty in making their payments. And so the payments that were made to investors were at some point reclassified from interest to principal in order to benefit the investors from a tax standpoint.

Q. Okay.

A. And then again, there is a surplus that was provided by other entities that put money into the Fortress Trust account that didn't belong to Fortress Trust. And so again, we end up with a surplus of sixteen hundred dollars that belongs to the operating company, which was NEI Capital.

Q. Okay.

MS. OWENS: And defendants move the admission of Defendant's Exhibit 185B. It is a bank statement.

THE COURT: Received.

(Exhibit No. 185B, received.)

BY MS. OWENS, CONTINUED:

Q. And this is the checking account for Fortress Trust 08?

A. Yes, and this is the last statement that we had access to, so it is March 2010.

Q. Okay, and it shows that ending bank balance of one thousand, six hundred dollars and sixty cents?

A. Correct.

Q. Okay, and if I can show you Defense Exhibit 182. Okay, and is this the balance sheet that you prepared?

A. Yes.

Q. Okay, and under accounts receivable?

A. Yes. That's AR Fortress Trust 08, and it reflects that ending bank balance of sixteen hundred dollars and sixty cents.

Q. Okay, and do you see under assets, it has a number of due froms and loans?

A. Yes. So the asset that relates to the alarm contracts is the due from MSFC Security Holdings in the amount of five hundred and two thousand, eight fourteen, and that number is substantially lower than the original purchase price of the assets because a certain amount of principal on that loan was repaid to NEI Capital.

Q. Okay.

MS. OWENS: If we could just go to the top again.

BY MS. OWENS, CONTINUED:

Q. On the balance sheet, it shows a total checking balance of ninety-five dollars and forty-three cents. Okay, and if I could just show you --

MS. OWENS: Or I move to admit Defense Exhibit 182C, the bank statement.

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 182C, received.)

BY MS. OWENS, CONTINUED:

Q. And is this one of the Mercantile Bank statements that you reviewed?

A. Yes.

Q. Okay, and I think there is a second page to this?

A. Well, the balance is shown right here on this first page.

Q. Oh, okay.

A. Ninety-five, forty-three, which is the same as the balance on the NEI balance sheet we just looked at.

Q. Okay, and did NEI have any other associated trust besides Fortress?

A. No.

Q. I am going to show you, it is Government's Exhibit GA21. Okay. TDMM Benchmark Trust 09. Is this another one of the PPMs that you reviewed?

A. Yes.

Q. Okay.

MS. OWENS: Could we just zoom in on the top section.

BY MS. OWENS, CONTINUED:

Q. It is a three million dollar offering and there is five different --

A. Yes. There is five maturities at each of the different interest rates and a different maximum offering amount. And the minimum -- it says minimum investment of twenty-five thousand dollars, but that relates to an individual person. I think that the minimum raise is actually indicated on the bottom portion of this page.

Q. Okay.

MS. OWENS: Could we just take a look at that?

A. Yes. It is two hundred and fifty thousand.

Q. Okay.

MS. OWENS: And if we could go to page four, please. The summary of the offering. Just enlarge that top section, please.

A. In the second paragraph under the trust, it

says: The trust will make a loan to TDMM Cable Funding as defined above, and TDMM will purchase the operating assets of Benchmark -- I believe it is Benchmark Communications, both contracts for a total consideration of approximately one million, nine hundred and fifty thousand dollars. And then below that, it sort of gives indication of the expected cash flow that can be received from those contracts that are purchased.

BY MS. OWENS, CONTINUED:

Q. Okay, and Benchmark, what type of company is that?

A. These were triple play cable contracts.

Q. Okay. Like similar to the TDM Cable Trust deal?

A. Similar to that and also similar to the TDMM Cable Trust deal.

Q. Okay.

MS. OWENS: Can we go to page, I believe it is, thirty?

BY MS. OWENS, CONTINUED:

Q. All right, and, Mr. Smith, do you know what this is?

A. Yes, this is the payment schedule for the shortest term that was offered, the eight percent term. It is just a twelve-month deal, and it fully amortized and paid back its principal over the course of the twelve

months.

Q. Okay.

MS. OWENS: If we could take a look at the next page.

BY MS. OWENS, CONTINUED:

Q. This is the nine percent deal?

A. Correct. You notice that this deal starts to amortize after -- in month thirteen after the eight percent has been repaid.

Q. Okay.

MS. OWENS: And the next page, please.

A. This is the ten percent. Again, the amortization starts after the retirement of the first two levels.

BY MS. OWENS, CONTINUED:

Q. Okay. And the next page?

A. This is the payment schedule for the eleven percent portion.

Q. Okay. There is one more, right?

A. Yes, there is a twelve percent.

Q. Okay.

A. That's shown here. So using those five payments schedules, I was able to create a model that encompasses the total debt service for all five.

Q. Okay, and I am just going to show you page

thirty-six. Do you know what is this is? It says escrow agreement.

A. Yes. This is just a document that stipulates what the conditions are for the escrow agreement to be broken.

Q. Okay. So similar -- somewhat similar to what we are talking about with the minimum raise?

A. I believe exactly similar.

Q. Okay.

A. In Section 4A, it actually says that once the minimum proceeds have been raised, the offering will commence.

Q. Okay, and did you -- I understand that you read this PPM. Was there anything you relied on in putting together your model?

A. I don't believe so.

MS. OWENS: At this time the defendants move the admission of Defense Exhibits 199, 199A, 200A, 200B, and 204.

THE COURT: Received over objection.

(Exhibit No. 199, 199A, 200A, 200B, 204, received.)

BY MS. OWENS, CONTINUED:

Q. Okay. I am going to show you Exhibit 199.

MS. OWENS: If we can make this a little bit

bigger.

BY MS. OWENS, CONTINUED:

Q. And I understand from the PPM that there is basically five levels of financing here, so I am not going to make you talk about them. Just very generally, can you describe this model?

A. Yes. Based on the actual amount that was raised, which was two million, five hundred thousand dollars, and using the schedules that were in the back of the PPM, I basically just combined the interest for each of the deals and the principal for each of the deals for all five of them into one monthly number. And so this is the payment schedule for the trust as a whole based on the two and a half million dollar loan.

And from the table in the PPM that goes through the contracts, the cable contracts, there is a cash flow, monthly cash flow estimate that is generated on the -- one of the right hand columns here, which says EBITDA. And that number is initially less than the total debt service required and eventually grows to be greater.

Q. Okay.

MS. OWENS: If we could scroll over to the right, please.

BY MS. OWENS, CONTINUED:

Q. We see that EBITDA again. What does that stand

for?

A. Earnings before interest, taxes, depreciation.

Q. And so that just basically means cash flow?

A. Correct.

Q. Okay. So over on the right hand side, that's that debts that they were talking about in the beginning?

A. Yes.

Q. All right.

MS. OWENS: And if we could scroll down.

BY MS. OWENS, CONTINUED:

Q. And then it looks like --

MS. OWENS: Scroll over a little bit to the left.

BY MS. OWENS, CONTINUED:

Q. -- sometime around month thirty-eight it results in a surplus?

A. Yes. So again, this is a place where the operating company structurally comes in handy because they can make up that shortfall fall early on.

Q. Okay. When the proceeds are lent from the trust to the operating company and the operating company enters into an agreement with the asset or borrower, is that what you mean?

A. Correct.

Q. Okay, and you reviewed a bunch of -- all of the

bank statements related to this particular trust?

A. Yes.

Q. Okay, and did you summarize them?

A. I did.

Q. Okay, and I am just going to show I defense Exhibit 200A. All right. This is just one of the summaries that you prepared for each level of the investment. If you can just take us through this briefly, please?

A. Okay. There is one level below this -- excuse me. But all five of them add up to two and a half million dollars, which is the total amount that is actually raised. And out of those proceeds that are to be lent to TDMM Cable Funding, we see that roughly, I believe the PPM called for a purchase price of like one million, nine hundred and fifty thousand dollars. So this again, is just an estimation of what portion of those funds will go to buy the assets.

And then below that, we see the underwriting spread, the underwriting fee that's paid out, the spread. And again, there is in the green section, the spread that resides at the operating company, TDMM Cable Funding.

Q. Okay, and then it looks like there is that ending bank balance of five hundred and fourteen dollars and eighty-seven cents?

A. And that's money that belongs to the operating company.

Q. Okay. I am going to show you Exhibit 200B. Is this one of the bank statements that you reviewed for TDMM Benchmark Trust 09?

A. Yes.

Q. This looks like it is from April 2010, and it has a balance of four hundred and twelve dollars and seventy-five cents?

A. Correct.

MS. OWENS: If we could just go to the second page, please.

BY MS. OWENS, CONTINUED:

Q. I believe this is the May 2010 statement. If we go down, there is an ending balance of zero.

A. Yes. Again, it looks like the account was just closed by the receiver.

Q. All right, and I am going to show you Defense Exhibit 204. Is this the balance sheet that you prepared for TDMM Cable Funding?

A. Yes. The only thing we did not look at was the escrow account for the trust, also had a remaining balance of about one hundred and two dollars. So that's what accounts for the difference here. The balance sheet shows five hundred and fourteen point eighty-seven compared to, I

think it was, four twelve, seventy-five.

Q. Okay, and let's see, if we go to assets, it says, from Benchmark Communications a million nine?

A. Yes. That number reflects the amount of money that Benchmark Communications received for the purchase of the cash flows.

Q. Okay.

MS. OWENS: And if we can scroll down a little bit.

BY MS. OWENS, CONTINUED:

Q. It says under the liability section, due to Benchmark Trust 09 of 2.4 million dollars?

A. Yes. So that's the two million, five hundred that was raised. And the eight percent deal received back about twenty-two thousand, four hundred in principal.

Q. Okay. So that the difference?

A. That's the difference, yes.

Q. Okay.

MS. OWENS: If we could just go to the top of this exhibit.

BY MS. OWENS, CONTINUED:

Q. Okay. So it says checking balance per TDMM Cable Funding, LLC, one hundred and ninety-three dollars and sixty-nine cents?

A. Yes.

MS. OWENS: And defense moves for the admission of Exhibit 206A. It is another bank statement.

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 206A, received.)

BY MS. OWENS, CONTINUED:

Q. So this is one of the Mercantile bank statements you reviewed in your analysis?

A. Yes.

Q. Okay.

MS. OWENS: And if we can go down.

BY MS. OWENS, CONTINUED:

Q. It looks like the April 2010 statement has a new balance of one ninety-three, sixty-nine. Is that the same that we just look at on the balance sheet?

A. I think so, but it is getting late. Should we look at it again?

MS. OWENS: Leslie, can you just go back to 204?

A. Yes, it is the same.

BY MS. OWENS, CONTINUED:

Q. And were there any other trusts besides TDMM Benchmark associated with TDMM Cable Funding, LLC?

A. No.

Q. Okay, and I am going to show you -- it is

Government's Exhibit --

THE COURT: All right. We will take a break for the evening. Members of the jury, you are going to be excused now until 9:30. I want to advise you that tomorrow the latest we will hold court is 12:30. So you will be -- perhaps earlier, but that will be the latest. You will be excused until Monday. So we will have a half a day tomorrow.

Don't discuss the case among yourselves, etcetera, etcetera. And thank you for your attendance. And we will see you tomorrow at 9:30 to 12:30 at the latest.

Mr. Minor.

COURT CLERK: Court stands adjourned until tomorrow morning at 9:30.

(Whereupon, the proceedings held on January 24, 2013, were ended at 4:40 p.m..)

CERTIFICATE OF OFFICIAL REPORTER

I, NANCY L. FREDDOSO, RPR, Federal Official Court Reporter, in and for the United States District Court for the Northern District of New York, do hereby certify that pursuant to Section 753, Title 28, United States Code that the foregoing is a true and correct transcript of the stenographically-reported proceedings held in the above-entitled matter and that the transcript page format is in conformance with the regulations of the Judicial Conference of the United States.

S/NANCY L. FREDDOSO, RPR

Federal Official Court Reporter

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,

vs. 12-CR-028

TIMOTHY M. MCGINN,
DAVID L. SMITH,

Defendants.

****

Transcript of the Trial Proceedings held on January 25, 2013, before the HONORABLE DAVID N. HURD, at the United States Federal Courthouse, 10 Broad Street, Utica, New York, before Nancy L. Freddoso, Registered Professional Reporter and Notary Public in and for the State of New York.

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I N D E X O F P R O C E E D I N G S

I N D E X O F E X H I B I T S

(WHEREUPON, the proceedings held on January 25, 2013, were commenced at 9:30 a.m..)

(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Good morning, all. Members of the jury, thank you for being with us. We will continue and conclude this morning with the testimony of Mr. Smith, and then we will adjourn.

Ms. Owens, you may continue with your direct examination.

MS. OWENS: Thank you, Your Honor.

DIRECT EXAMINATION BY MS. OWENS:

Q. Good morning, Mr. Smith.

A. Good morning.

Q. I would like to show you, it is Government's Exhibit GA11. Is this one of the PPMs that you reviewed in your analysis?

A. Yes.

Q. Okay. This is for Integrated Excellence Jr. Trust 08?

A. That's right.

Q. And can you just briefly give us the background on this deal?

A. This is the junior portion of the Integrated Excellence Trust 08. There was also a senior portion. It had a maximum offering of nine hundred thousand dollars. This one had a maximum offering of five hundred and eighty thousand dollars, minimum of two hundred and fifty thousand. And it was a six and a half year term paying ten percent interest.

Q. Okay. Is it six and a half or five and a half?

A. Yes, five and a half. Thank you.

Q. All right.

MS. OWENS: If we could go to page four, please. If we can just highlight the top section, the summary of the offering.

BY MS. OWENS, CONTINUED:

Q. The summary of the offering, did you read this section?

A. Yes.

Q. Okay, and it says in the first highlighted sentence: The sole business activity of the trust fund will be to acquire the junior tranche of a financing secured by a portfolio of contracts?

A. Yes. So the structure of this trust was slightly different in the sense that it didn't explicitly have an operating company like the rest of them. It did acquire financing that was secured by a senior participant

which, later in the document, indicates that it is McGinn, Smith Transaction Funding. But it actually acquires that financing. So it says here the trust fund will acquire the junior tranche of a financing secured by the contracts owned and originated by Integrated Excellence Funding, LLC, which is an alarm servicing company in Georgia.

Q. A non-McGinn, Smith entity?

A. Correct.

Q. Okay.

MS. OWENS: If we could go to page five. And if we can go under the compensation and fee section?

A. Yes.

MS. OWENS: Make that a little bit larger, please.

BY MS. OWENS, CONTINUED:

Q. So compensation and fees, this is where it references McGinn, Smith Transaction Funding Corporation, MSTF?

A. Yes, it says that MSTF will be paid a brokerage fee in connection with the acquisition. So a brokerage fee simply -- it is basically a spread, again, but the difference here is that this language indicates that MSTF is actually going to earn that spread as income. And so the language says brokerage fee.

Again, that's just calculated by the difference

between the amount of money raised for the debt offering and the amount of money that is actually advanced by MSTF to the Georgia company.

Q. All right, and MSTF, you are familiar with that entity as well?

A. Yes.

Q. What was the purpose of that entity, if you recall?

A. The purpose was essentially to act as a bridging facility to advance funds to get deals started and basically smooth out the closing process of the trust raises.

Q. Okay.

MS. OWENS: And if we could please go to page seven. And then down towards the bottom, business of the trust fund.

BY MS. OWENS, CONTINUED:

Q. Okay. So I see here as Integrated will convey fifteen thousand of recurring monthly revenue, RMR, by July 15, 2008, as collateral for the financing?

A. Yes. This is information that can be used to figure out basically the intended loan or proceeds that will go to purchase the contracts. So you have to use this sentence in conjunction with some information on the next page, but it basically says that initially they are going

to pledge as collateral fifteen thousand dollars of monthly revenue. And then it is anticipated that that amount will grow by somewhere around another twenty-five thousand dollars.

Q. Okay. So that subsequently it is anticipated that approximately an additional twenty-five thousand of RMR will --

MS. OWENS: If you can go to the next page .

BY MS. OWENS, CONTINUED:

Q. -- be contributed by December 31, 2008, as collateral for the financing. Then it has another, I guess, RMR calculation. Could you please explain that?

A. Yes. So this is how you discover what the purchasing price of that RMR is. So it says they will pay 26.67 times whatever the eventual pledged monthly revenue is. The language in that document says that it is going to be approximately forty thousand dollars. And so you can use that multiplication to come up with basically what the maximum loan to Integrated Excellence Funding would be.

MS. OWENS: If we could go to page forty-five.

BY MS. OWENS, CONTINUED:

Q. And is this the monitoring receivable financing agreement that you were talking about before between Integrated Excellence Funding, LLC and McGinn, Smith

Transaction Funding Corp?

A. Yes.

MS. OWENS: And the next, please.

BY MS. OWENS, CONTINUED:

Q. And then this outlines the terms of the agreement?

A. Yes, and I believe there is a sub-exhibit to this agreement that indicates the interest rate on that loan.

Q. I think it is on page sixty-five. Is this it?

A. Yes. So at the very top it says nominal annual rate 21.35 percent.

Q. And that figures into the calculation rate that you were talking about before?

A. Yes, that would be used to figure out what the payment schedule on that loan would look like.

MS. OWENS: If we could go to page ninety-five or ninety-six.

BY MS. OWENS, CONTINUED:

Q. What is this?

A. This is the payment schedule that the trust will pay to investors for the senior portion of the trust. So it shows the senior tranche beginning balance in the middle of nine hundred thousand. That is based on the maximum raise. That deal paid nine percent interest and, after the

first three months, was scheduled to begin amortizing. And so, again, that is just a payment schedule that is found in the PPM that you can use to analyze the deal.

Q. Okay. Was there a schedule for the junior participants?

A. There is. I think it is just a few pages down.

Q. I believe it is ninety-nine. Or one hundred or one hundred one. Junior participants schedule cash flow?

A. Yes.

Q. Is this something else that you reviewed?

A. Yes, and this just shows the junior beginning balance of five hundred and eighty thousand, which would be the maximum raise. And it pays ten percent interest only until the senior deal has been fully paid back and then it begins to amortize later on?

Q. Okay. So the five hundred and eighty thousand dollars, that was what we looked at on page one of the PPM where it says maximum raise five eighty?

A. Yes.

Q. And was there a minimum raise in this deal?

A. Two hundred and fifty thousand dollars.

Q. And I believe you said when you were looking at the senior participant schedule there was nine hundred thousand dollar maximum?

A. Yes.

Q. Was there a minimum associated with that as well?

A. I believe it was also two hundred and fifty thousand.

Q. And from the scheduled cash flows and interest rate and RMR calculations that we just discussed, did you derive an intended funding amount from this data?

A. Yes, I did. And when you say that, you mean intended funding to Integrated Excellence Funding?

Q. Yes, yes.

A. Yes.

Q. Did you prepare a model based upon the information in the PPM?

A. I did.

MS. OWENS: Defendants move to admit Defense Exhibit 196.

MS. COOMBE: You have my continuing objection, Your Honor.

THE COURT: Received.

(Exhibit No. 196, received.)

BY MS. OWENS, CONTINUED:

Q. And this model that you prepared, what is this representing?

A. So using the language in the PPM that discusses the multiple that would be paid for the recurring monthly

revenue. I derived a maximum funding or an intended funding of nine hundred and ninety-six thousand, six fifty-five. And then from the exhibit there, we saw that the loan would pay interest at 21.35 percent.

And so this is just another payment schedule that amortizes that loan. And something that's interesting to point out, in the first six months when the RMR that's pledged is actually less than that full intended amount, the interest payable on that nine, ninety-six is, in fact, greater than the amount of available cash flows. So we call that paying in kind.

So they pay as much cash as is available. And that's shown in the total debt service of seven thousand dollars. And then the remaining ten thousand, four hundred from that interest payment is actually added to the principal.

So in the early stages of the loan, you actually see the principal balance increase. And then as more RMR is pledged, it finally generates enough cash to start paying down the loan from Integrated Excellence Funding.

Q. Okay. So we see in that RMR column, it is the third column from the left, the payments or the increase as the months go on?

A. Yes.

MS. OWENS: If we could move down to the

bottom.
BY MS. OWENS, CONTINUED:
Q. This is the model that you structured for both the senior and the junior raises?
A. Well, this is the -- this first page is the cash flows from Integrated Excellence Funding that will be available to service, the payment schedules for two trust offerings. And we can see those payment schedules on the next two pages, but they were just pulled directly from the PPM.
Q. Okay.
MS. OWENS: If we could just go to the second page.
BY MS. OWENS, CONTINUED:
Q. And this is the payments to the senior trust?
A. That's right. It shows nine percent interest. And again, it is a mirror image of the information in the exhibit in the memorandum.
MS. OWENS: And if we could go to page three.
BY MS. OWENS, CONTINUED:
Q. This is for the junior trust and reflects that five hundred and eighty thousand dollar raise?
A. Yes.
Q. So these, the models that you put together based

upon the information in the PPM for both the senior and junior raise, that's all the -- at the time the PPM is written, that's what is intended to occur based upon the information in the PPM?

A. Yes.

Q. Is that a fair statement?

A. Yes.

Q. So did events occur after the raise that affected what was intended to occur?

A. Yes. There were two limiting factors. The first was that Integrated Excellence Funding, I believe the agreement actually calls for sort of a line of credit. So they can take in that loan up to a certain amount. And I believe at some point they decided that they didn't need any more capital.

And sort of around the same time, the junior trust failed to raise the maximum amount of funding. So instead of raising five hundred and eighty thousand dollars, the junior trust actually raised two hundred and seventy thousand.

Q. Does that have an effect on the brokerage fee?

A. No.

Q. Did you prepare a summary on these three models, one summary sheet?

A. Yes.

Q. All right. I would like to show you Defense Exhibit 196A.

THE COURT: That's received over objection.

MS. OWENS: Thank you.

(Exhibit No. 196A, received.)

BY MS. OWENS, CONTINUED:

Q. Can you just briefly summarize what this exhibit reflects?

A. Sure. This is, again, based on the intended loan to Integrated Excellence Funding and also a maximum raise in the junior and senior trusts. But it, again, shows a funding amount of nine ninety-six, six fifty-five at 21.35. Based on the total debt service payments prepared and the schedule we just looked at, the cash flow that's generated from loan is one million, nine seventy-one, five zero six.

There were also partner loans that were paid out of the brokerage fee that was earned by MSTF in the amount of -- total amount of eighty-five thousand dollars, so repaid at three percent. If you make those loans available to the trust, that's another one hundred thousand and five dollars. So the total cash available from the deal is two million, seventy-one thousand, five twelve. And in order to retire the debt with interest, you need two million thirty-eight thousand, one seventy-nine. So there would be

a resultant equity, expected resultant equity of thirty-three thousand, three thirty-two. And that equity would actually belong to the trust because there is no operating company.

Q. The brokerage fee that we discussed before you put together the calculation is based on the information that we just discussed?

A. Yes.

Q. I would like to show you previously admitted Exhibit 229. And is this calculation based upon what actually happened in the raise?

A. Yes. This shows that the senior trust raised its maximum amount of nine hundred thousand. The junior trust raise two hundred and seventy thousand. So the gross raise on the whole trust was a million, one seventy.

And underwriting fees were paid to the broker-dealer out of the senior escrow account of fifty-six thousand, seven hundred and that encompassed the underwriting fee for both the senior and junior. So that leaves you with a net raise of one million, one thirteen, three hundred.

And the trusts, themselves, directly lent three hundred and twenty-nine thousand, one seventy-nine to Integrated Excellence Funding. MSTF was actually used prior to the deal closing as a bridge facility. So they

lent actually three hundred and sixty-eight thousand, six hundred and thirty-six dollars to Integrated Excellence Funding. And the trust repaid them this number here, which is three fifty-eight, four hundred. So that left an outstanding balance that the trust never repaid MSTF for of roughly ten thousand dollars.

So using those numbers we know that Integrated Excellence Funding actually received for their loan six ninety-seven, eight fifteen. And so the way that the brokerage fee here is determined is the net raise minus the loan to Integrated Excellence Funding. And that generates a brokerage fee due to MSTF of four hundred and fifteen thousand, four eighty-five. And then they also are still owed that remaining balance on the bridge facility.

So the trusts, the Integrated Excellence trusts, owed MSTF four hundred and twenty-five thousand dollars, and MSTF didn't receive any of that money. Instead the trust made some agency transfers on behalf of MSTF.

The first was an investment banking fee to McGinn, Smith of one hundred and ninety-seven thousand dollars. And in the summary financial statements that I created, that becomes an expense of MSTF and it is paid out of the brokerage fee, which is recorded as income.

And then there is three other agency payments that are made directly from the trust, but on behalf of

MSTF. That's the ninety-seven thousand dollars that goes from the junior escrow account to the Firstline Senior Trust. The forty-five thousand dollars that goes from the junior escrow account to the TDM Luxury Cruise Trust, and eighty-five thousand dollar loan to partners.

Those four disbursements add up to the exact amount of what MSTF was due to receive from the trust. So because of the agency relationship there, all those transactions, even though the physical money actually was transferred from the Integrated Excellence trust accounts, on my summaries they are recorded as expenses and loans from MSTF.

Q. And did you -- so based on this, you also did a substantial review of the bank statements associated with the Integrated Excellence trust?

A. Yes.

Q. Okay. I would like to show you a defendants exhibit, Exhibit 197.

MS. OWENS: Move to admit Exhibit 197.

THE COURT: Received over objection.

(Exhibit No. 197, received.)

BY MS. OWENS, CONTINUED:

Q. And is this tracking the bank transactions that you created for Integrated Excellence?

A. Yes, it is.

Q. Okay, and we see just like we saw yesterday the blue for investor deposits, and I see you have it broken down between the senior, the senior trust and the junior trust?

A. Yes.

Q. And remind me what the minimum raises were for each?

A. Two hundred and fifty thousand in both the senior and the junior.

Q. So for the senior trust, I see a date of June 1st, 2008, and a deposit of five hundred thousand dollars?

A. Right. So by that time escrow has been broken in the senior account.

Q. And then for the junior?

A. So here there is one hundred and five thousand that comes in on 7/30 and one hundred and forty-five thousand that comes in by 8/30. I believe when I prepared this I was just looking at the total deposits at month end, and that's why you have just the ending dates and the large deposits. So we wanted to see when escrow was actually broken in the junior account so we last night looked at the bank statement for this account, and I think we are going to show that. But it turns out that escrow was actually broken on August 28th and not August 30th.

MS. OWENS: Defendants move the admission of Exhibit 197C?

MS. COOMBE: No objection.

THE COURT: Received.

(Exhibit No. 197C, received.)

BY MS. OWENS, CONTINUED:

Q. This is a Mercantile bank account statement for Integrated Excellence Junior Trust. This is one of the bank statements that you reviewed in putting together that transaction spreadsheet?

A. Yes.

Q. And this is for -- goes until August 31, 2008?

A. Yes, and if we just move the down the page just a little bit, you can see that the one hundred and forty-five thousand in deposits that I recorded on the spreadsheet, the last deposit comes in on 8/28 for ten thousand dollars. And that's the deposit that meets the escrow requirement.

MS. OWENS: If we could just go back to Defense Exhibit 197, please.

A. So if we just scroll down to the green section, it is just important to point out that the transactions, the agency transactions that come out of that brokerage fee that we just discussed, are all transferred out of various accounts after escrow has been broken.

So the one hundred and ninety-seven thousand, twenty-four comes out of the senior escrow account on 6/19, which is after the escrow agreement has been met for the senior account. And then we see -- if we move over to left a little bit. These are two of the three partner loans on 7/1 of thirty-five thousand and thirty-five thousand, both from the senior escrow account as well. So that's after the escrow agreement has been broken. And then just on the next page there is just a couple of more.

7/15 is the final fifteen thousand -- I am sorry. You have got to go back one. At the top it shows fifteen thousand. That's the third transaction that makes up the partner loans. And then we see the final two, which is the ninety-seven thousand from Firstline Senior Trust on 8/29. And also on 8/29 is the forty-five thousand that we discussed that was transferred to TDM Luxury Cruise. And both of those transactions happened the day after the junior escrow was broken.

Q. So I see those transactions occurred on August 29, 2008, and that Mercantile bank account statement that we looked at, it showed that one hundred and forty-five thousand dollar deposit breaking escrow on August 28, 2008?

A. Yes.

Q. Okay.

MS. OWENS: And if we could just go to the last page.

BY MS. OWENS, CONTINUED:

Q. We won't go through this spreadsheet in the same amount of detail as we did with the TDM Cable Trust, but -- so this actually has an operating account balance of over thirty-one thousand dollars. Is that because it didn't have a -- there was no surplus because it didn't have an associated operating company?

A. Yes, and also the interest expense, the last interest expense that was recorded on the bank statements I looked at was on 3/16 of 2010. Oftentimes investors would receive checks, physical checks, instead of wires into their accounts. And as people do sometimes they just don't deposit them the day they get them. And so it is likely that income came in and was recorded to make those payments, either other payments that were made in March or more likely April payments that just weren't cashed by the end of April.

So, here, there is an operating account balance of thirty-one thousand three fifty-four, zero six. And we were actually able to look at the May bank statements, at which point there was a closing transaction for that full amount that was initiated by the Receiver. I am not sure where the money went to.

MS. OWENS: At this time the defendants move the admission of Exhibit 197B, like boy.

THE COURT: 197B?

MS. OWENS: Yes.

THE COURT: I believe that has already been received.

MS. OWENS: Okay.

THE COURT: That's the bank statement?

MS. OWENS: Yes, Your Honor.

BY MS. OWENS, CONTINUED:

Q. And this is for Integrated Excellence Junior Trust. And the spreadsheet that we are looking at was both for junior and senior. So this April 2010 statement has a zero balance in it?

A. Yes.

MS. OWENS: And if we can go to the next page.

BY MS. OWENS, CONTINUED:

Q. This is the bank statement for the senior trust?

A. Yes. And this is the May statement that I talked about. So you see that it has income coming in. It has a balance of thirty-one thousand, two fifty-four, zero six. And then there is a check written or a debit of some sort of -- I think it is just a closing transaction that zeros out the account.

Q. Okay.

MS. OWENS: And if you can scroll down a bit.

BY MS. OWENS, CONTINUED:

Q. Is that -- this is just the miscellaneous debit?

A. Yes.

Q. I understand that you said MSTF wasn't truly the operating company for Integrated Excellence. Did you still prepare some tracking of the flow of funds based upon your review of the bank statements and an understanding of the private placement memorandums for both MSTF and Integrated Excellence?

A. Yes.

MS. OWENS: Defendants move the admission for Defense Exhibits 192, 190, 194.

THE COURT: Received over objection.

(Exhibit No. 192, 190, 194, received.)

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, I am going to show you Defense Exhibit 192.

A. Okay.

Q. This is a profit and loss detail, okay. It is a little bit -- looks a little bit different than the balance sheets that we have been looking at?

A. Yes, this is, again, another financial statement

that was prepared basically summarizing all of the transactions that took place by MSTF on both cash transactions and agency transactions.

So the brokerage fee that we were discussing is recorded here as income. If you look at -- just from the top, maybe that one, two, that third section down, it says investment banking fee income. And the top line there says Integrated Excellence Senior Trust, Integrated Excellence brokerage fee. And if you move to the right, it indicates the amount that we calculated, which was four thirteen, seven eighty-eight. And then from that is where those agency transactions are paid out of.

So if we move down to the expense section, we will be able to see that one hundred and ninety-seven thousand dollars that was paid to McGinn and Smith as an investment banking fee. And I believe it is under a heading called professional fees. So just -- I think these sections go alphabetically. So it is just on the next page. Right there.

So again, the top line, and this is the investment banking fee that's paid by Integrated Excellence Senior on an agency basis. So again, there is no cash actually flowing through MSTF to record these transactions, but because the -- both the income and the expense are paid on an agency basis, I record both of them here. So if we

could just move to the right, you will see that it is one hundred and ninety-seven thousand, twenty-four.

MS. OWENS: Could you just move to the right a little bit, please?

A. And it is there on the top line.

BY MS. OWENS, CONTINUED:

Q. And I am just going to show you Government's Exhibit GB2. What is this, Mr. Smith?

A. This is the private placement memorandum for McGinn, Smith Transaction Funding. This is a ten million dollar maximum offering, a minimum of five hundred thousand. And this deal also had a minimum purchase of two hundred and fifty thousand. And that was not a hard and fast rule but just suggested.

And the way that this deal was structured was it would pay eight percent on the loan every -- I believe two percent a quarter. And then it also had a participation agreement or basically sort of a kicker based on the investment banking business that McGinn, Smith & Company actually transacted. So the actual numbers are in here somewhere, but as more business was generated, it would pay a higher and higher percentage at the end of the year to the investors in this deal.

Q. Okay, and I see that McGinn, Smith Transaction Funding Corp. is just a little bit different than the trust

transactions that we have been reviewing so far?

A. Yes. So this is set up as a corporation. And so this is simply a debt offering within that corporation. So just like any business would, any normal business would raise money through a combination of debt and equity and, you know, have an ownership structure. And so the investors in this debt deal are nothing more than the debt portion of that company. The corporation has the obligation to those investors.

Q. Okay.

MS. OWENS: If we could go to page five. And just highlight I believe just underneath the heading McGinn, Smith Transaction Funding Corporation.

BY MS. OWENS, CONTINUED:

Q. So I see in the paragraph in the middle, it says, the company will also -- or the company will also invest in other public and private securities deemed by management to be creditworthy. What do you understand that sentence to mean?

A. This paragraph dictates what the corporation is intending to do to run its business. So the primary function is actually -- in the first sentence -- and that's to be a bridge facility, as I explained before to get new trust deals going or really any deal that McGinn, Smith is going to offer through as broker-dealer. So this company

would be the facility that would close that deal. And then an offering would be made through a trust or some other vehicle and would pay them back the bridge loan.

So it says that the company anticipates that those activities will experience durations of ninety to one hundred and fifty days. And then it says the company will also invest in other public and private securities deemed by management to be creditworthy.

And the next sentence is also important. It says: The company has agreed to purchase one million, five hundred thousand dollars of McGinn, Smith & Company Preferred Stock. So this is an equity investment that the company is making in the broker-dealer. They are going to exchange money for equity in the broker-dealer.

Q. So a reading of this paragraph, it lays out three purposes for MSTF. One to provide bridge financing to raises undertaken by McGinn, Smith, I guess it is meaning the broker-dealer?

A. Yes.

Q. Two, that it is able to invest in public and private securities that the management deems are creditworthy. And three, purchase 1.5 million of preferred stock?

A. That's right.

Q. Okay. So the first two, bridge financing and

investing in public and private securities deemed by management to be creditworthy, those are sort of broad mandates almost?

A. Yes, they are. You know, those two sentences can almost be wrapped together and looked at as sort of a blind investment pool. So the investors in this deal are reading that and saying management is going to decide how to utilize the capital.

Q. I would like to show you Defense Exhibit 190.

THE COURT: 190, is that admitted.

MS. OWENS: I believe I moved a number of them in the beginning, 190.

THE COURT: All right. Received.

(Exhibit No. 190, received.)

BY MS. OWENS, CONTINUED:

Q. It is a balance sheet with the balance sheet detail. Is that something that you prepared?

A. Yes.

Q. What does this balance sheet detail include?

A. Again, this is a summary of all the transactions, both cash and agency transactions, that took place through April of 2010 for MSTF.

MS. OWENS: Go to page five, please.

BY MS. OWENS, CONTINUED:

Q. And I see it starts: Due from CMS Financial

Services, and then you said what the amounts of that were. So those are all of the --

A. These are the assets of MSTF.

MS. OWENS: If we can go down a little bit more. Stop please.

BY MS. OWENS, CONTINUED:

Q. Okay. I see due from David Smith. And there is some more detail there?

A. Yes. Again, I think we are just a little out of order here, but this is again referencing the agency payments from the brokerage fee of four thirteen. So we are just showing that the loans to the partners and the loans to MS Funding, which eventually paid the ninety-seven to Firstline and TDM Cable Funding, which eventually paid forty-five thousand dollars to Luxury Cruise, are all carried on the balance sheet of MSTF as assets.

So, here, due from David Smith will show the thirty-five thousand dollar loan that he received, which was paid by Integrated Excellence. And if we go down the page a little bit, we will see the other ones. So this is due from MS Funding at the bottom here. And just maybe about a quarter of the way down, there is a transaction on 8/29 that says paid to Firstline Senior Trust from INEX Senior on behalf of MSTF. And that's the ninety-seven thousand dollars that we referenced before.

And then if we keep scrolling down, we will see the other two. I actually can't see the left side, but here is the two from the Timothy McGinn account. And the top two lines make up the other fifty thousand of the partner loans. So it came in two transactions, thirty-five thousand and fifteen thousand.

Q. And this is the brokerage fee that we talked about before that was owed to MSTF from Integrated Excellence?

A. Yes.

MS. OWENS: And if we could go to page eight.

A. This is actually a liability of MSTF. And that liability is owed to TDM Cable Funding due to a number of agency transactions and loans that they company received form TDM Cable Funding. So we are looking for the forty-five thousand dollar payment that was made to Luxury Cruise Trust. And it is here on 8/29, again, about a -- maybe -- yes. You have got cursor right on it. So that's the forty-five thousand dollars that was transferred from Integrated Excellence on behalf of MSTF.

Q. And yesterday you testified that back in May of 2010 you requested a bunch of McGinn, Smith internal accounting staff QuickBook records, you requested them from the Receiver or from the CFO at the time, Mr. Brian Shea?

A. Yes.

Q. Okay, and based on those QuickBooks, were you able to put together some spreadsheets? I think before earlier in this balance sheet detail, it said some payments to the Fisher family and Cornacchia?

A. Yes. So I used the bank statements and also reviewed the existing McGinn, Smith accounting records for MSTF, and I created a spreadsheet that is really sort of a snapshot of just one account within this balance sheet, which is the loan that MSTF makes to MS Advisors and MS Capital Holdings.

Q. I would like to show you previously admitted Exhibit 194. Is this the spreadsheet that you prepared?

A. Yes.

Q. And this is actually a little bit different than the spreadsheets that we were reviewing before because it says loans to MS Advisors and MS Capital Holdings?

A. Yes, it looks the same. It is set up in the same way in the sense that I have looked at specific bank transactions and organized them into sections.

But this is -- this focuses on just the bank statements of MSTF and just those transactions that relate to the loan account from MSTF to MS Advisors and MS Capital Holdings. So the blue section at the top is -- these are agency payments that are made from MSTF to the Fisher

family, and they are booked as loans to MS Advisors. So essentially that means that each of these payments will be repaid by this company called MS Advisors and MS Capital Holdings. I guess the two companies are combined to have that obligation.

Q. And that's just based upon the books that you received from Mr. Shea?

A. Yes.

Q. So you see the blue is the Fisher family. These are all -- and you said these are all recorded on the books. Did you review the bank statements as well?

A. Yes.

Q. Okay.

MS. OWENS: Just go down to the second page.

BY MS. OWENS, CONTINUED:

Q. And then there is a Mr. Joseph Cornacchia?

A. Yes, and those payments total sixty thousand dollars. And then the green section is payments that went to other members of the Fisher family, his wife, his kids, his grandkids I think.

Q. All right.

MS. OWENS: Go to the next page, please.

A. And then when I was reviewing the books of MSTF, the internal accounting books, this loan account also showed two transactions or three transactions, rather that

were not payments to individuals. The first two is one hundred and fifty thousand and one hundred and twenty-five thousand of money that was transferred to McGinn, Smith & Company and booked, again, as a loan to MS Advisors on an agency basis.

And then there is also a payment to Verifier Capital that -- it was indicated that it was a reverse commitment fee for Verifier Capital. I wasn't exactly sure what that meant, but I recorded it because it was a cash transaction on the statements and in the records.

So then below that, I actually removed -- in my analysis, I removed the one hundred and fifty and one hundred and twenty-five from this loan account because, as we looked at before, McGinn, Smith Transaction Funding is mandated to purchase preferred stock from McGinn, Smith & Company. And these are transactions, this is money that's flowing between those two entities, but the consideration for that transfer is not recorded in the internal books as a purchase of preferred stock. Instead it is recorded as a loan to MS Advisors on an agency basis. And that just doesn't make sense.

So what does make sense is that McGinn, Smith Transaction Funding would be purchasing the preferred stock that is dictated in the private placement memorandum. So I removed from this loan account, I have removed that two

seventy-five as money that MS Advisors would have to pay back to MSTF.

And then if we could just move down the sheet a little more, there is a blue section that says accrued interest. This is a calculated number at eight percent. The internal books had already calculated an accrued interest number on this account at eight percent, but that number was calculated on a balance that still had the two seventy-five that I removed in the loan account. So I recalculated that number. And so MS Advisors on this loan account would owe twenty-three thousand, one forty-nine in interest to MSTF.

BY MS. OWENS, CONTINUED:

Q. So just -- I think it was a little bit difficult to see before, but just to recap, the blue section you see the one hundred and fifty thousand dollars and one hundred and twenty-five thousand dollars and that reverse commitment fee from Verifier Capital that you just talked about, and you said that these were booked to McGinn Smith and Company, but you removed them because based upon your reading of the private placement memorandum, you understood that this should have actually have been going for the purchase of preferred stock?

A. Yes, and just to be clear, I did not remove the actual transactions from the book and records. All I did

was, because that's a cash transaction and it happened and it is on the books and records. What I have done here is I have removed it from the loan account to MS Advisors, and I have instead classified those cash transactions as the purchase of preferred stock, which is what McGinn, Smith Transaction Funding is supposed to do.

So it is just -- the only difference here is that I have replaced -- on the balance sheet of MSTF, I have replaced one asset with another, and I have replaced it with the appropriate asset.

And then if we move to the next page, there is a number of transactions that come into this loan account. This is money that physically comes into MSTF, and it comes into MSTF from various entities. And you will notice the Four Funds, TAIN, FIIN, FEIN, and even FAIN. Those are also agency transactions. And those payments are used to pay down the MSA MSCH loan.

So these transactions were actually on the internal accounting books that I looked at. They were classified that way. And so that indicates that they are repayment of the MSA loan on an agency basis. So the effect that that would have on MS Advisors and the Funds would be that there would be some asset and liability created between those two entities. And so the total here is in repayments is seven hundred thousand dollars. And

that actually turns out to overpay the loan that was due by MS Advisors with interest by an amount of forty-seven thousand, five hundred and one dollars.

Q. I am going to this show you a previously admitted Exhibit 208. Do you recognize this, Mr. Smith?

A. Yes.

Q. What is it?

A. I believe -- can we just go up a little bit so I know what I am looking at? Yes. This is the McGinn, Smith Transaction Funding general ledger that was prepared by the McGinn, Smith accounting staff.

MS. OWENS: If we could go to page eleven, please.

A. So this is the asset on the balance sheet that I was just speaking about, which is a loan to MS Advisors and MSCH. And that is indicated by the title that says DF or due from MSA and MSCH.

And so we might want to zoom out a little bit. I know it is hard to see.

So this shows all of those payment transactions that I had organized. And this also includes the one hundred and twenty-five and one hundred and fifty thousand dollar transfers that went to McGinn and Smith, the broker-dealer, and were booked as loans to MS Advisors. And I think you can see those on -- 9/23 is the first one

for one hundred and fifty thousand. And on 11/14 at the very bottom is one hundred and twenty-five thousand.

MS. OWENS: Leslie, can you just enlarge that, please? It is difficult to see.

BY MS. OWENS, CONTINUED:

Q. So on 9/23, it is booked to McGinn and Smith for one hundred and -- I think it was fifty thousand dollars?

A. Yes.

Q. And then on November 14th, there is another McGinn, Smith entry for one hundred and twenty-five thousand dollars. So this is in the due to MSA and MSCH?

A. Due from MSA and MSCH.

Q. Due from?

A. Yes. So these two transactions as they are recorded here are essentially the money is being transferred to the broker-dealer and is indicated that it will be repaid by another entity, McGinn, Smith Advisors. So it is booked as a loan to MS Advisors.

Q. But based upon the reading of the private placement memorandum, it should have been for preferred stock?

A. Right. So these transfers should show up in a different asset account, which is McGinn and Smith Preferred Stock. I think we were looking at it.

MS. OWENS: Leslie, I believe it is page

thirteen. Here we are.

BY MS. OWENS, CONTINUED:

Q. And there would be the MS Preferred Stock ledger items. So we see some entries booked on May 2nd, November 26th, and April 14th.

MS. OWENS: And keep scrolling over to the right.

A. So, yes, this indicates that there were three transactions that were booked directly as transfers from MSTF to McGinn and Smith in exchange for preferred stock. And the interesting thing here is that the two transactions that were incorrectly booked in the MS Advisors loan account actually happened in between all these three transactions. So it was done correctly, then incorrectly, then correctly. I don't really have an explanation for that.

MS. OWENS: And at this time defendants move for the admission of Exhibits 186, 187, and 188.

THE COURT: Received over objection.

(Exhibit No. 186, 187, 188, received.)

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, I would like to show you Defense Exhibit 186. Is this a chart that you prepared based upon the ledger from the McGinn, Smith general accounting staff?

A. It is, but it is actually more accurately

prepared using the spreadsheet that we had looked at that I prepared which removes the one twenty-five and one-fifty. So this is just a timeline of that loan account because when you look at the spreadsheet I prepared, because it sections things off and all the repayments are made on the last section, this sort of puts things into a chronological order.

So starting at the left, it shows that the first agency payments are made on behalf of MSA and MSCH on May 15, 2008. And then those payments grow that loan balance eventually up to a balance of five hundred and eleven thousand, four thirty-two by October 30th. And then two weeks later on November 14th, the first repayment on that loan is made of one hundred and twenty-five thousand dollars.

And so this pattern just continues as time goes on where agency payments are made on behalf of MS Advisors and recorded as a loan to MS Advisors. And then that loan is repaid on an agency basis by either TAIN or FEIN or FIIN or whichever fund repays that loan. So this just indicates how chronologically the balance of that loan account is increased and then repaid, increased and then repaid.

Q. All right. I would like to show you Defense Exhibit 187. Are these some charts that you created detailing what we have been talking about with the loans to

Mr. Fisher and Mr. Cornacchia and discussion of the McGinn, Smith Preferred Stock purchases?

A. Yes. So this is just a summary of what we have been discussing. And it just puts it in more of a visual way to look at it.

So the text box on the top right shows the total amounts that were paid on behalf of MS Advisors to Fisher and Cornacchia. So that total was six hundred and twenty thousand, 849.

And then below that, the box that reads six hundred and fifty-two thousand, four ninety-eight, that number includes the twenty-three thousand dollars in accrued interest that we discussed. And it also includes -- because here we are looking at balance of that loan account, there is also that eighty-five thousand dollar -- or excuse me, eighty-five hundred dollar reverse commitment fee that I did not have an explanation for, but it was part of the loan account. So that's included there.

And that's the amount of money that needs to be paid back to MSTF by MS Advisors. Moving over to the sort round circle here, because seven hundred thousand dollars was transferred from the funds to MSTF on an agency basis. Essentially what that does is reduces the liability of fees that are owed from the Funds to MS Advisors.

So what could have happened here is the Funds

could have paid seven hundred thousand dollars in cash to MS Advisors, and they could have taken the cash and paid it to MSTF to pay off their loan. Instead we just have an agency transaction where the Funds, instead of paying their fees due, just paid MSTF on behalf of MS Advisors, kind of like when we were talking yesterday about the loan to Mr. Jones and Mr. Dreyer, and Mr. Jones pays Mr. Dreyer's National Grid bill.

And so the end result here is that MS Advisors has repaid its entire loan with interest and also contributed another forty-seven thousand, five hundred and one dollars to MSTF. How that extra money is recorded is sort of unclear. It could be an equity infusion into the business or it could be recorded as a loan. The other way, now a loan to MSTF from MS Advisors. Either way it is fairly immaterial here.

Q. And I think that we skipped over this point, but MS Advisors, is that an investment vehicle, what exactly is that?

A. No. It is an entity that is owned by Mr. Smith and Mr. McGinn.

Q. What's the purpose of it?

A. I know that it has a relationship to the Four Funds in that it is the entity that earns the management fees associated with those deals.

MS. OWENS: If we can go to the next page of this slide or this PowerPoint?

A. So again, this is just another way to look at the transfer of seven hundred thousand dollars from the Funds directly to MSTF. So the Funds have a liability, which are fees due to MS Advisors. And MS Advisors has an equal asset, which is the fees that they are supposed to receive from Funds.

And then MS Advisors also has a liability, which is the loan that was created through the payments to the Fishers and Cornacchias with interest, and that is six hundred and fifty-two thousand, four ninety-eight. Again, MSTF has the offsetting asset that they are supposed to receive that money from MS Advisors. So this is sort of the setup and the scenario. And then on the next page we will see how it gets repaid.

So this shows the first five hundred and fifty thousand dollars being paid directly from the Funds over to MSTF. And the effect that that has is that it reduces every one of those accounts by that amount. So the MS Advisors, both their asset and their liability to MSTF, are both reduced by five fifty. And MSTF reduces or gets repaid that, the asset they had, by five fifty. And the Funds reduce their liability in fees owed to MS Advisors by five hundred and fifty thousand. And then on the next page

we will -- just sort like a moving diagram I guess.

So now, the final one hundred and fifty is transferred. And so this pays off that liability of the fees owed. MS Advisors doesn't have a claim to any more fees in relation to this transaction. And they have now contributed an extra forty-seven thousand, five hundred and one to MSTF.

Q. So at the end of this very complicated transaction, the result is in that green circle after the loans go out and are paid back, the net result is that MSTF owes MS Advisors the forty-seven thousand dollars?

A. That's right.

MS. OWENS: Go to the next page, please.

BY MS. OWENS, CONTINUED:

Q. What this Mr. Smith?

A. So this now shows how the repayment of that MS Advisors loan, which is made by the Funds comes in to MSTF and then is subsequently transferred to McGinn, Smith in change for preferred stock. And these are -- these three transactions that we looked at, which total five hundred and twenty-five thousand dollars. And it is just breaking them out by date and by specific fund.

But it just shows that the money comes into MSTF as a repayment of the loan that they made to MS Advisors. And they use that money to make a new investment in McGinn,

Smith Preferred Stock. And that investment, of course, is directed by the PPM.

Q. And if we go to the next page?

A. Yes. This is just a closer look at the actual asset on the McGinn, Smith Transaction Funding books of how much preferred stock they actually own, which is a million, six seventy-five. And so, of course, we read in the PPM they are mandated to buy a million -- 1.5 million dollars of preferred stock. But we also read that they can make investments in public and private securities that are deemed by management to be good investments.

So that language, I just wanted to point out, that language doesn't put a limit on the amount of preferred stock that MSTF can buy. It really puts a floor on that amount and says that they must buy at least a million and a half dollars worth.

BY MS. OWENS, CONTINUED:

Q. So the fact that it is over a million five is not restricted in the PPM?

A. Correct.

Q. Now, the purchase of preferred stock, and this is just in general, is a company limited in what it can do when the funds are received for the preferred stock or the regular stock or common stock is purchased?

A. When a company raises capital in any manner,

whether it is through debt offering or preferred stock, common stock, they are using that capital to operate the business. Otherwise, if they didn't need to use the capital to operate the business, they wouldn't sell a piece of their company. They would keep it.

So obviously when selling preferred stock, those funds will be used for any number of things, rent, pay salaries of employees. You are probably not going to sell preferred stock and take the money and put it into a checking account to earn half a percent. You are going to utilize it to help grow your business.

So this money, even though it was exchanged for preferred stock, it actually was transferred I believe directly into the payroll account of McGinn, Smith to meet salaries. And, you know, the payroll account is just nothing more than another checking account that's operated by that company.

Q. And I would like to show you, go back to what we saw before, Defense Exhibit 208. This looks like it is MSTF internal accounting staff general ledger that you received from Mr. Shea?

A. Can we just scroll to the top to be sure of that? Yes, that's right.

MS. OWENS: If we could go to page nine.

BY MS. OWENS, CONTINUED:

Q. It looks like there is a section, it is DF TMM, due from, and I believe it is Timothy McGinn?

A. Yes.

Q. So these entries, it looks like they begin on August 1st, and then there is a number of entries --

MS. OWENS: You may need to scroll over to the right a little bit.

BY MS. OWENS, CONTINUED:

Q. So these entries are on the books here coming from escrow?

A. Yes. So the escrow was one of the checking accounts that MSTF had and these show cash transfers to Timothy McGinn, and they are booked here as loans to him, which is why they are in the due from TMM account. And you can see that each one of these transactions under the column that says split, that tells you where that money came from. So each one of these transactions shows that the money came out of that checking account.

And then we see a repayment of one hundred thousand dollars that says checking. So that indicates that that is physical cash that was transferred in to repay a portion of that loan.

And then finally, there is a transaction on 11/2, which is the one on the bottom. And it is the repayment of the remaining balance of this loan for one

hundred and thirty thousand dollars. And the split account is not a checking account. It is not out of the checking or escrow accounts. So that tells me that this loan is repaid, not by cash, but with some other asset.

And so this says TMM loans should be NEI, and the loan is repaid out of the liability account for MSTF that says due to NEI. And so next we want to look at, well, what is that account, due to NEI? So it is a liability for MS Transaction Funding. And if we scroll down, we can take a look at that account and see what effect this specific transaction has on that liability of MSTF.

MS. OWENS: And just to back up a little bit before we scroll down, could you just make page nine a little bit bigger again.

BY MS. OWENS, CONTINUED:

Q. I just wanted to point out that it looks like all those entries in the due from TMM section, they are all there --

MS. OWENS: If we scroll over to the left.

BY MS. OWENS, CONTINUED:

Q. -- we see all these transactions coming from the MSTF escrow account, fifty thousand dollars, fifty thousand dollars, twenty thousand dollars, fifty thousand dollars, thirty thousand dollars. It looks like a portion -- one

hundred thousand dollars is paid back.

A. Yes. So this just shows that none of these -- these are actual cash transfers. And these transfers are on the bank accounts, and they are still on the books and records. If we went all the way to the top of the page and looked at the actual escrow account, which would show us every cash transaction, we would find each one of these transactions there.

So they are in plain sight. There is nothing that's concealing them or covering them. What is happening is that the balance of the loan is simply being repaid by the reduction of a related liability or obligation of MSTF.

Q. And we see the last one, it says it is for one hundred and thirty thousand dollars, and then there is I guess a memo, it says, tMM loans SB, should be, NEI, and then in the next column is due to NEI. If you go over to the left again, it says general journal. What does that mean, general journal?

A. Okay. So the type column indicates whether it was a cash transaction or a non-cash transaction or some sort of agency transaction. So the first several say check, and those are physical checks or wires going out. That's cash that's leaving the account. Deposit indicates that cash is coming into the account. And general journal just means that this is an entry that doesn't involve cash.

So it is an offsetting entry.

So we are going to look at it in a second, but just by looking at this line without even looking at the other account, it indicates to me that this loan has been repaid by the reduction in another liability for MS Transaction Funding.

So in other words, MS Transaction Funding is not going to receive cash of one hundred and thirty thousand dollars, but in turn, they are not going to have to pay cash of one hundred and thirty thousand dollars that they owe to NEI.

Q. So just to recap, just looking at this, it records all of the escrow transactions to Mr. McGinn and then the deposits to Mr. McGinn is check, check, check, deposit. And then the only -- it looks like it is just an addition. It is just a general journal entry, basically a comment, but no money has actually been changed because they are cash transactions and this is just a ledger?

A. That's right.

MS. COOMBE: Objection. Counsel is testifying.

THE COURT: Yes. So noted.

MS. OWENS: If we could go to page fourteen, please.

A. So here it says DT NEI, and that's a liability

of MSTF. This is money that they have received from NEI. You can see under type, there is one, two, three -- there is four transactions that say deposit. So NEI Capital has deposited money or made a loan to MSTF, and they now have a liability on their books for receiving that money. So they have to pay it back to NEI.

And then here we see on 11/2, we see general journal. And we see the name TMM and the same memo that we just looked at, which says TMM loans should be NEI. And then here if we just scroll over to see the amounts, here is that one hundred and thirty thousand dollars.

So prior to that transaction, MSTF had an obligation to pay two hundred and eighteen thousand, five hundred dollars back to NEI Capital. And now, because of this general journal entry that reduces Mr. McGinn's loan account, they no longer have to pay that much back. They only have to pay eighty-six thousand, five hundred dollars back. So the effect on McGinn, Smith Transaction Funding of this offset is zero. It simply rearranges the assets and liabilities, and it is just nothing more than an offsetting entry.

MS. OWENS: If we could just go back to the left again.

BY MS. OWENS, CONTINUED:

Q. So we see it says deposit, deposit, deposit.

Again, those are the actual cash transactions from bank records and then that --

A. That's right. And that's also indicated just on the very right here where we see escrow, escrow, escrow, and then we finally see due from TMM. So that indicates that these, this liability and the asset which was due from TMM are just offsetting one another.

Q. So just so we understand the books correctly, a general journal entry of TMM loan should be NEI, is that like a comment on the books, but no effect on the bank records?

MS. COOMBE: Objection. Counsel is testifying again.

THE COURT: Yes. Sustained, sustained.

BY MS. OWENS, CONTINUED:

Q. And were there any other trusts or corporations that you reviewed in your analysis, Mr. Smith?

A. No.

Q. Okay, and did you undertake an analysis of all of the balance sheets that you prepared for each individual operating company and a matching up of the assets and liabilities for each one?

A. Yes.

Q. Okay, and I would like to show you --

MS. OWENS: And, Leslie, just a heads up,

there will be a number of them coming up that we will flip back and forth with.

BY MS. OWENS, CONTINUED:

Q. -- previously admitted Exhibits 158, 171A, 182, 204, and 189. And I will show you --

THE COURT: All right. We will take a break now, members of the jury, before we get into all of these. You may have a break and come back in about fifteen minutes. Don't discuss the case among yourselves or anyone else.

(Whereupon, the proceedings were held in open court out of the presence of the Jury.)

THE COURT: Be seated.

For the record, Mr. Smith's testimony has taken much, much longer than I anticipated or was represented to me. So to make it clear, that if it is not completed by 12:30 we are going to adjourn, and we will just have to continue on Monday because we adjourn at 12:30. If his testimony isn't completed, he will have to come back Monday.

Mr. Minor.

COURT CLERK: Court stands for the morning recess.

(Whereupon, a brief recess was taken.)

THE COURT: You may continue.

BY MS. OWENS, CONTINUED:

Q. Mr. Smith, I am going to show you Defense Exhibit 158. Is this the balance sheet for TDM Cable Funding that you prepared that we looked at yesterday?

A. Yes.

MS. OWENS: And can we scroll down a little bit?

BY MS. OWENS, CONTINUED:

Q. Okay. I see a section, it says related entity assets. What does this represent?

A. So we have been talking a lot about agency transactions. And when looking at the bank statements for all of the trusts, there were transactions that went either between two trusts or from an operating company that was not specifically the obligor for that trust. And those have all been recorded as agency transactions. And what that does is it creates an asset and liability between two operating companies.

So we just want to show on the balance sheets of the various operating companies that those agency transactions have been properly recorded on both operating companies that are involved in that transaction. So the asset here on this balance sheet should match exactly the liability on the opposing balance sheet.

So here we are going to start and look at due

from MS Funding. And this is TDM Cable Funding, and they are owed ninety-eight thousand, two ninety-six, thirty from MS Funding. So now we will look at MS Funding's balance sheet and be sure that the same liability exists there.

Q. I will show you Defendant's Exhibit 171A.

MS. OWENS: And if we could go to, I believe the second page.

A. Here is related entity liabilities, and there is an account called due to TDM Cable Funding, and it indicates the same amount, ninety-eight, two ninety-six, thirty.

BY MS. OWENS, CONTINUED:

Q. And MS Funding owes TDM Cable Funding that amount?

A. Yes.

Q. Okay.

MS. OWENS: And if we can go back to Defense Exhibit 158.

BY MS. OWENS, CONTINUED:

Q. And back to the related entity assets, I see due from MSTF?

A. Yes. So this indicates that MSTF owes twenty-seven, nine sixty-two, nine to TDM Cable Funding, and we should see the same number on the liability side of MSTF's balance sheet.

Q. Showing you Defense Exhibit 189, and I believe the liabilities are down towards the bottom?

A. And so here, due to TDM Cable Funding, the same number, twenty-seven, nine sixty-two, nine.

Q. Okay.

MS. OWENS: If we could go back to Defense Exhibit 158.

A. The third one or the last one there is due from NEI Capital, twenty-eight thousand dollars. And so we should see the same liability on NEI Capital's balance sheet.

BY MS. OWENS, CONTINUED:

Q. I show you Defense Exhibit 182 and then down a little bit under the liability section?

A. And we see due to TDM Cable Funding twenty-eight thousand.

MS. OWENS: And if we could go back to Defense Exhibit 158. And if we go down to page two.

BY MS. OWENS, CONTINUED:

Q. Is there an asset or liability for TDMM Cable Funding?

A. So TDM Cable Funding has a liability. They owe money to TDMM Cable Funding in the amount of seventy thousand, two seventy-five, sixty-eight. So TDMM Cable Funding should have an asset in that amount on their

balance sheet.

Q. I show you defense Exhibit 204.

A. And we see under other assets due from TDMM Cable Funding that same amount, seventy thousand, two seventy-five, sixty-eight.

Q. Now, MS Funding --

MS. OWENS: If we could go back to Defense Exhibit 171A.

BY MS. OWENS, CONTINUED:

Q. This is the balance sheet that we looked at a couple of minutes ago?

A. That's right. So we are looking at the liabilities again. So we have already looked at the liability for TDM Cable Funding.

The next thing I guess we can look at with any one of them, due to NEI Capital seven hundred and fifty-five dollars and sixty-eight cents. So NEI should have an equal asset due from MS Funding.

Q. That's Exhibit 182?

A. And we see under assets due from MS Funding seven fifty-five, sixty-eight.

MS. OWENS: If we could go back to Exhibit 171A.

A. Another liability for MS Funding is due to TDMM Cable Funding in the amount of two twenty-seven, five

hundred.

BY MS. OWENS, CONTINUED:

Q. I will show you Defendant's Exhibit 204, that balance sheet for TDMM Cable Funding?

A. And under other assets due from MS Funding, two twenty-seven, five hundred.

Q. Okay.

MS. OWENS: And back to Exhibit 171A.

BY MS. OWENS, CONTINUED:

Q. I think there was another entity for MSTF?

A. Yes, there is one more. So there is a liability due to MSTF in the amount of one million, sixty-seven thousand, seven fifty-seven. And just as a side note, that number is larger than most because MSTF provided the capital to make agency payments to Firstline on behalf of MS Funding for some period of time.

Q. Okay, and I will show you Defense Exhibit 189. This is the MSTF balance sheet that you prepared?

A. Yes.

Q. And then I see under other assets there is a -- it looks like due from MS Funding for that same number?

A. Yes. One million, sixty-seven thousand, seven fifty-seven.

Q. And I will show you Defense Exhibit 182 again, the balance sheet for NEI Capital, LLC.

A. I think we have covered the one from MS Funding already. So the other asset here is due from MSTF twenty-nine thousand. And that should be an equal liability on MSTF's books.

Q. I show you Exhibit 189.

MS. OWENS: And if we could go down to the liability section.

A. So then we see here due to NEI Capital twenty-nine thousand.

BY MS. OWENS, CONTINUED:

Q. And then I will show you Exhibit 204, TDMM Cable Funding balance sheet?

A. Yes.

Q. And then is there a liability to -- is MSTF on here?

A. I believe so. You just have to this scroll down a little bit. So there is a liability due to MSTF in the amount of thirty-three thousand, three seventy-five.

Q. If we could go back to Defense Exhibit 189?

A. And there is an asset due from TDMM Cable Funding thirty-three thousand, three seventy-five.

Q. So all of these assets and liabilities that we just looked at under the balance sheets for the operating companies, what exactly are they representing?

A. It just indicates that any agency transactions

that took place between the trusts and the operating companies as a whole are accurately reflected in the balance sheets for the operating companies that I prepared.

Q. So they are showing assets and liabilities between operating companies in what we just looked at?

A. That's right.

Q. And did you prepare a summary of all of the models and the bank transactions that we looked at this morning and yesterday?

A. Yes.

MS. OWENS: At this time I would like to move for the admission of Defense Exhibit 207.

THE COURT: Received over objection.

(Exhibit No. 207, received.)

BY MS. OWENS, CONTINUED:

Q. This is the chart that you prepared?

A. Yes.

Q. And it appears that is organized in the first column, it looks like operating company with each related trust underneath and then go through a number of columns. If you just want to explain that, please?

A. Yes, that's right. So the trusts are organized underneath the associated operating company. And then there is totals for each operating company and then a grand total at the bottom.

So the first column shows the amount raised in each trust. The second column shows the amount of money that was repaid as principal to investors. The third column shows the amount of interest that was paid to investors on each of those deals. And then there is a total of money that was paid to investors, both principal and interest.

The column after that just represents that total amount paid as a percentage of the amount that was raised in each deal. And because these are chronological, you will notice that the last deal or three up from the last deal is TDMM Benchmark, which was only in existence for about three or four months. So it is not out of the ordinary that it is such a small amount compared to the raise that was repaid on that deal.

And then if we keep scrolling to the right, there is a column that says net accrued interest payable. And this is the amount of interest that, interest expense that was incurred by each trust and not paid in cash as of yet. And there could be several reasons for there to be accrued interest payable. One is fairly common.

Some of these deals paid on a quarterly basis, but would still accrue interest in the months prior to a quarterly payment. So there would be an accrual of interest, and then it would be paid maybe in the next

month. So that's one reason for accrued interest payable.

And another reason is simply economics of some of these trusts. I think it is well established that the Firstline Trusts at some point stopped making their payments. That doesn't mean that those trusts stopped earning income. They just haven't been paid. So there is accrued interest payable due to those Firstline Trusts even though they have not received the money. So that's what that column indicates.

And then the next column is basically a percentage of how much money out of what is due in total to investors including the accrued interest payable and the money that they have already been paid, what is the percentage of that. So it essentially puts the accrued interest payable into a percentage number.

And then finally, there is the partner loans that were paid out of the operating companies, and they are segregated by each operating company. And then a grand total at the bottom.

And then finally, the last column there indicates how much coverage those loans provide based on the accrued interest payable through April 2010. So the grand total indicates that the loans have almost three times coverage of the interest that was due and payable to the investors at the end of April 2010.

Q. So if we look at the partner -- at the bottom for the partner loan column, it is about 4.7 million dollars, and the net accrued interest payable to investors was about 1.7 million dollars, and that's where you get that 2.8 million all the way over to the right?

A. That's right. And there is, of course, a difference between those numbers of about three million dollars.

Q. And based upon your review of the bank records, and I know that you said that you provided some reasons for why the interest accrued, but how late were the interest payments to investors I guess with the exception of Firstline?

A. I can't right now recollect each individual one, but maybe two or three months.

Q. Were any of the actual trusts being in default?

A. Other than the Firstline Trusts, no.

Q. And when you reviewed the various private placement memoranda, the bank statements, the internal accounting staff records, I mean, what were you really looking for when you were analyzing all of these deals?

A. Well, from an investment analysis standpoint, when I am reading the PPM and constructing the models of the estimated cash flows, the thing that is most important to me is do the expected cash flows, are they sufficient to

repay the debt with interest. Can I -- as an investor, can I reasonably expect that this deal is going to work for me? And in all cases that was true. And because that's the most important thing, the resultant spread amount that's derived from each raise is fairly immaterial.

Q. Thank you, Mr. Smith.

A. You are welcome.

THE COURT: Mr. Jones, do you have any further direct questions to this witness.

MR. JONES: I do not, Your Honor.

THE COURT: Let's have a sidebar, counselors.

(Whereupon, a sidebar conference was held outside the hearing of the jury.)

THE COURT: Ms. Coombe, you may cross-examine.

MS. COOMBE: Thank you, Your Honor.

CROSS-EXAMINATION BY MS. COOMBE:

Q. Good morning.

A. Good morning.

Q. Let me put that down for a minute.

A. Sure.

Q. You are Mr. Smith's son; is that correct?

A. Yes.

Q. And you are not a certified public accountant?
A. No.
Q. You also have never worked in the field of accounting directly, correct?
A. Not with the title of accountant.
Q. And you have never worked in the accounting department of McGinn, Smith & Company, Incorporated, correct?
A. Incorrect. When I had the mail room duties I worked as an assistant to Brian Shea and a woman by the name of Allison Cooper. Both were in the accounting department.
Q. You -- I take it since you were working in the mail room at the time, that you didn't have any significant responsibilities in the accounting department for Mr. Shea; is that correct?
THE COURT: Take this off the screen.
A. I don't think they were significant in the sense that I wasn't making decisions.
BY MS. COOMBE, CONTINUED:
Q. Were you in college at the time?
A. Yes.
Q. Now, on all of the analysis that you have done and that you have talked about for the past day and a half, you have done all of that after the search warrants were

executed, correct, and the investigation had become public?

A. Yes.

Q. And you mentioned some records that you had look at. Didn't you also talk to anyone about the transactions that you testified about here today?

A. Did I talk to anyone?

Q. Right.

A. Sure.

Q. Did you talk to your father?

A. In relation to the analysis that I performed?

Q. No. Did you talk to your father about any of the transactions involved in your testimony here today?

A. Yes.

Q. Did you talk to Mr. McGinn?

A. Yes.

Q. Did you ever talk to Mr. Shea?

A. Yes.

Q. About the substance of these transactions?

A. No.

Q. How about Mr. Rees, did you ever talk to him about the substance of these transactions?

A. No.

Q. Did you ever talk to Mr. Cooper about the substance of these transactions?

A. I didn't speak to him, no.

Q. Did you ever interview any investors about any of these transactions?

A. Yes.

Q. Did you interview any investors about the transactions that are subject of the counts in the indictment?

A. Yes.

Q. Who did you interview?

A. I had conversations with Glenn Eisenberg (phonetically), who was a customer of mine and another customer of mine, James Johnson.

Q. Other than that?

A. No.

Q. Now, all of your analysis that you talked about for the past day and a half, to the extent that it relies on actual accounting records, you used the records that Mr. Shea gave to you in May of 2010; is that correct?

A. I didn't use those records to do my analysis. I used the bank statements and the PPMs.

Q. To the extent that you relied on or prepared -- you did testify about some accounting records, right, there were ledgers and there were balance sheets and other sorts of accounting records, right?

A. There were, yes.

Q. And you looked at the ones -- for preparing

those, you used the ones that Mr. Shea gave you in May of 2010?

A. Yes.

Q. And you changed some of them, right?

A. No.

Q. The last group of exhibits that you just looked at with Ms. Owens, you didn't make any changes to any of those?

A. I didn't change the accounting records that were provided by Mr. Shea.

Q. Well, you made your own accounting records?

A. I did.

Q. Now, to the extent that you were using Mr. Shea's records, those were not the records that were sent to FINRA in October of 2009, were you aware of that?

A. I have no knowledge of that.

Q. Okay. Well, they -- you are not -- you said you reviewed all the discovery in this case. You are not aware of the fact that accounting records were sent to FINRA in October of 2009?

A. I was aware of that.

Q. And obviously the records that Mr. Shea gave you in May of 2010, a lot of months have passed between October of 2009 and May of 2010, right?

A. Seven months.

Q. Right. And all sorts of accounting work could have been done during that time, right?

A. And also real transactions, cash transactions took place.

Q. And May of 2010 was also a month after the search warrants were executed, correct?

A. Yes.

Q. The receiver had taken over and had begun his work, correct?

A. For about ten days, yes.

Q. So those records that you looked at in connection with your analysis, they are completely different than the records that were provided to FINRA in October of 2009; is that correct?

A. No. They wouldn't be completely different. They would have additional transactions.

Q. Well, they would reflect seven months of additional -- any records that were changed in those seven months, right?

A. Of course.

Q. And you didn't look at those records in doing your analysis that you presented to the jury, the ones that went to FINRA, right?

A. No.

Q. And you did not do any analysis to compare the

records that were sent to FINRA with the ones that existed just a few days before they went, did you?

A. Could you rephrase that?

Q. Sure. In your analysis, you didn't account for the fact that those records were sent to FINRA in October of 2009, that there were a number of entries that were changed just before they were sent to FINRA; is that correct?

A. No. Yes, that's correct, I did not.

Q. Now, obviously in doing your analysis to the extent that you weren't creating your own accounting records, what system did you have in place to make sure that you did not accidentally make any changes to the records that Mr. Shea gave you?

A. I used QuickBooks, and I created new files and then I entered every transaction from every bank statement.

Q. That was when you were creating your own records?

A. Correct.

Q. How about to the extent that you were looking at the ones Mr. Shea gave you, what did you do to make sure that you did not accidentally make any changes to those along the way?

A. I never touched the number keys on my key paid.

Q. You didn't have any write protection or do

anything to make sure that they weren't changed?

A. No.

Q. Now, what I want to do is try to sort out what part of the analysis that you talked about for the past day and a half reflects actual bank statements and the actual accounting records that were prepared by the staff of McGinn, Smith & Company Incorporated versus the ones that you, yourself, have prepared, okay?

A. Okay.

Q. And I would like to start by talking about Firstline, and I am just going to put that screen up for you.

MS. COOMBE: Just a reminder, we loaded some of the defense exhibits into our system, so Mr. Kittelson will be distributing them. Could we please look at D174?

BY MS. COOMBE, CONTINUED:

Q. Mr. Smith, this is the amortization schedule that you prepared in connection with the May raise for the Firstline deals; is that correct?

A. Yes.

Q. And this schedule assumes that everything works out just fine, correct?

A. Yes.

Q. It assumes that Firstline Security, Incorporated makes all of the payments that it owes on the loans,

correct?

A. Yes.

Q. And it assumes that Firstline never filed for bankruptcy and that the payments never stopped, correct?

A. Correct.

MS. COOMBE: Could we look at Defense Exhibit 175, please?

BY MS. COOMBE, CONTINUED:

Q. This is a similar schedule for the October raise, is that correct?

A. Yes.

Q. And this schedule also assumes that everything works out just fine, right?

A. Of course.

Q. And it assumes that Firstline Security, Incorporated makes every single payment on the loans, correct?

A. As they were contracted to do.

MR. JONES: Objection. That's an inappropriate statement because it is not the truth. MS Funding was making the payments.

THE COURT: Overruled. Cross exam.

BY MS. COOMBE, CONTINUED:

Q. And, Mr. Smith, it assumes that Firstline Security, Incorporated had not filed for bankruptcy,

correct?

A. Yes, of course.

Q. And it doesn't reflect the fact that Firstline Security, Incorporated never made a single payment on these particular obligations in connection with the October raise, right?

A. Yes, it would assume that.

Q. Right. That's not reflected there, the fact that Firstline Security, Incorporated never paid a single penny on the raises -- on the loans in the fall --

MR. JONES: Objection. It is a misstatement of the facts.

THE COURT: Overruled. Cross examination. It is up to the jury to decide.

A. This is a schedule of payments under the contract that was signed. It is not a reflection of what actually happened.

BY MS. COOMBE, CONTINUED:

Q. And all of the amortization schedules that you and Ms. Owens talked about for the past day and a half, they have the same underlying assumptions, correct?

A. Yes, of course.

Q. That everything was going to work out just fine?

A. Yes.

Q. And none of these amortization schedules have

made any attempt to reflect what actually happened, correct?

A. Correct.

MS. COOMBE: Could we please look at 174A?

BY MS. COOMBE, CONTINUED:

Q. This is another example of the kind of chart that you prepared. This is for the Firstline Trust 07 raise in May of 2007?

A. Yes.

Q. Now, this is another example of a chart where you assume that everything was going to work out just fine?

A. Yes, this is the expected cash flow.

Q. Right, and so it assumes that Firstline Security, Incorporated would make all of the payments on the loans?

A. Yes.

Q. And it assumes that Firstline had not filed for bankruptcy and the payments had stopped, right?

A. It does.

Q. And it also assumes that the more than seven hundred and eighteen thousand dollars that had been paid out to Mr. McGinn and Mr. Smith, that those would all be repaid, correct?

A. Well, actually that indicates the repayment of the loans with interest. So an amount less than seven

hundred and eighteen, seven fifty was paid out.

Q. I understand that, but it assumes that they will be paid back with the -- you set the interest rate at three percent, right?

A. It assumes that they be available as an asset for repayment, yes.

Q. And so then it assumes too that they actually would pay back that money, correct?

A. It assumes that they actually would, yes.

MS. COOMBE: Could we look at 175A, please?

BY MS. COOMBE, CONTINUED:

Q. This is the same sort of chart for the fall raise; is that correct?

A. Yes.

Q. Yet again, it assumes that everything is going to work out just fine, right?

A. Of course.

Q. And it assumes that Firstline Security, Incorporated is going to pay every penny that it owes on the loans that it took in the fall of 2007?

A. Under the contract, yes.

Q. And it also -- it doesn't reflect the fact that Firstline Security, Incorporated never paid a penny on the loans that it received in the fall of 2007, correct?

A. Correct.

Q. Again, it assumes that the amount of money that Mr. McGinn and Mr. Smith had taken would be repaid with three percent interest, correct?

A. Yes.

Q. And it also assumes that they would actually pay that money back, correct?

A. Yes.

MS. COOMBE: Could we look at 176, please?

BY MS. COOMBE, CONTINUED:

Q. Now, this is another table that you did. Just so that we are all clear, is this one that you typed in the entries yourself?

A. I did.

Q. So these are not the actual books and records of the -- that were maintained at the broker-dealer, these are records that you have created?

A. These are reflections of the bank statements only.

Q. Well, let's look at that comments column. Are those on the bank statements?

A. I thought you asked me about the numbers that I typed in. The comments are a reflection of reviewing the McGinn, Smith records, that's true.

Q. The comments are your opinions, right?

A. They are my analysis of accounting rules.

Q. Your analysis reflects your opinions of -- your application of your knowledge to these particular facts, right?

A. Accounting is not really an art form, but, yes.

Q. So you would agree that this reflects -- this comments section actually reflects your opinion; is that correct?

A. In some cases.

Q. Right. For instance, about halfway down the page -- well, that is all right.

MS. COOMBE: Withdrawn. Let's look at 176A, please.

BY MS. COOMBE, CONTINUED:

Q. This is that summary chart that you created, right?

A. Yes.

Q. And this is another example of a chart that assumes that everything works out just fine?

A. No. This is a chart of actual bank transactions that took place.

Q. All right. It doesn't reflect anywhere on here that Firstline Security, Incorporated filed for bankruptcy, right?

A. It wouldn't.

Q. Right. And it does reflect that some money went

to investors, but it doesn't say where that money came from, does it?

A. No.

Q. It doesn't explain that money was being scrounged on every month from --

MR. JONES: Object to the form of the question.

THE COURT: Overruled.

BY MS. COOMBE, CONTINUED:

Q. It doesn't reflect Mr. McGinn was scrounging up money every month in order to pay Firstline investors after the bankruptcy, does it?

A. I don't think I can answer that question. All this reflects is actual bank transfers from bank statements, added up and categorized.

Q. It doesn't reflect where that money actually came from, right?

A. It does not.

Q. So when McGinn, Smith Funding continued to pay those Firstline investors, are you familiar with the term lulling payments?

A. No.

Q. You are not familiar with the term lulling payments?

A. No.

Q. You ever never heard of a lulling payment, a payment that's made to convince someone that everything is okay even though it is really not?

A. I haven't heard of that term.

Q. Well, the investors when they were being paid after the Firstline bankruptcy, they had no idea that the money was coming from all sorts of other McGinn, Smith entities; isn't that right?

A. They expected their money to come from MS Funding who was the obligor.

Q. They -- are you familiar -- I know you haven't been in the courtroom, but are you familiar with the fact that there have been a number of investors who have come in and testified in this case?

A. Yes.

Q. And that they have testified about their understanding about where the money would come from?

MR. JONES: Objection.

MS. OWENS: Objection.

THE COURT: Overruled. Cross exam.

A. What is the question?

BY MS. COOMBE, CONTINUED:

Q. Are you familiar with the fact that they came in and they talked about their understanding about where the money would come from to repay them?

A. No, I wasn't in here.
Q. And the PPMs, which explain that the money will be coming out of the payments that Firstline Security, Incorporated was making on its loans?
A. I am sorry?
Q. You are not familiar with that either?
A. The PPMs say that money will come from MS Funding.
Q. Right.
A. I think we went over that in the testimony.
Q. They also explained that the money --
MR. JONES: Objection to what the investors explained.
THE COURT: Overruled.
BY MS. COOMBE, CONTINUED:
Q. Are you aware that there were also brokers who came in here and testified?
A. Yes.
Q. Are you aware that it was their understanding that the payments --
MR. JONES: Objection as to what their understanding was.
THE COURT: Overruled.
BY MS. COOMBE, CONTINUED:
Q. It was their understanding that the payments

that would be made on these Firstline deals from the McGinn, Smith Funding, LLC would come from the money that Firstline Security, Incorporated was paying on the loans that it had taken. Did you know that?

A. I don't know what the other brokers understood or didn't.

Q. Now, you sold the Firstline Series B product yourself, didn't you?

A. Yes.

Q. As a broker, the fact that Firstline Security, Incorporated had filed for bankruptcy is information that you would have wanted to disclose to your clients; isn't that correct?

A. Prior to sale or after sale?

Q. Prior to the sale?

A. Of course.

Q. You were also an investor in Firstline Series B, correct?

A. I believe I was an investor in the May deal.

Q. As an investor, you would have wanted to know that your payments were not being made by Firstline, correct?

A. I would have wanted to know that my payments were being made by MS Funding.

Q. Mr. Smith, you assumed that the payments were

coming from the payments that were being made by Firstline Security, Incorporated, correct?

A. I assumed that the payments were being made directly by Firstline?

Q. No. You assumed that money was coming -- I am sorry. You assumed that the money that was coming from the payments were being made by Firstline Security, Incorporated, in other words, the money that you were receiving as an investor?

A. Yes.

Q. If you learned at some point the payments had not been made and/or that the payments had been less than required by Firstline Security, Incorporated, as an investor, that's something that you would have wanted to know, right?

A. After I had already invested, it would have been immaterial.

Q. Do you remember testifying in the Grand Jury?

A. Yes.

Q. I am handing you a copy of your Grand Jury transcript.

MR. DREYER: Page, please.

MS. COOMBE: Yes. Page twenty-four, line eight.

BY MS. COOMBE, CONTINUED:

Q. Did I ask you this question and did you give this answer?

Question: If you learned at some point the payments had not been made and/or that the payments had been less than required by Firstline Security, Incorporated, as an investor that's something that you would have wanted to know, right?

Answer: I suppose I would have wanted to know that.

And then you went on to talk about risk and other issues; is that correct?

A. Correct.

Q. Did I ask you that question and did you give that answer?

A. Yes.

Q. Now, the fact that the trust had never been a day late or a penny short indicated to investors that the investments, here we have been talking about the loans to Firstline Security, Incorporated, were performing, right?

A. Sure, yes.

Q. That wasn't true, was it?

A. Excuse me?

Q. That wasn't true, was it?

A. Well, if payments were being made, the loans were performing.

Q. Well, the underlying investments, which here we are seeing loans that were made to Firstline Security, Incorporated, they weren't performing, the payments weren't being made, the company had filed for bankruptcy, right?

A. Yes, there is no indication that the collateral was performing.

Q. Well, the underlying investments were those loans that were made to Firstline Security, Incorporated, right?

A. That was the underlying collateral, yes.

Q. And the fact that the trusts, including Firstline, had never been a day late or a penny short indicated to investors that those investments that were related, that they were performing, right?

A. No, it indicates that --

Q. You just said yes when you answered that question two minutes ago.

MR. JONES: Objection.

THE COURT: Yes. That question may be stricken. Next question.

MS. COOMBE: Let's look at Exhibit 196.

A. Okay.

BY MS. COOMBE, CONTINUED:

Q. 196A. Let's talk about Integrated Excellence Trust for a moment. This is another chart that assumes

that everything works out just fine, right?

A. Yes.

Q. That Integrated would borrow just under a million dollars?

A. Yes.

Q. And it didn't borrow that much, right?

A. No.

Q. It only borrowed six hundred and eighty-seven thousand dollars and change, right?

A. That's right.

Q. That's not reflected in this analysis on this page, is it?

A. No.

Q. And it assumes that Mr. McGinn and Mr. Smith would pay back the money that they had taken at an interest rate of three percent, correct?

A. That's right.

Q. It assumes that they could do that, correct?

A. Yes.

Q. And it assumes that they would do that?

A. Yes.

MS. COOMBE: Could we look at Government's Exhibit GA1C, please?

BY MS. COOMBE, CONTINUED:

Q. This is a chart that shows transactions that

occurred on July 1st and July 15, 2008. Thirty-five thousand dollars to Mr. Smith and two transactions totalling fifty thousand dollars to Mr. McGinn. You are familiar with these transactions, correct?

A. Yes.

Q. And the money that went to Mr. McGinn and Mr. Smith, it came directly from a bank account for the trust, correct?

A. The cash transfer, yes.

Q. And are you aware that Mr. McGinn directed the July 1st, 2008, transfers himself in an electronic mail message?

A. I am not.

MS. COOMBE: Could we look a GA1C, please, support? Could we look at page seven, please?

BY MS. COOMBE, CONTINUED:

Q. This is an electronic mail message from Mr. McGinn to a Ms. Birnbach at Mercantile bank. If you look at the bottom, number four: Please wire from Integrated Excellence Senior Trust thirty-five thousand dollars to M&T Bank in an account in the name of Mr. Smith and thirty-five thousand dollars to M&T Bank in an account in the name of Mr. McGinn. Is that accurate?

A. Yes.

Q. So Mr. McGinn directed these transfers himself;

is that correct?

A. It seems that way.

MS. COOMBE: Could we look at page seventeen, please?

BY MS. COOMBE, CONTINUED:

Q. This is an electronic mail message from Mr. McGinn to Ms. Birnbach dated July 15th of 2008 stating: Forgot, one more. Please wire fifteen thousand dollars form Integrated Excellence Trust 08 to an M&T bank account in the name of Timothy M. McGinn.

So Mr. McGinn directed these transfers as well correct?

A. Sure.

Q. And they didn't go through MSTF first, they went right from the trust bank account to Mr. McGinn and Mr. Smith's accounts, correct?

A. Correct.

MS. COOMBE: Could we look at GA1D, please?

BY MS. COOMBE, CONTINUED:

Q. This is a chart that shows money that was transferred on August 29th of 2008 from Integrated Excellence Junior Trust 08 bank account, forty-five thousand dollars which was used to pay investors in TDM Luxury Cruise Trust 07 and ninety-seven thousand dollars that was used to pay investors in Firstline Senior

Trust 07; is that correct?

A. Yes.

Q. You are familiar with these transactions, right?

A. I am.

Q. And the money came directly from the trust bank account, right?

A. Yes.

Q. Didn't go through MSTF first?

A. Didn't have to.

MS. COOMBE: Move to strike. Non-responsive.

A. No, it didn't.

MS. COOMBE: Let's look at GA1D, please, support. I am sorry. Could we look a page three, please?

BY MS. COOMBE, CONTINUED:

Q. This is an electronic mail message from Mr. McGinn to Ms. Birnbach dated August 29th of 2008 directing those two wire transfers that we just talked about. Mr. McGinn, himself, directed these transfers directly out of the Integrated Excellence Junior Trust 08 bank account; isn't that correct?

A. Yes.

MS. COOMBE: Could we look at GA11, please? Could we look at page five? Could we look at compensation and fees.

BY MS. COOMBE, CONTINUED:

Q. It states McGinn, Smith Transaction Funding Corporation, an affiliate of both McGinn, Smith & Company, Incorporated, the sales agent, and McGinn, Smith Capital Holdings Corp, the trustee, will be paid a brokerage fee in connection with the acquisition of the contracts by the trust fund and the senior participant.

It doesn't state how much the brokerage fee will be, yes or no?

A. No, it does not.

Q. Now, the brokerage fee that you calculated is four hundred and twenty-five thousand dollars and change; is that correct?

A. No.

MS. COOMBE: Could we look at 197A, please?

BY MS. COOMBE, CONTINUED:

Q. Do you see the green box?

A. Yes.

Q. That says brokerage fee due to MSTF, four hundred and twenty-five thousand dollars and change. This is a document that you prepared, right Mr. Smith?

A. Yes, but about ten thousand dollars was actually a repayment for a bridge loan. So the brokerage fee I calculated on the MSTF balance sheet and income statement is actually closer to four hundred and fifteen thousand

dollars.

Q. Okay, four twenty-five, four fifteen. Either way, that is about thirty-six percent of the actual amount raised; isn't it?

A. I don't have a calculator, but I will believe you.

Q. Well, that is all right.

MS. COOMBE: Let's go -- we will zoom out.

BY MS. COOMBE, CONTINUED:

Q. Nine hundred thousand, two seventy.

A. Yes, I can do the rough math.

Q. That is right, right about thirty-six percent?

A. Yes.

Q. And that's on top of the underwriting fees, correct, yes or no?

A. Yes.

Q. And the PPM doesn't have that number anywhere in it, does it?

A. Nope.

Q. In fact, that amount is more than the entire amount that was raised in connection with the Junior Integrated Excellence Trust deal, correct?

A. That's correct.

Q. Almost twice as much?

A. Almost.

MS. COOMBE: Could we look an 192, please?

BY MS. COOMBE, CONTINUED:

Q. Can you explain to us, are these the accounting records that Mr. Shea gave to you in May of 2010 or are these the ones that you created?

A. This is a sheet that I prepared.

Q. And so these were -- this particular exhibit and these other profit and loss details, similar ones, they reflect what you think should have been on the books and not what was actually on the books; is that correct?

A. They reflect a summary of my categorization of actual transfers of cash.

Q. They reflect your opinions about how things should have been booked, yes or no?

A. No.

Q. You typed these up, right?

A. I did.

Q. And they are not the actual records that were maintained that you received from Mr. Shea in May of 2010, right?

A. They reflect the actual records.

Q. Yes or no, Mr. Smith?

A. They are not what Mr. Shea maintained, no.

Q. And they are not the ones that were sent to FINRA in October of 2009, right?

A. Of course not.
Q. They are the ones that you wrote yourself, yes or no?
A. I prepared them.
MS. COOMBE: Could we look at 186, please?
BY MS. COOMBE, CONTINUED:
Q. This is another chart that you prepared, correct?
A. Yes.
Q. And this is based on the accounting records after they had been changed and sent to FINRA; is that correct?
A. I don't know.
Q. Well, you are familiar, you said, with the documents that were produced in discovery in this case, right?
A. Yes.
Q. So I am assuming that you are familiar with the instructions that Mr. Smith wrote directing Mr. Shea to make new accounting entries in connection with payments that had been made from MSTF; is that correct?
A. I believe the instructions were to change the consideration for the transfers from the funds.
Q. And are you familiar with the fact that there were also instructions to change the books and records

regarding payments to preferred investors that had been made out of MSTF?

A. I am not.

Q. You are not familiar with the fact that Mr. Smith directed that accountants make new entries before those books and records were submitted to FINRA?

A. Yes, I am aware of that.

Q. Are you aware of the fact that those books and records were submitted to FINRA, the ones that had just been changed, without any statement to FINRA that they had been changed?

A. I guess I am aware of that from reading your indictment.

Q. You are not aware of that from reading the documents that were produced in discovery?

A. Maybe as well as that, yes.

Q. You are not familiar with those sheets that show the records, how they looked on October 10th of 2009 and how they are charged on October 12th of 2009 and then shipped off to FINRA?

A. Yes, I am familiar with that.

Q. That's what happened, right? They were -- and this requires a yes or no answer. The books and records --

MR. JONES: Well, object to that, whether it requires yes or no for an answer. Is not a proper

question.

THE COURT: If he can answer yes or no, you may answer yes or no. If not, say you can't answer yes or no. Go ahead with your question.

BY MS. COOMBE, CONTINUED:

Q. The books and records were a certain way on October 10th of 2009, October 12, 2009, they were different, and after that, they were sent to FINRA?

A. Yes.

Q. And the letter that went to FINRA didn't tell FINRA that those changes has been made, correct?

A. Apparently not. I don't remember the letter.

Q. And FINRA had said if there are any omissions or changes or anything, to provide detailed information about that, do you remember that from the FINRA letter?

A. I believe so.

Q. And so just so we are all clear, this chart is based on the records, not as they looked on October 10th, but how they looked on October 12th?

A. That's correct.

MS. COOMBE: Could we look at GB12, please?

May I approach, Your Honor?

THE COURT: You may.

MS. COOMBE: May I have blanket permission?

THE COURT: You may.

MS. COOMBE: Okay. Thank you.

BY MS. COOMBE, CONTINUED:

Q. I am showing you now previously admitted Exhibit GB12, and I can take your Grand Jury transcript back if you like?

A. Sure.

Q. Thank you. You can take your time and look that over. Let me know when you are ready to proceed.

A. Okay.

Q. This is an electronic mail message dated April 14th of 2009. It is from Joseph Carr to Mr. McGinn, and there is a copy to Mr. Smith. It states: Tim, I have attached three promissory notes evidencing loans to McGinn, Smith Transaction Funding Corp. Dave requested that I forward them to you for your signature. After signing, please mail the original signed notes to my attention, Joe.

MS. COOMBE: Could we look at the next page, please?

BY MS. COOMBE, CONTINUED:

Q. This is a note for a transaction that is dated April 14th of 2009 for one hundred thousand dollars and it indicates that MSTF owes TAIN one hundred thousand dollars; is that correct?

A. Yes.

Q. There is no mention of MSA or MSCH in this note,

is there?

A. No.

Q. It indicates that the loan was between TAIN and MSTF, right?

A. Yes.

MS. COOMBE: And could we look at GB1C for a moment, please? Could we go to the third page, please?

BY MS. COOMBE, CONTINUED:

Q. That's one of those transactions that is on this document, Mr. Smith, correct, under April 14th of 2009?

A. Yes.

Q. And it shows that it was a -- there was a note actually that it was a loan between the Four Funds and MSTF, and there is no mention of MSA or MSCH, right?

A. No.

Q. And both Mr. Smith and Mr. McGinn were on that e-mail; is that correct?

A. Yes.

MS. COOMBE: Could we go back again and look at GB12, please? Could we look at the next note with FEIN.

BY MS. COOMBE, CONTINUED:

Q. This is dated April 14th of 2009 for fifty thousand dollars. It states that MSTF owes FIIN fifty thousand dollars; is that correct?

A. Yes.

MS. COOMBE: Could we go back and look at GB1C again?

BY MS. COOMBE, CONTINUED:

Q. Again, that is that fifty thousand dollars in pink, right?

A. It appears so.

Q. And there is nothing in that note that is GB12 that says anything about MSA or MSCH, correct?

A. Correct.

MS. COOMBE: Could we look at the next note in GB12, please?

BY MS. COOMBE, CONTINUED:

Q. This is a note for one hundred thousand dollars dated April 14th of 2009. It is between MSTF and FEIN, and that is the blue represented on the chart that is GB1C, correct?

A. Yes.

Q. And the note doesn't have any reference to MSA or MSCH, right?

A. Nope.

MS. COOMBE: Could we replace GB12 on the screen now with GB13, please?

BY MS. COOMBE, CONTINUED:

Q. This is a copy of one of the notes we just looked at. It is the one between MSTF and FIIN, which is

represented in yellow on GB1C, correct?
A. Yes.
Q. And this one is actually signed, there is Mr. McGinn's initials on the bottom of each page and the date, correct?
A. Yes.
Q. And he signed it; is that correct?
A. It looks like it.
MS. COOMBE: And could we look back at the first page?
BY MS. COOMBE, CONTINUED:
Q. That's your father's handwriting at the top; isn't it?
A. I have no idea.
Q. Okay. Now, there is not a single word in that note about MSA or MSCH, is there?
A. No.
MS. COOMBE: Could we look at GB16 now in place of GB13? Could we look at the next page, please?
BY MS. COOMBE, CONTINUED:
Q. And I will bring you a copy of this exhibit, Mr. Smith. Please take your time and look this over and let me know when you are ready to proceed.
A. Okay.
Q. Okay.

MS. COOMBE: Could we look at the second page, please? Actually the third page. I am sorry, Ron. Could we go back to the second page?

BY MS. COOMBE, CONTINUED:

Q. That's a note dated November 26th of 2008 between FIIN and MSTF; is that correct?

A. Yes.

MS. COOMBE: And if we could look at GB1C and if we could go back to the chart for November 26th.

BY MS. COOMBE, CONTINUED:

Q. And that's the amount FIIN is in pink; is that correct?

A. Pink or blue or yellow.

Q. Okay. If you look down under the Four Funds, do you see that's in pink?

A. Yes.

Q. And there is no reference to MSA or MSCH in GB16; is that correct?

A. No. That's correct.

MS. COOMBE: Could we look at the next page, please?

BY MS. COOMBE, CONTINUED:

Q. This is a note dated November 14th of 2008 for fifty thousand dollars between FIIN and MSTF. It is signed by Mr. McGinn at the bottom. This corresponds to the pink

over in GB1C; is that correct?

A. Yes.

Q. And again, to the reference to -- I am sorry. This is November 14th.

MS. COOMBE: Ron, if we could look at the first page of that chart.

BY MS. COOMBE, CONTINUED:

Q. So this is the pink amount, the November 14th money that was transferred from the Four Funds to MSTF, correct?

A. Sure, yes.

Q. And again, there is no reference to MSA or MSCH, right?

A. Nope.

Q. All right.

MS. COOMBE: Is there another page of GB16? Can we go back and look at Defense Exhibit 186 again?

BY MS. COOMBE, CONTINUED:

Q. This chart doesn't account for those promissory notes that we just looked at, does it, they have no reference to MSA and MSCH and indicate the loans were actually made between the Four Funds and MSTF; is that correct? Please answer it yes or no.

A. You will have to ask the question again then.

Q. That's fine. This chart does not reflect the

fact that there are promissory notes indicating that loans were made between the Four Funds and MSTF that do not refer to MSA or MSCH at all, that's not reflected at all on this chart; is that correct, yes or no?

A. Correct.

MS. COOMBE: Let's look at Exhibit 187, please.

BY MS. COOMBE, CONTINUED:

Q. Just so that we are all clear on this, this again reflects the books and records, not as of October 10th of 2009 or earlier, but as of October 12th, 2009, or later after Mr. Smith had instructed that new accounting entries be made; is that correct?

A. Yes, the corrected entries.

Q. This reflects the entries that were sent to FINRA; is that correct?

A. I believe so.

Q. And you are familiar with the fact that FINRA was not told that these changes had just been made, correct?

A. Apparently.

Q. And FINRA had asked if any changes were made, any omissions --

MR. JONES: Objection.

THE COURT: Kind of repetitious.

BY MS. COOMBE, CONTINUED:

Q. Now, your chart showed money that Mr. McGinn and Mr. Smith and Mr. Rogers had taken from various limited liability corporations, correct?

A. Yes.

Q. And you testified that sometimes you could not line up money that they had taken with a specific raise, right?

A. That's right.

Q. You didn't have any records to rely on to sort that out because they were going through the same LLC account and some raises were close in time together and it made it difficult to sort out?

A. I relied just on looking at similar timeframes.

Q. There weren't any records that made clear what money was taken in connection with what deal, correct?

A. Correct.

Q. And Mr. McGinn and Mr. Smith didn't take any money from the LLCs that were unrelated to deals entirely, did they?

A. I can't answer that.

Q. You didn't look at that in your analysis, correct?

A. Look at what?

Q. Whether Mr. McGinn and Mr. Smith took money out

of the LLCs that were totally unrelated to the trust deals?

A. All I know is that money transferred from the LLCs to Mr. Smith and Mr. McGinn.

Q. So you didn't look at whether they took any money from the LLCs that were totally unrelated to any deals, did you?

A. I wouldn't know whether or not they were related or totally unrelated. I made a judgment based on the timeframe.

Q. Because there were no records about that, right?

A. Right.

MS. COOMBE: Could we look at 152, please?

BY MS. COOMBE, CONTINUED:

Q. And you testified about this yesterday, correct?

A. Yes.

Q. And you've got the example of a one-year CD there and also the example of TDM Verifier Trust 07. Now, when somebody takes a CD out from a bank, they don't get a private placement memorandum, right?

A. They get some sort of a legal document.

Q. They don't get a document that says the money will only be used for X, Y, Z purpose, do they?

A. I don't know. I have not invested in a CD.

Q. A CD isn't regulated by the securities laws, is it?

A. I am sure that it is. It is a security.
Q. And you believe -- but you don't know whether you get a PPM with that?
A. It is not a private placement, so no.
Q. Right. And so if there is no private placement, then there is no book explaining how the money will be used, correct?
A. It is a certificate of deposit. There is language describing the money.
Q. It is a totally different kind of investment vehicle, right?
A. It is an investment vehicle.
Q. Right. Totally different from the contract certificates that are at issue here?
A. Not totally different. They both pay interest.
Q. Well, other than both paying interest, there are a lot of differences, aren't there?
A. Not really.
Q. There is a difference, there is a PPM, right? There is a PPM for a contract certificate and not for a CD?
A. They both have offering documents.
Q. They don't have a PPM, do they?
A. CDs don't have a private placement memorandum, no.
Q. Okay, and they don't make -- there are other

differences as well, aren't there?

A. There are. Do you want to know what they are?

Q. No, thank you.

MS. COOMBE: Could we look at 168, please?

Ms. Baldwin, could we look at 168, please?

MS. OWENS: It might take a couple of minutes. Our computer froze.

MS. COOMBE: I have it. We can put it on the Elmo.

BY MS. COOMBE, CONTINUED:

Q. You talked about this bank statement with Ms. Owens yesterday. Do you remember that?

A. Yes.

Q. And you criticized the title on the account, do you remember that?

A. Yes.

Q. You criticized it because it wasn't very clear, correct?

A. That's correct.

Q. And you criticized whoever had opened that account; is that correct?

A. Yes.

Q. You said they didn't really understand what was going on?

A. I criticized, I believe, Mr. Cooper for not

knowing what was going on.

Q. Okay. I am going to hand you Government's Exhibit 16.

MS. COOMBE: Your Honor, I move the admission of Government's Exhibit 16. It is a bank record subject to stipulation.

THE COURT: Received.

(Exhibit No. 16, received.)

BY MS. COOMBE, CONTINUED:

Q. Take your time and look through that let me know when you are ready to proceed?

A. I am familiar with it.

Q. I would like to direct your attention to the second to the last page of the document.

MS. COOMBE: Do you have that, Ron?

BY MS. COOMBE, CONTINUED:

Q. That's a signature card, right?

A. I don't see that on the screen, but it is written in some bubbly handwriting at the top.

Q. Right. You see the title of the account is there, and at the top it says updated signature card?

A. Yes.

Q. Do you see the names there are David L. Smith, and Timothy M. McGinn?

A. Yes, it looks like they signed it.

Q. Right.

MS. COOMBE: Could we look, please, at page six of this document as well?

BY MS. COOMBE, CONTINUED:

Q. This is an earlier version of the signature card?

A. Yes.

Q. And if you look at the bottom, please, do you see who signed it?

A. It looks like that is all he did was sign it.

Q. Mr. McGinn. Well, he signed it in two places, right?

A. Yes. The rest of the writing is not his, but, yes.

Q. Right. Now, Mr. McGinn and Mr. Smith signed these pages, and they didn't ask anyone to change the title on that bank account, did they?

A. Perhaps they didn't read it. I don't know.

Q. That's not my question. My question was they didn't --

A. I don't know if they asked or not.

Q. Please let me finish my question. They did not ask anyone to change it, did they?

A. I don't know.

Q. Well, it is not the reflected on the account,

the document?

A. It is not reflected on the document.

Q. Mr. Smith, you have to let me finish my question. It is not reflected on the account documents, is it?

A. No.

Q. And if they had a problem with it, they could have said something to someone about it, couldn't they?

A. I suppose.

MS. COOMBE: Your Honor, this would be a good place.

THE COURT: All right. Members of the jury, we are going to adjourn now. We will complete the testimony of Mr. Smith on Monday at 9:30. I told you we were going to have a half day today, and that is all that we have. We thank you for your service of course.

Mr. Smith, just sit down a second.

All right. You can be excused now until 9:30 tomorrow -- or Monday morning. Remember you have got a long weekend. Don't discuss the case among yourselves or anyone else or do any research or any publicity or anything that may appear on this case. And have a good weekend, and we will see you at 9:30 on Monday morning. You are excused with the thanks of the Court.

Mr. Minor.

COURT CLERK: Court stands adjourned until Monday morning at 9:30.

(Whereupon, the proceedings held on January 25, 2013, were ended at 12:15 p.m..)

CERTIFICATE OF OFFICIAL REPORTER

I, NANCY L. FREDDOSO, RPR, Federal Official Court Reporter, in and for the United States District Court for the Northern District of New York, do hereby certify that pursuant to Section 753, Title 28, United States Code that the foregoing is a true and correct transcript of the stenographically-reported proceedings held in the above-entitled matter and that the transcript page format is in conformance with the regulations of the Judicial Conference of the United States.

S/NANCY L. FREDDOSO, RPR

Federal Official Court Reporter

Motion

witnesses on behalf of Mr. McGinn. And then Mr. Dreyer will have an opportunity to present any additional witnesses on behalf of Mr. Smith.

So we are going to start out with a joint defense on behalf of both defendants, and then we are going to move to individual. As I told you at the start, there is no obligation on the defense to present any evidence, but if they wish to do so, they, of course, have that absolute right to present evidence. And they have elected to start out at least with a joint presentation.

Mr. Dreyer, you may call the first joint witness on behalf of the both defendants.

MR. DREYER: Thank you, Your Honor. I call Richard Engel.

RICHARD ENGEL, having been called as a Witness, being first duly sworn, was examined and testified as follows under oath:

DIRECT EXAMINATION BY MR. DREYER:

Q. Good afternoon, Mr. Engel. Mr. Engel, would you tell us what county and/or city you reside in?

A. Yes, I reside in Syracuse, Onondaga County.

Q. How are you employed?

A. I am an attorney.

Q. And for what firm do you work for?

A. I work for -- I am a partner at Mackenzie, Hughes.

Q. Would you take us back to your educational background, start there and tell us first what your educational background is, and then we will ask you a few questions about your experience in the practice of law?

A. Yes, I graduated my undergraduate studies at Boston College. I then came back to Syracuse, went to law school in Syracuse, and received a JD in 1989.

Q. After 1989, how did you become employed?

A. I went to work for my father. He was a sole practitioner in Syracuse. He practiced in Securities Law, and when I graduated from Syracuse University Law School, I went directly to work for him, passed the Bar and that would have been 1990.

Q. And when you say he practiced in Securities Law, can you give us a little background specifically what his practice and your practice included?

A. Sure. My father was primarily a business practitioner. His securities practice was probably half of his legal practice. It includes -- it included practicing in securities fraud, securities regulation, private placements.

At the time, the predecessor to FINRA was the

NASD, the New York Stock Exchanges, and he was involved and got me involved in arbitration proceedings in front of those two bodies.

Q. At least while you were employed -- and by the way, what was the name of that firm after you joined it?

A. It was Engel and Engel. I was the second Engel.

Q. All right. You were the second Engel?

A. Yes.

Q. After you became employed by your father and during the time that you were there, what did you do in connection with your legal work?

A. I took an interest in securities field, in securities practice even when I was still in law school. And so when I joined my father's practice, I primarily practiced in the securities field. Again, in securities fraud, securities regulation.

I became involved in arbitrations, misconduct arbitration, and fraud arbitrations. I also began representing several investment advisors and did the regulatory work, litigation, compliance work.

Q. Did you also represent investors during the time that you were at Engel and Engel?

A. I did, several investors. I represented issuers of private placements and also, on many occasions, represented investors who were reviewing private placements

memoranda, looking for legal counsel to give them guidance on how or whether to invest.

Q. So with respect to your client base and without mentioning any names -- by the way, did you also represent institutional clients in any of these representational capacities?

A. I did and continue to. Universities, colleges, endowment funds, foundations, trusts, other institutional clients, banks in securities matters.

Q. And specifically in connection with private placements, does any of your work on behalf of these clients take you into the area of reviewing and/or creating or authoring private placements?

A. Yes, both, substantially. I have drafted and authored many private placement memorandum for issuers seeking to raise capital in the private securities markets. I have also represented, as I mentioned, colleges and universities who were using endowment funds to invest in private placements, which gave me the opportunity to read and review many, many private placements, as well as authoring them.

Q. We will come back to that in a moment, but when did you leave Engel and Engel?

A. Dad retired in 2003, at which time I joined Mackenzie, Hughes. Mackenzie, Hughes is a very old law

firm in Syracuse, over one hundred and twenty-five years. Their primary practice area is in the business world, and they were looking to grow that business field into the securities practice and saw -- we saw together as an opportunity. So I joined Mackenzie, Hughes that same year in 2003.

Q. All right, and in connection with your work at Mackenzie, Hughes since 2003, have you concentrated your legal work -- I can't use the word expert, but have you concentrated your legal work in the field of securities law?

A. Yes, I have.

Q. In connection with your work in securities law, do you also go outside of the law firm and teach at any institutions or seminars or Bar Associations in connection with securities work?

A. Yes, I do.

Q. Would you explain that?

A. Yes, I have regularly taught at the LeMoyne College business class, business school class on private placements and securities regulation.

I have also done that for the Syracuse University School of Management, for the Syracuse Tech Garden with respect to startups, giving them lectures and seminars on private placements.

I have participated in several continuing legal education seminars in which I have presented on the subject securities law, particularly private placement memoranda.

Q. And in connection with those presentations, those are mandated CLE programs by the State of New York?

A. That's correct.

Q. And under whose auspices, do you present those lectures to the lawyers who attend those lectures, the Bar Association?

A. Yes, I have presented for the Onondaga County Bar Association, for the local Corporate Counsel Institute, and for my own firm. Mackenzie, Hughes is a provider of continuing legal education.

Q. In connection with your work as a securities lawyer, can you tell us how much time you devote to issues surrounding or related to the private placement memorandum?

A. Yes, I would say well over half of my practice is in securities, and of that half of my practice, I would say nearly half of that is dedicated to issues surrounding private placements.

Q. And you may have said this, but if you did, I will do it briefly. How many private placement memoranda have you actually authored yourself, if you know?

A. Over twenty-four years of preparing them, I would say it is probably approaching a hundred.

Q. Okay, and in connection with the -- also in connection with your representation of institutions and/or individuals, how many have you reviewed?

A. Probably many times that number. Sometimes one of my clients would be looking at multiple private placements memoranda with various people giving them advice and comments on each of them. So it would be many times that, that I have authored.

Q. One final question along these lines. You have testified before, I believe, that when you were at Engel and Engel, you practiced before FINRA or the predecessor agency. Do you still practice in front of FINRA?

A. I do.

Q. How often do you actually appear before FINRA with respect to any kind of case that you have before them?

A. Well, I would say that part of my practice is -- slowed down some. I am involved in a FINRA arbitration in one way or another. I would say two or three a year and then far less frequently than that do they actually end up being arbitrated.

Many, the majority of those, end up before a mediator and get settled or get settled sometime during the discovery process. So my actual time in front of a FINRA arbitration is, I would say, not very frequently.

Q. Does your work take you before the SEC or

Securities Exchange Commission?

A. Yes, it does.

Q. In what respect?

A. I have been involved mostly with the SEC in regard to their examination process for several clients of mine who are investment advisors. The SEC conducts sweep examinations over the years, and I counsel my clients on how to respond to an SEC examination.

I have also been involved with the SEC in connection with allegations of insider trading. Certain clients of mine and other matters that bring me before the SEC when I have regulatory questions, I often turn to and resolve with the SEC.

Q. Now, with that background, I have asked you to review certain things and also to testify before this jury concerning certain questions that I am going ask you; is that correct?

A. Yes.

Q. Mr. Jones and I have done that?

A. That's correct.

Q. And in connection with those inquiries, I am going to ask you to talk to the jury about certain topics. I am going to tell you what those are right now and try to limit ourselves to those topics.

One of them is going to be the types of business

models that are found in a typical private placement relationships between investors and other companies, number one.

Number two, the issue of materiality and Reg-D, although we are not going to ask you to interfere with the Court's function and talk about the law.

In connection with materiality, I am going ask you to discuss what a rescission event is and other terminology related to materiality.

We are going to ask you about what a PPM is required in general to contain what you as an attorney look for when you review PPMs.

And finally there may be some ancillary questions that arise during our discussion with you, but I am going to ask you not to opine about specific facts in this case that you may have picked up as a result of your review of records.

Fair enough?

A. Fair enough.

Q. All right. Now, in connection with the business model that exists in this case, I want to throw out the name LLC and/or operating company to you and ask you if in your review of private placements and investor borrowing, the concept of, or the use of, an operating company and/or an LLC in conjunction with a trust is circumstances that

you have seen before?

A. Yes, I have.

Q. And can you tell the jury under what circumstances you have seen it?

A. Yes. In the context of a private securities offering, I would say it is quite common, perhaps not exactly in the trust scenario, but more so you see it set up in the limited partnership field.

So it is very common to see a number of general partners who are selling a private offering to limited partners. And in that setting, they have other entities that are related to the general partners and to the issuer, which would include often limited liability companies and operating companies and managers and management companies, sometimes who are related to the general partners or, in this case, to the trusts in the business model that I have seen in this matter. So, yes, I would say that's a fairly common business model.

Q. All right. I am going to come back to that in a moment, but I want to just define one term before we go further, and that is, in the private placements that you have seen, have you worked with both equity investments and debt investments?

A. Yes, I have.

Q. Could you describe the difference between the

two and then we are going to come back to operating companies?

A. Yes. The definition of a security in the 1933 Securities Act is broad indeed. Having said that, while many things are securities, the vast majority of private offerings are either the sale of equity, stock in a company or debt. The form of debt often is in the form of a promissory note or certificates in which there is a promise to pay back investors the amount that they have invested in plus some interest.

There are differences between these offerings, some substantial differences. In an equity offering, an investor is actually purchasing a piece of the issuer. He is an owner of the stock of that company. And in that business model, as an owner of a company, that stockholder or investor is generally going to be an investor for some indefinite period of time for a long period of time, and very much interested in the day-to-day operations of that issuer and what the company is doing.

In contrast, in a debt offering, when you, as an issuer, are selling the promissory note or a certificate with a promise to pay and some interest, the investor in that instance is really focused in on interest rates and the return on his investment and the time period that he or she is going to be repaid their money.

Q. Similar, but not the same as, for example, investing in a municipal bond?

A. Yes, that's exactly light.

Q. So in connection with the differences between the two, does that also, the differences between the two, also sometimes dictate what material and what is not material is in the disclosure statements?

MS. COOMBE: Objection. Relevance.

A. Yes, it does.

THE COURT: Overruled. Go ahead.

A. The rule is the same for either offering, you are to provide material information, but the issuer has to make the determination as to what is material.

In a stock offering, in an equity offering, that which is material is, I would say, broader. As I mentioned, an investor, the average investor would be interested in knowing what all of the day-to-day operations of that issuer are, what the company is selling, what their profits may be, etcetera.

Whereas, in a debt offering an investor, again, is to be provided material information, but the material information that they are looking for really is --

MS. COOMBE: I am going to object again.

THE COURT: Overruled.

A. -- is the term of the note. When am I going to

be repaid? What is the interest rate that I am going to be paid? Those are the really the material terms in a debt offering.

BY MR. DREYER, CONTINUED:

Q. Now, my question then becomes, in strictly a debt offering, have you seen and can you talk about the relationship of an operating company and an LLC as an obligor to the investment group that gives capital to the trust to give to the asset-based borrower, if you understand my question?

A. I do. In the business model and, you know, it is repeated again and again, there is often an issuer of a debt offering who is selling often promissory notes to an investor. And then there are, as I mentioned earlier, sometimes there are related companies, operating companies, limited liability companies, asset-based companies along the stream. In those instances, sometimes those other companies do -- they participate in the creation of wealth that ultimately pays back the investor.

Q. And those LLCs or operating companies, if they are an obligor, if they stand in the shoes of an obligor, do they have independent fiduciary duties in your experience to the investment group?

A. Not directly to the investors, no. Sometimes there are contracts and management agreements and

partnership agreements or limited liability company operating agreements that describe those relationships, but, no, the investor in this type of business model in which there is a debt offering is really focused in on the issuer of the debt instrument, of the certificate or the note.

Q. Now, in connection with materiality --

MR. DREYER: Withdrawn.

BY MR. DREYER, CONTINUED:

Q. Is there a rule -- without getting into the details, is there a rule or a regulation which governs private placements and separate the private placements from general securities law? Do you understand my question?

A. I do. Yes. Just a tiny bit of background. After the stock market crash in 1929, the SEC required that all securities be registered with the SEC. And shortly thereafter, there were exemptions that were carved out of that requirement, that registration requirement, because it was found that they were small companies that could not afford to go through a stock registration and then be traded on the exchange.

Instead, exemptions were carved out under Regulation D of that 1933 Act. And there really are six rules, six relevant rules under Regulation D, three of which are so-called transactional exemptions of a private

securities offering. Those are rules 504, 505, and 506.

Now, among those three, Rule 506 is by far the most utilized of the exemptions from the registration in a private securities offering. And part of that reason is the rule, itself, that permits an issuer to raise an unlimited amount of money from accredited investors and up to thirty-five non-accredited and otherwise sophisticated investors, but also because the National Securities Improvement Market of 1996 preempted all state blue sky laws.

Meaning that, you, as an issuer, if you want to sell securities under Regulation D, can do it through a 506 without having to satisfy any registration requirements that the state might have because Rule 506 preempts all of those state's securities laws with the exception of some notice requirements.

Q. In your experience, may an issuer of a private placement memoranda to the investment group that you have described, first of all, rely on presumption that the investor has read the private placement memorandum that has been given to them?

A. Yes, yes, they do. In fact, it is typical that there would be a subscription agreement and an investor qualification questionnaire that would ask, you know, have you read this private placement memorandum, and the

investor would affirm and represent that they had.

Q. In connection with private placement memorandums, do either your experience or rules or regs target certain investor groups or investors based on their sophistication concerning the issuance of private placement memoranda?

A. Yes.

Q. Would you explain that, please?

A. Sure. The SEC, in carving out these exemptions, has taken the position that certain investors really can, in their words, fend for themselves. And there are restrictions on whom you can sell these private securities offerings to.

Among other restrictions, you can only sell them to accredited investors. The definition of accredited investors is specified in the law, but generally it means high network individuals unless it is an institutional investor. If it is an individual investor, they are really required to have a million dollars in net assets excluding their home or that they earn two hundred thousand dollars a year or with their spouse, three hundred thousand dollars a year for the past two years with the expectation of earning that in the coming year. So these are high net worth individuals.

Then Rule 506 permits you to also sell to

investors who might not be accredited, but they are nevertheless sophisticated investors, which means that they generally have a good understanding of financial matters and business matters and can weigh the risks associated with a private placement.

Q. Now, I want to turn to materiality and disclosures for a moment and ask you to define for the members of the jury based on your own experience, your review of private placement memoranda, your preparation and authoring of private placement memoranda, what materiality means with respect to a private placement memo?

MS. COOMBE: Objection.

THE COURT: Sustained.

BY MR. DREYER, CONTINUED:

Q. Does the concept of materiality, is the concept of materiality written into the law anywhere?

A. It is.

Q. Okay. Which law is that?

A. It is under Regulation D, Rule 502.

Q. Okay. So without defining it, that's where we find it; is that correct?

A. That's correct.

Q. Now, with respect to disclosure in private placement memoranda, I am going to ask you to tell the jury what the main features of disclosure are when you make a

debt offering, when you are saying to an investor this is the interest rate and this is the term after which the principal is going to be repaid. What are your disclosure requirements in a private placement memorandum?

A. Generally in a private placement memorandum of this nature, you would see a description of the issuer. And then a description of the offering. And then you would see certain risk factors associated with the investment.

You would see a provision on use of proceeds. How is the issuer going to use the money coming in? Then you would often see a business plan and financial statements, which are required when you are selling to non-accredited investors.

And you would then also see typically an investment question or an investor questionnaire, which certain representations I have mentioned, representations will be made from the investor. And then finally, you would see a subscription agreement in which the investors agreed to purchase the debt offering.

Q. All right. In connection with what you have just described, is there a continuing duty to disclose, and if so, does it apply to both equity investments and private placement memorandum debt offerings?

MS. COOMBE: Objection.

THE COURT: Overruled.

A. Yes. There is generally a -- well, this isn't perfectly codified, but there is an obligation while the term of the offering remains open, typically twelve months or shorter, while the term of that offering is still open, issuers do have an obligation to supplement or correct a private placement memorandum in the event of certain circumstances.

Now, while that's not defined, I will say that supplementing PPMs and correcting PPMs generally happen when there has been some sort of a compliance mistake or if there has been something that is so material that it needs to be disclosed to the investors.

BY MR. DREYER, CONTINUED:

Q. All right. Can you define what a rescission event is?

A. Yes, a rescission event is probably even rarer than the circumstances that I have just described. A rescission event occurs when there really is, I would say, a fatal compliance problem with a private placement memorandum.

Perhaps the law has changed or something that will absolutely prevent the business plan from occurring, then the issuer in those circumstances really has an obligation to offer to rescind, meaning to cancel, the transaction with its investor and return the investor's

money or have some sort of correction done to the non-compliance problem in which you would tell your investor while you are permitted to rescind this offer, I have done X, Y, and Z to correct it, and you are free to remain an investor in this offering or rescind it. Then it would be an option of the investor.

Q. Now, in connection were your review --

MR. DREYER: Withdrawn.

BY MR. DREYER, CONTINUED:

Q. Although you have reviewed documents here in the next line of questioning, questions will not be aimed at your specific review, but I am going to ask you to talk to the jury about the relationship of a trust and the creation of an escrow or trust account?

A. Okay.

Q. All right. Tell us under what circumstances an escrow account is created?

A. An escrow account is required under, it is the 1934 Act, and that would be Rule 9(b) and Rule 15(a). Both of those sections of the 1934 Exchange Act require issuers to establish an escrow account to be with a bank in circumstances where there is, what they call, an all-or-nothing or a-part-or-nothing securities offering.

What that means is that you have set a minimum investment amount to your private placement. If you wanted

to, for example, raise five million dollars, but you think that you could accomplish your business plan if you raised only three million dollars, then in that case that would be a part-or-nothing offering in which you would be required to establish an escrow account.

All of the investment money would be put into this escrow account following the rules. And then the issuer would only be free to break that escrow and use any of the investment money once that minimum investment number has been reached, in my example, three million dollars.

Now, if less than three million dollars is raised, then the issuer did not reach their minimum investment amount and is required -- they haven't raised the money during the typically twelve-month period that the offering is open, they are required to return the money to the investor, and the offering is closed.

Q. What if the raise, minimum or otherwise, is raised and deposited in an escrow account and escrow is then broken, what's the significant of that with respect to the escrow account?

A. Once the minimum investment amount is reached, then the issuer is free to either -- what happens is either they close the escrow and put all their money into their operating account, and then future investments would go into their own operating account.

Or because the account has been established, oftentimes an issuer will just continue to use that escrow account to have additional subscription money, investor money, go into that account, and then, you know, the issuer is free to take the money out of that account as it is needed.

Q. Have you seen cases where there have been multiple trusts formed and multiple operating companies formed in the same broker-dealer or in the same investment advisory group?

A. Definitely, yes.

Q. What is the relationship, if any, between the operating company and the LLC which exists?

A. Well, it certainly varies from transaction to transaction. But, you know, in many models you have an issuer that is set up. The purpose of that issuer is disclosed to the investor. And then that issuer might have relationships with the operating company or the management company or the limited liability company or an asset based borrower depending on how the model is set up.

And, you know, oftentimes those limited liability companies or operating companies have relationships with other entities in which their goal is to raise money, to generate capital, to make the transaction successful.

And then -- again, there is no one model, but it is often the case that as wealth is generated and created in that limited liability company or operating company, it then may have obligations to the original issuer to return money to the issuer, which is then shared with investors in accordance with the private placement memoranda.

Q. Have you reviewed any PPMs in this case?

A. I have.

Q. All right. About how many have you reviewed?

A. I have reviewed six PPMs in this case, and those would be the Firstline Trusts 07, the Firstline Trust 07, the Firstline Trust Senior 07. The McGinn, Smith Transaction Funding PPM, as well as the TDM Cable 06 private placement, the TDM Verifier Trust 07, and TDM Luxury Cruise Trust 07.

Q. Are the descriptions of risk in the PPMs that you reviewed consistent with what is required based on your own understanding and practice?

A. Yes, they were.

MR. DREYER: May, I have a moment, Judge?

THE COURT: You may.

MR. DREYER: Thank you, Your Honor. We have no further questions.

THE COURT: For the record, Mr. Jones, do you have any direct questions of this witness?

MR. JONES: I do not, Your Honor.

THE COURT: Ms. Coombe, you may cross examine.

MS. COOMBE: Thank you, Your Honor.

CROSS-EXAMINATION BY MS. COOMBE:

Q. Good afternoon.

A. Good afternoon.

Q. My name is Elizabeth Coombe. I am an Assistant United States Attorney. It is nice to meet you.

A. Nice to meet you.

Q. We have never meet before, correct?

A. We have not.

Q. Did you know that I had asked for an opportunity to interview you, and Mr. Dreyer and Mr. Jones said no?

A. I was aware of that.

Q. Do you know why you didn't want to meet with me before you testified here today?

A. I didn't make the decision. I heard it offhand. I didn't participate in that decision.

Q. That wasn't your call?

A. That's correct.

Q. So you are not trying to hide anything?

A. No, I am not.

Q. Now, you haven't prepared any reports or

summaries, have you?

A. I have not.

Q. And other than the retention letter, you haven't sent any letters to Mr. Dreyer or Mr. Jones or any other written work product?

A. I have not.

Q. Now, the purpose of a PPM is to provide information to investors, right?

A. Correct.

Q. And certain information is required by Regulation D, correct?

A. It is.

Q. And for instance, fees have to be disclosed in the PPMs; is that correct?

A. There is no rule under Regulation D that says you must disclose fees, but generally they are, yes.

Q. And once you choose to disclose fees and obviously you have to be honest about the fees that are being taken, correct?

A. All matters disclosed in private placement memoranda should be honest, that's correct.

Q. And if -- now, let's just get a little background on Regulation D. That's just an exception so that a company doesn't have to do something called a registration statement, which is a big fancy book that

takes a lot of work, and go file it down in Washington, D.C. with the Securities and Exchange Commission, that is necessary to trade on the stock exchanges, right?

A. That's correct.

Q. And Regulation D just says, hey, you don't have to do all of that, you can be exempt from that requirement if you follow the rules, right?

A. Right.

Q. Regulation D doesn't relieve anyone of the anti-fraud provisions of the 1933 and 1934 Acts, those are the Securities Act or the Securities and Exchange Act, correct?

A. Correct.

Q. And obviously you are familiar with those provisions, and they are designed to protect investors, right?

A. I am.

Q. To make sure that investors get the information that they are entitled to?

A. Yes.

Q. So that they can make the decision about what to do with their money?

A. That's correct.

Q. Now, if a PPM discloses how the proceeds of a raise are going to be used, obviously then you have to

follow what has been told to investors, right?

A. Yes.

Q. You can't raise money and then go use it to do something else, whether it is raised through a trust or any other entity, you can't say I am going to use it to invest in a company and then use it to go play Black Jack in Las Vegas?

A. Right. There is a use of proceeds section in most PPMs, and it generally describes how investor money is to be used, that's correct.

Q. And it has to be followed?

A. It should be followed, that's correct.

Q. And the particular language of each PPM, for instance, if there is a use of proceeds, it governs how the money will be used in connection with that particular raise, right?

A. Correct.

Q. And investors rely on those representations when deciding how to invest their money?

A. I would say generally that's true.

Q. Now, a PPM also can't -- it can't include any false information, right?

A. Again, what the law requires is that you provide material information that's not misleading.

Q. Right.

A. That balances the Regulation D and the Rule 10(b)(5), which is another section.

Q. Right, and Rule 10(b)(5), something that the jury doesn't know, is the anti-fraud provisions of the 1934 Securities and Exchange Act, right?

A. That's correct.

Q. And it was designed to protect investors?

A. Indeed.

Q. And you also mentioned you can't omit material information from a PPM, right?

A. What the rule requires is that you not omit material information that a reasonable investor --

Q. Well, I am going to interrupt you because we don't want to hear your definition of materiality. Just that it has to include material information, right?

A. Yes, generally that's correct.

Q. And that's because investors have a right to know how their money will be used so that they can decide whether this investment is for them?

A. Correct.

Q. Now, those principles aren't any different for a debt offering right, are they?

A. They are not.

Q. And your investors are still entitled to all material information, right?

A. Yes. What is material in each of those offerings generally is different, but the rules are the same for each.

Q. And you can't make any false statements even in a debt offering in the PPM?

A. Material false statements, that's correct.

Q. And investors still want to know how their money is going to be used, right?

A. There generally is a use of proceeds provision, yes.

Q. Right. They want to make sure if they are told that their money is going to be used to invest in a specific company, that it is not used for something entirely different to pay bills of some other company, right, or to pay investors in some other raise?

A. I know you are alluding to some specific example.

Q. No, I am not. I am just asking you a general question.

MR. DREYER: Your Honor, I object. She can't ask the question and then --

THE COURT: Rephrase your question.

BY MS. COOMBE, CONTINUED:

Q. Investors, even in debt offerings, want to know how their money is going to be used, right?

A. I would imagine generally investors would want to know that, that's correct.

Q. And if representation is made about how the money was going to be used, then that needs to be followed?

A. What the law requires is that you provide material information to the investors. It is just -- I am not trying to be evasive. It is just hard to say yes the way you have stated the question.

What the law requires is that you provide your investor with material information. Now, issuers and courts have taken the position that when you are providing material information, that you would generally provide a use of proceeds section.

Now, there isn't a bright line test and there perhaps couldn't be as to exactly what you are to provide, but that is the general requirement, that you provide material information that would assist an investor in making an informed decision on whether or not to invest in the issue.

Q. Once you decide to include a use of proceeds section, then it has to be accurate, right?

A. It has to provide material information. It has to be accurate. You can't leave the materiality of it.

Q. It has to provide the investor with all material information, there cannot be any material inaccuracies and

there cannot be any material omissions?

A. Yes, thank you. That's what I wanted to add to it because if there is a minor deviation, it is determined not to be material, then there is no need to correct or rescind your private placement memorandum.

Q. Now, you have never prepared any of the PPMs in this case, correct?

A. That's correct.

Q. You didn't give any advice to anyone about the PPMs prepared in this particular case?

A. I did not.

Q. And you only know about this case and those PPMs what the defendants and their attorneys have told you, right?

A. Yes, that's true.

Q. Now, you mentioned that some of your practice has been in front of FINRA involving arbitrations where investors bring actions?

A. Can I correct my last answer? I am sorry.

Q. Sure.

A. You asked me whether or not everything I know about the PPMs came from the attorneys and the defendants in that case. And the answer is I independently reviewed them and made certain determinations and observations on my own given my experience in reviewing such documents just to

add to that.

Q. Right. You only read the ones that they gave you though, right?

A. That's true.

Q. Now, you mentioned that you had some experience with arbitration issues in front of FINRA and the prior agency, NASD?

A. Yes, I have, and the New York Stock Exchange.

Q. Are you familiar with whether there any arbitration judgments that have been entered by FINRA against Mr. McGinn and Mr. Smith?

MR. DREYER: Objection, Your Honor.

MR. JONES: Objection.

THE COURT: Sustained. Beyond the scope of direct exam.

BY MS. COOMBE, CONTINUED:

Q. Now, there are no provisions in securities laws that make it acceptable to hide material information from investors, right?

A. Again, what the law requires is that you provide material information to your investors. There isn't a provision that doesn't say that either. I mean, again, it is how an issuer has to interpret this question of materiality. And it differs from issuer to issuer who struggles to make sure that they provide all the

information that a reasonable investor would consider material.

So I guess the answer to your question is -- the short answer is yes, it doesn't say you cannot hide information. What the law requires is that you provide material information.

Q. You have to provide all material information even when times are good, the economy is doing well, right?

A. Of course.

Q. You have to provide all material information even when the economy is bad and times are bad, right?

A. Right.

Q. You have to provide all material information whether your company is doing well, correct?

A. Correct.

Q. And you have to provide all material information even when your company is not performing well, right?

A. Yes.

Q. You talked a little bit about trusts and LLCs. I think you said that that wasn't that common to have a trust and an LLC, but you talked about some other circumstances.

Now, if a PPM indicates that money would be raised and then transferred to an LLC, you can't have a use of proceeds that says it will be used to invest in the

company and then use the money to go play Black Jack in Vegas, right, after it gets to the LLC?

A. I am sorry. I am not sure how to answer that question. I can tell you generally though what a use of proceeds section --

Q. Let me ask my question again.

MR. DREYER: Objection, Your Honor.

THE COURT: Well, he is not answering the question. Go ahead. Next question.

MS. COOMBE: Yes, Your Honor.

BY MS. COOMBE, CONTINUED:

Q. The use of an LLC does not allow people to avoid the securities laws, raise money from investors to invest in company acts, and then go play Black Jack in Las Vegas, right?

A. I guess right. I mean --

Q. Well, that would be theft, right?

MR. DREYER: Objection, Your Honor.

THE COURT: Overruled.

BY MS. COOMBE, CONTINUED:

Q. That would be theft?

A. I would need to know the specific circumstances. I certainly can't, given the question that you have said to me, express whether or not a crime has been committed based on those circumstances.

Q. Unless the PPM said the purpose of this offering is to raise money to go play Black Jack in Las Vegas, are you really telling this jury that it is okay to transfer money to an LLC and then take the money and play Black Jack in Vegas?

MR. DREYER: Objection. That's not the question that she has asked, Your Honor.

THE COURT: Overruled.

A. Well, let me try to answer it. I will say that the activities, the business activities or other activities, of the limited liability company are not always part of the offering.

In the circumstances that I have seen in this case, we have an issuer --

Q. I am going to interrupt you. I am not asking you about this case. In fact, Mr. Dreyer said that as well.

A. I can speak to it generally.

Q. Right. It could you focus on --

MR. JONES: Objection.

MR. DREYER: Objection, Your Honor. She cut him off. Let him answer.

THE COURT: Limit your questions to the direct exam. I mean, you are going off and you are going to go way out beyond what he testified.

He didn't testify to any specifics. And now you are getting into specifics. Do you want to make him your witness?

MS. COOMBE: No, Your Honor.

THE COURT: Well, you are close to doing that.

THE WITNESS: Your Honor, if I may --

THE COURT: No, you may not.

THE WITNESS: Thank you, Your Honor.

BY MS. COOMBE, CONTINUED:

Q. Are you being paid to testify here today?

A. I am.

Q. How much are you being paid?

A. I am charging my regular hourly rate of three hundred and thirty-five dollars an hour that I would charge to any client.

Q. And does that include -- you are also billing for time that you spent preparing for your testimony today?

A. Yes.

Q. And for the time that you spent reviewing documents?

A. Yes.

Q. And for meeting with the defense attorneys?

A. Yes.

Q. And that includes your expenses as well?

A. As it would with any client.
Q. And is there a total amount of fees that you have earned so far?
A. Yes.
Q. Could you tell us what it is, please?
A. I don't remember the exact number, but I believe we sent a bill for approximately twenty-four hundred dollars.
Q. Is there some cap on the amount that you can get in connection with this case?
A. Yes.
Q. How much is it?
A. Twenty-five thousand dollars.
Q. Did you know Mr. McGinn or Mr. Smith before you testified here or before you were retained?
A. Not before I was retained, no.
MS. COOMBE: May I have a moment, Your Honor?
THE COURT: You may.
MS. COOMBE: I have nothing further, Your Honor.
THE COURT: Redirect, if any.
MR. DREYER: Just one clarification question.

REDIRECT EXAMINATION BY MR. DREYER:

Q. Mr. Engel, in connection with Ms. Coombe's questions about use of proceeds, does the use of proceeds provision in a PPM in your experience relate or restrict -- is it restricted to the issuer or does it pertain to the downstream affiliated companies, including the LLCs?

A. It is restricted to the issuer. There are activities of downstream LLCs that do not need to be disclosed in a private placement memorandum and might be unrelated to the use of proceeds provision in a private placement memorandum.

MR. DREYER: Thank you very much.

THE COURT: Mr. Jones, any questions?

MR. JONES: No, Your Honor.

THE COURT: Ms. Coombe, anything further with this witness?

MS. COOMBE: Nothing, Your Honor.

THE COURT: Okay. You may step down. Thank you.

THE WITNESS: Thank you, Your Honor.

(Whereupon, the Witness is excused.)

THE COURT: Mr. Dreyer.

MR. JONES: I have got the next witness, Your Honor. John D'Aleo.

Exhibit 25

PREPARED SUMMARY OF THE FOUR FUNDS IN NOVEMBER 2007

	Original Investment	Current Value	Note Liability
FAIN	$14,514,376	$12,115,487	$16,639,000
FIIN	$24,687,857	$18,917,857	$19,850,000
TAIN	$24,972,298	$21,378,546	$29,882,000
FEIN	$17,585,097	$10,472,655	$19,770,000
Totals	$81,759,628	$62,884,545	$86,141,000

Loss in Investments

- $18,875,083
- 23.1%

Loss in Equity

- $23,256,455
- - 27.0%

association with McGinn, Smith did you review the PPMs involved in the Cable Funding/Cable Trust relationship?

A. No.

Q. At any time from August, September of 2006, through November of 2007, did you review the relationship between TDM Cable Funding and TDM Cable Trust 06?

A. No.

Q. Did you know, Mr. Rees, that the money in TDM Cable Funding from which the three hundred and fifty thousand dollar loan payments were made, came from a bridge loan to TDM Cable Funding before TDM Cable Trust ever came into being? Did you know that?

A. I was not aware of that.

Q. You were the lead accountant in the office at that time, were you not?

A. I was.

Q. And as the lead accountant, you had responsibility for making sure the books and records were accurate, complete, and correct, were you not?

A. That is correct is correct.

Q. At any time in fulfilling those responsibilities with respect to TDM Cable Trust, TDM Cable Funding, did you review the PPM to assist you in understanding the structure of those transactions so you could make accurate entries in the books and records?

A. I did not review the PPMs for those.
Q. Now, you have told us under oath today that you were told by David Smith to characterize the money that came from TDM Cable Funding to Mr. Smith, Mr. McGinn, and Mr. Rogers as loans, correct?
A. Yes.
Q. Have you ever testified about that subject before?
A. I spoke to FINRA about it.
Q. And you spoke to FINRA under oath, did you not?
A. Yes.
Q. And it was the same oath you have taken in this courtroom, wasn't it?
A. Yes.
Q. And that was in January of 2010, correct?
A. Yes.
Q. That was three years ago, correct?
A. Yes.
Q. A little closer in time to the events in question, correct?
A. Yes.
Q. And you have reviewed your testimony before FINRA in preparation to be a witness in this courtroom, have you not?
A. Correct.

the role of finance, but in our software program, I was able to create an expense account.

Q. In the context of this specific transaction involving the fee/loan issue, correct, you created an origination fee?

A. Yes.

Q. Now, you also referenced in that answer the trust. The trust was not in being at the time the money was loaned. It was not trust money. Did you know that?

A. I was unaware of that.

Q. Are you familiar with the PPM for MSTF?

A. I know it exists. I have not read it in its entirety.

Q. How about for MSA, do you have any knowledge of the structure of MSA?

A. I thought it was the holding -- the management company for the income note funds.

Q. Do you understand the relationship between MSTF and MSA?

A. Not with perfect clarity.

Q. How about any clarity?

A. I can't say that I know.

Q. Do you have an understanding of the agency relationship between MSTF and MSA?

A. That would have been disclosed in the PPM, which

I have not read.

Q. Is it fair to say that with respect to in all of the accounting entries that you were responsible for making in connection with the various entities under the McGinn, Smith umbrella, that you had not read any of the PPMs associated with those and had no idea of the structure of the PPMs, what was authorized and what was not authorized?

A. I -- my experience with PPMs was really to look to find out what the commissions were and other types of expenses. I have not read them cover to cover.

Q. Did you know who MSTF could loan money to?

A. They could invest in preferred stock of McGinn, Smith, and then make bridge loans.

Q. And they could make bridge loans as MSTF chose to make bridge loans, correct?

A. Yes.

Q. Were you aware that MSA would use MSTF as their agent for the purpose of making investments, securing loans, and loaning money?

A. I was not aware of that.

Q. Were you aware that the Four Funds, FIIN, FEIN, TAIN, FAIN, those four funds, could loan money to MSTF?

A. I did not know that.

Q. Did you know that the Four Funds and MSTF and MSA could repay loans to other entities affiliated and

related to the MS & Company umbrella?

A. I did not know that.

Q. Were you aware that it was a practice of Tim McGinn and Dave Smith to accrue their fees in order to protect investors?

A. I am not sure what you mean by that.

Q. Did you know that they didn't take fees when they could from these transactions?

A. I am sorry, say it again.

Q. Did you know that Tim McGinn and David Smith did not take fees they were entitled to from these transactions?

A. Yes.

Q. And when you don't take a fee, that is accruing the fee, isn't it?

A. If you record it on your books as a liability.

Q. And if you accrue those fees, those fees are still due and owing you, correct?

A. Correct.

Q. Are you aware that Tim McGinn and David Smith would use their accrued fees to secure the transactions between and among the various entities and related companies?

A. I wasn't aware.

Q. Were you aware that at one point in time fees

A. They are to prepare monthly financial statements. Depending on your filing requirements, you have to file monthly, quarterly, annual financial statements. Originally they were hard copy, but as times became more advance, you did it electronically. And there were other -- there was a couple other filings that we had to do that I was responsible for.

Q. And in the period after you returned in 2009, what was the month again?

A. April.

Q. You began a review of the books and records of McGinn, Smith and related entities; is that correct?

A. Yes.

Q. Did you find new businesses had grown up since you last left?

A. Yes.

Q. You found the Trusts, for example, were new, correct?

A. Yes.

Q. The Funds were new, were they not?

A. Yes.

Q. These were things that you had not been familiar with the first time you were there?

A. Not through the first time. I was an investor in one of the Four Funds so I knew of them.

Q. So you come back in 2009 and you take, as your responsibility requires you to as the FinOP, you review the books and records of the MS related entities pursuant to your responsibilities, and you go and report what? What do you report to these gentlemen when you conduct a review?

A. The -- first of all, the FinOP's responsibilities relate only to the regulated entities of McGinn, Smith & Company. So then there was the approximately eighty other entities that were not regulated and didn't have those same monthly filing requirements. So I went back and reported to them that these books and records were -- of the non-regulated entities were in --

Q. They were a disaster I think your words were, correct?

A. They were not in very good condition.

Q. And you told Mr. Smith, did you not, when you first talked to him about this that it was going to take you six or more months to figure out what was going on in the books and how to correct them, is that an accurate statement?

A. I don't remember giving him that timeframe. I know that I talked to him that it was going to take some time to get everything straightened out.

Q. Who were the persons who had been in the positions in the accounting office at McGinn, Smith who

were responsible, in your view, for the records as they were in 2009?

A. David Rees, my predecessor, would have been primarily responsible for the accounting records. And again, the same employees that worked for me worked for him, Brian Cooper and Tricia Trombley.

Q. Of those three members, who did what, in other words, what were their responsibilities that you discovered as a result of your review?

A. Tricia Trombley did payroll and accounts payable. Brian Cooper made investor payments and issued monthly or daily cash reports. He also did some general accounting. And then the bulk of the general accounting would fall on Mr. Rees and then myself.

Q. Okay, and were any of those people still there when you got there in 2009?

A. Yes, Tricia Trombley was out on maternity leave, but she returned.

Q. What about Mr. Cooper?

A. Yes, he was there.

Q. All right, and as you were doing your reviews of all these books and records, did you have occasion to talk to Mr. Cooper?

A. Yes.

Q. About entries that had been made just in

general?

A. Yes.

Q. Did you have occasion to pick up the phone and call Mr. Rees and ever ask him to come in and talk to you about what had been done?

A. Yes.

Q. Did he come to the office and assist you or try to assist you in straightening some things out?

A. He came at least once, maybe twice.

Q. Okay. Now, in the scheme of the operations at McGinn, Smith, Mr. Smith and Mr. McGinn had customers that they dealt with over the years; is that correct?

A. Yes.

Q. They were involved in a different aspects of the company than the nitty-gritty day-to-day accounting work, is that fair to say?

A. They chose to be, yes.

Q. What were they doing, they go out and marketed their funds and their trusts; is that correct?

A. They were most skilled at raising money.

Q. They were skilled at retail; is that correct?

A. Yes.

Q. And so -- by the way, when you got back to the broker-dealer in 2009, did you sit down and read each and every private placement memorandum for the Funds and for

the Trusts?

A. No.

Q. And to this day, you still haven't done that, correct?

A. That's correct.

Q. And the source of all the information concerning what an investor should know and what he is told is found in those private placement memos, if you know?

A. Yes.

Q. So moving forward, you began in 2009 to have these discussions with Mr. Smith about the books and records and the corrections and the things that had to be done, and then FINRA shows up, correct?

A. Yes.

Q. And they showed up at about September of 2009?

A. I think they may have showed up before that. Their presence was either through other requests was -- they were -- there was ongoing requests for information.

Q. Did you ever meet with them one-on-one, in other words, with Mr. Smith or Mr. McGinn or Mr. Guzzetti or someone else who was not there?

A. Yes.

Q. And where did that take place?

A. There was a meeting at McGinn, Smith & Company.

Q. When?

A. I am not sure. It may have been January of 2010.

Q. January of 2010 would have been, of course, before you actually gave testimony at FINRA; is that correct?

A. I believe so.

Q. And to move forward then, after September of 2009 when you met with FINRA and with others, how many times altogether did you meet with FINRA?

A. Probably at least twice. I know at least twice. There was people in our office in December of 2009. We got shut down, and then I believe a meeting after that.

Q. Well, let's get right to this issue. Sometime you went to New York or some place and testified under oath, was it New Jersey?

A. Yes.

Q. And you testified under oath, you raised your hand just as though you did here, just as you did here, and you swore to tell the truth in front of FINRA; is that correct?

A. Yes.

Q. And there came a time when you were asked about some of the subjects which the prosecution talked to you about yesterday, correct?

A. I am not sure what you are referring to.

Q. If you don't recall, you don't recall because I am going ask you in a moment obviously.

A. Can you either refresh my memory or show me a document?

Q. Well, let me do it this way. Let me ask you this. Yesterday you said to this jury that the money that went from the Four Funds or transferred from the Four Funds, if you wish, to McGinn, Smith and through MSTF for payroll and for other things that went on, that was all unauthorized. In a nutshell, that's what you testified to yesterday; is that correct?

A. Can you say that again?

Q. Yes. Money was transferred from MSTF to McGinn, Smith specifically to pay a payroll account and it was done to disguise the fact that the Four Funds, which was the source of the money, your words, to disguise the fact that the Four Funds could not transfer this money to McGinn, Smith & Company.

It is a paraphrase of what you said on the stand yesterday. Do you know what I am talking about?

A. Yes.

Q. Why don't you say it in your own words so the jury understands what we are both referring to?

A. I said there was a series of loans from the Four Funds to MSTF. They were recorded as loans on the books of

the Four Funds and loans that MSTF -- the money came in to MSTF, and then was advanced to McGinn, Smith either as an investment in the McGinn, Smith preferred stock or fees, and that was used to facilitate the payment of payroll at McGinn, Smith.

Q. Well, on page 108 of the FINRA transcript, and I am going to start at line sixteen, were you asked the following questions and did you make the following responses concerning the very topic that we are now talking about?

A. Can I see that page?

Q. No. I am going to read it to you. If you have to see it later, you can. I am just going to ask you if made these answers to the following questions.

Question, Mr. McCarthy: I just want to clarify this one last point because I am not sure that I understand you.

At some point or at any point between April 2009 and today, did you start to question the practices of the firm?

Answer: Yes.

Question: Why didn't you come forward?

Anser: I mean, I think the biggest area of concern, your words, I think the biggest area of concern is the investments that the Four Funds made. Since the time I

have been there, you guys have been investigating it.

Question, Mr. McCarthy: When we were all sitting in the room, in that room in Albany, at any point, did you consider saying, listen, let me share with you my concerns?

Witness, you: I thought we had an open and honest dialogue.

Mr. McCarthy: Did you ever consider, you know, what -- I better speak out here?

The Witness: I certainly felt like I had been communicating, providing all documents that had been requested.

Mr. McCarthy: I think you wanted to tell us, didn't you?

The Witness, you: I think you guys have looked at these balance sheets and come to your own conclusions.

Mr. McCarthy: What are our conclusions?

You, the witness: That all these investments were made honestly and with supporting documentation. Some of the outcomes have been favorable.

Mr. McCarthy: Do you think that's our conclusion?

Witness: Yes.

Mr. McCarthy: Is that your conclusion?

You: Yes.

Did you make those answers to those questions?

A. I believe that's my testimony.

Q. And you were under oath at the time?

A. Yes.

Q. Yesterday you told the members of the jury, and I am going to skip around here, that you had a specific discussion with Mr. Smith. You didn't mention anybody else. You said you had a specific discussion with Mr. Smith about tracking the fees and accrual of fees in order to do another cover up or scheme, I think you called it.

Do you remember what you told the members of the jury or do you want me to refresh your recollection?

A. I remember talking about fees. Proceed.

Q. All right. Did this topic come up at FINRA as far as you recall?

A. I don't recall.

Q. Would it be fair to say that back in Albany at the McGinn, Smith broker-dealer building, once this whole discussion about creating corrections, new adjustments, new entries in the records that you knew were completely messed up, that you were assigned or given the responsibility of showing certain fees on the books and records of the company, accrual of fees, advisory fees, etcetera, that were due to the operating company from one of the Funds

and/or Trusts, let's say. That was your responsibility, was it not?

A. Mr. Cooper was responsible for the Four Funds. I really got involved with accounting for them in February of 2010, was when I really sat down with him and tried to straighten out the supporting schedules to the ledger.

Q. 2010?

A. Yes.

Q. I thought you said this morning 2009, October of 2009?

A. The Four Funds.

Q. Not the Trusts?

A. They are different entities. The entities were split up between myself and Mr. Cooper. Mr. Cooper was responsible for the accounting on the Four Funds.

Q. Okay.

A. And then I met with him, I believe it was around February of 2010, where I finally sat down with him and said let's get these all straightened out and get the proper entries on there.

Q. So when you were talking to FINRA about the tracking of the fees, the advisory fees in order to offset the use of those fees against certain related party investments, did you have a conversation with FINRA in October, November, December, January, one-on-one with them,

about that project that was going on?

A. I don't recall. Is it part of my testimony? Can you refresh my memory?

Q. This is background. I am just asking you to recall for the jury. This was a project that was going on inside of McGinn, Smith, to correct the books and records and to figure out where these advisory fees should be booked, how it should come about, how they should be offset against transactions that have occurred, correct?

A. Correct.

Q. There were advisory fees accruing, accruing in the Funds, were there not?

A. They were not. They were not -- it was an Excel spreadsheet that Mr. Cooper was working on with Mr. Smith, and they had to be entered to the books. They were not on the books and records, I don't believe, until February of 2010 around that time.

Q. Well, to jump ahead, and we are going to get to this in a little more detail in a little while. Weren't there accrued fees of over $956,000.00 in connection with -- accrued fees due ultimately to these gentlemen from the Four Funds. That was money in the bank, those were accrued fees, were there not?

A. I am not sure about the dollar amount, but there was --

Q. $956,000.00, that doesn't ring a bell?

THE COURT: Wait until he answers the question. Go ahead. Finish your answer.

MR. DREYER: I am sorry, Your Honor.

A. If you want to show me document that has a dollar amount that there was fees. There certainly was fees that were due McGinn, Smith Advisors and McGinn, Smith Capital Holdings for private placement.

BY MR. DREYER, CONTINUED:

Q. Mr. Newman, page seventy-five, line seven.

Mr. Newman: How did you first learn about this project, who explained it to you, and how was it explained?

You: I don't know if it was Mr. Smith or Cooper who told me about it originally, but they explained that we have to calculate what the underwriting and management advisory fees are from the Funds to get their books and records up to date. And then probably David Smith told me he was going to use those fees to offset certain related third-party investments.

Is that what you told FINRA under oath?

A. If you are reading from my testimony, yes.

Q. So in other words, if I am reading from your testimony then, yes. You don't remember this?

A. I do recall it.

Q. Were you lying to FINRA?

A. No.

Q. Mr. Newman asked you at line twenty-four, and by the way, again to orient this question, you said yesterday that all these conversations you had with Mr. Smith.

Mr. Newman: You don't know whether it was Mr. Cooper or Mr. Smith that originally told you about the need to come up with this calculation?

The Witness, you: I don't recall.

So within a few months after all these conversations took place in the office, in FINRA in February of 2010, you don't even recall the conversations which were about these fees, but yet, two years later now in this courtroom under the questioning of the prosecution, all these conversations took place with Mr. Smith, is that your testimony?

A. Yes.

Q. Now, I want to turn to some of the testimony you gave yesterday, and we will try to move toward to today and we are going to talk about FINRA again. I want to turn to some issues that we talked about this morning that you and I talked about, but that you also brought up yesterday.

And I believe you made a general statement that the Four Funds could not transfer money to McGinn, Smith period; is that correct? What was the reason for your conclusion that they couldn't do that?

A. The context, I believe, was if the Four Funds made a loan to McGinn, Smith & Company, that the loan wouldn't have been a credit, we would have gotten the cash to get an offsetting liability so that it wouldn't have been valuable towards the net capital computation.

Q. Well, are you aware, sir, that under the terms of the PPMs, under the terms of the raises, they call it the raise of the investment money, the Four Funds actually, the PPM which now you claim in front of this jury that you have never read, that the PPM allowed investor money to be used for the expenses of the broker-dealer. Are you aware of that?

A. Can you read the whole section that relates to that?

Q. I am going to in a moment, but first I am asking you of your own memory. You testified yesterday in front of this jury, but then you testified today that you never read the PPM, correct?

A. I have read part of the PPM. And you are talking about different things.

Q. Well, I am asking you about the specific statement that you made yesterday, that the Four Funds could not use investor money to pay expenses of the broker-dealer?

Obviously you are not answering, so let me ask

you an intermediate question.

Was your testimony that the Four Funds could not send investment money to MSTF?

A. Yes.

Q. And what was the reason why you concluded that it could not send money to MSTF?

A. It was a related party transaction.

Q. And you said that by sending it to MSTF it was a disguise of something, a disguise of what?

A. It became a disguise because the money came from the Four Funds into MSTF, and then the money was transferred to the broker-dealer to make payroll.

Q. And when, by the way, in preparation for your testimony about that very topic, when was the last time you read any one of the PPMs from the Four Funds?

A. I don't recall, not recently.

Q. Not recently. Years ago, I would take it, two, three, four years ago?

A. I am not sure, but not recently.

Q. Well, not recently.

MR. DREYER: May I ask you to pull up a government exhibit?

BY MR. DREYER, CONTINUED:

Q. We are going to pull up a government exhibit. I guess I have to put the screen up. The first one will be

Government Exhibit GC1, private placement memorandum to FIIN. Do you have that up in front of you, sir?

A. I do.

MR. DREYER: Could you turn to page one of the document entitled summary? You are there. Now, under the business section, do you think you could blow that up for us?

BY MR. DREYER, CONTINUED:

Q. Do you see that, Mr. Shea?

A. I do.

Q. Are you able to read that?

A. Yes.

Q. Do you see in the fourth line from the top where it says: We may acquire such investments directly or from our managing member or affiliate of us or a managing member that has purchased the investment. If the investment is purchased from a managing member or any affiliate.

And then it goes on to say what they will or will not do concerning prices. So that is one paragraph that I wanted to show you, okay?

A. Yes.

Q. They can purchase investments from affiliates of the McGinn, Smith, correct? Is that what it says?

A. Yes.

Q. Let's turn to page seven of the document, and I

am going to turn -- I am going to actually direct your attention and ask that it be blown up.

MR. DREYER: If you could blow up the first paragraph. Yes that's it.

BY MR. DREYER, CONTINUED:

Q. FIIN was organized -- and I am looking at the second paragraph. FIIN was organized in 2003. We have no historical financial statements or results of operations. As a result, you will have no historic data on which to base your estimation of our likelihood of success in achieving business and financial goals.

Now, if you can go down to the paragraph that starts: We require a substantial amount of cash liquidity to operate our business. Do you see that?

MR. DREYER: And then just scroll down, please. Okay. Stop.

BY MR. DREYER, CONTINUED:

Q. We require a substantial amount of cash liquidity to operate our business, among other things, we use cash liquidity to pay incentive commissions to our managing member salesmen at the rate of two percent. Pay our managing member a portfolio management fee of one percent of the aggregate principal amount of the notes per year over the term of the notes.

Do you happen to know what the total raise of

FIIN was during the time of its life?

A. No.

Q. Well, if I told you it was well into the millions, and one percent of many, many millions of dollars would have been a significant amount; is that correct?

A. Yes.

Q. So certainly FIIN had the wherewithal and the right under the PPM, which had been circulated to investors, to pay legal fees or they could be -- not legal fees -- excuse me, fees. Do you see that?

A. Yes.

Q. You hadn't read this though in how many years when you testified yesterday?

A. I am not sure how many years. It wasn't recently.

Q. All right, and that is -- by the way, did you ever identify when you said yesterday about MSTF not being able to take money from one of the Four Funds, did you ever identify whether the money that you were talking about came from one or all of the Four Funds?

A. I believe the money came from three of the Four Funds.

Q. Why don't you tell us what you recall they came from?

A. I am not sure which three they were.

Q. FAIN was one of them, wasn't it? Do you recall?
A. I don't recall.
Q. Let's take a look at Government's Exhibit GC2, PPM for FEIN.
MR. DREYER: I am going to ask you to turn to page one under the summary and under business, if you could blow up the business section.
BY MR. DREYER, CONTINUED:
Q. And if you see over in the end of the fourth line down, we may acquire such investments directly, etcetera. It is the exact same language as the FIIN business plan that I just read to you before; is that correct?
A. I believe so.
Q. All right. Now, turn, if you would, to page seventeen, if you would. And specifically under affiliated transactions?
MR. DREYER: If you could blow up the first paragraph.
BY MR. DREYER, CONTINUED:
Q. And it says our managing member is McGinn, Smith Advisors, MSA; is that correct? Is that what it says?
A. Yes.
Q. A limited liability company. And then it goes on to explain its relationship with McGinn, Smith, McGinn,

Smith Holdings, David Smith. It advises anyone who is reading this of all these relationships.

MR. DREYER: Now, if you could scroll down. Please stop right there. That's good.

BY MR. DREYER, CONTINUED:

Q. And in the middle of the page, it says: Our servicing agent, McGinn, Smith Capital Holdings Corp. is an affiliate of our managing member, McGinn, Smith, LLC, and our placement agent, McGinn, Smith & Company, McGinn, Smith Capital Holdings is fifty percent owned by David Smith, etcetera. It goes on and on, but it describes who the affiliates are, correct?

A. Yes.

Q. And under the first PPM that I showed you on the screen for FIIN and under this one for FEIN, affiliated transactions and payments to various investments among affiliated organizations is specifically authorized, is it not?

A. The purchase of assets from the affiliates is authorized.

Q. How about investments, how about -- well, how about a loan, would a loan be authorized?

A. My personal opinion --

Q. I am not asking for your personal opinion.

A. The loan would not be authorized. It is not the

purchase of an investment from an affiliate.

Q. And you are saying this without having read the PPM for a number of years?

A. Yes.

Q. Now, I want to take a look at -- just to cover all the bases, Government Exhibit 3, which is another PPM, this time for TAIN, which stands for Third Albany Income Notes. And again, we are going to start on page eleven this time.

MR. DREYER: I am just going to turn to my hard copy for a moment, Your Honor. And in the middle of the page, if would you start with the bullet points and then blow the first five bullet points up.

BY MR. DREYER, CONTINUED:

Q. We require a substantial amount of cash liquidity to operate our business. And then it lists the same things on all the other PPMs for the funds list. And it requires funds including for satisfying working capital requirements, paying operating expenses including accounting and legal expenses, and we estimate to equal .25 percent of the aggregate principal amount of the notes per year.

Does that particular provision concerning satisfying working capital requirements mean anything significant to you?

A. Yes.
Q. What does it mean?
A. It means that they could pay expenses to operate the Funds.
Q. Okay, and let's just move down one paragraph. Is there a provision in there about fees or do you want me to?
A. I am sorry. Where are we?
Q. I am sorry.
MR. DREYER: If you scroll down. Just right there, please. I am sorry. Just going to have to look at my -- well, first of all, let's turn to page five of this and back into the fee issue. If we can turn to page five under the business model, middle of the page where it says: We may again. It is about the fourth line down.
BY MR. DREYER, CONTINUED:
Q. We may acquire such investments directly or from a managing member or affiliates of us or a managing member that has purchased the investment.
So this is the same language again under the business description that every other PPM in the Funds has; is that correct?
A. Yes.
MR. DREYER: And turn again to page eleven. If you go to the second bullet point. If you would blow

that up.
BY MR. DREYER, CONTINUED:
Q. And that's, again, where we pay our managing member a portfolio management fee of one percent of the aggregate principal amount of the notes per year over the terms of the notes, correct?
A. Yes.
Q. And so on the Third Albany Income Notes, you were aware that this was a very large raise, correct?
A. Yes.
Q. Do you know off the top of your head?
A. Tens of millions.
Q. Tens of millions. And one percent of that would have been what?
A. $100,000.00.
Q. $100,000.00. And these were being accrued. These fees were not being taken by these gentlemen, did you know that?
A. Yes.
Q. So you did know that?
A. Yes.
Q. Thank you. So in each of these PPMs, the investors are specifically being told this is what we may do with the money, we may send the money to affiliated organizations. We are going to pay our brokers a

percentage, and we are going to charge a percentage for accrued commissions fees?

MS. COOMBE: Objection. The question mischaracterizes the document. It doesn't say anywhere that it is going to be used to -- it doesn't say that.

BY MR. DREYER, CONTINUED:

Q. All right. It says it may. Is that correct? Let me rephrase the question for you.

The PPM specifically tells the investors that all these commissions and fees that you have been talking about to the jury yesterday and today, all these fees are due to the McGinn, Smith, to the manager of the fund?

A. To the entities identified in here by their labels, servicing agent managing member.

Q. And then just to repeat my question and to get your answer again on the record. You knew that those fees were being accrued and were not be taken by the organizations that were entitled to receive them, correct?

A. Those fees were not being accrued on the books and records.

Q. I am not asking you that.

A. Okay. They were not.

Q. Okay. But at some point in time, that's the discussion that you had with Mr. Smith and others at the company; is that correct?

A. Yes.
Q. About accruing those fees that had not been taken?
A. Yes.
Q. And documents were then created, if you want to use that word, we may as well, to reflect what those fees were, correct?
A. Yes.
Q. And at some point you, yourself, I believe were privy to or saw a document which showed accrued fees, fees had been accrued among the Four Funds in the amount of almost a $1,000,000.00, correct?
A. I believe that is correct, yes.
Q. Those accrued fees were then used to offset payments that you claim before this jury are improper, correct, yes or no? They were used on the books and records to offset those payments?
A. Not all the transactions were improper.
Q. If the Funds could not lend, in your words, money to MSTF -- is that your testimony, that in your view as the FinOP you concluded, although without reading the PPM with any care, if that's what your testimony --
MS. COOMBE: Objection.
THE COURT: Sustained.
BY MR. DREYER, CONTINUED:

Q. If your testimony is that it could not lend money to MSTF, wouldn't it be permitted for one of the Funds or all of the Funds to make direct transfers to MSTF under the terms of the PPMs under any scenario in your opinion?

A. Under any scenario?

Q. Yes.

A. It -- yes, under any scenario.

Q. Yes, it couldn't or yes, it could?

A. Yes, it could.

Q. Okay, and one of the ways it could do that, could it not, the PPMs could send money to MSTF to do what, to buy stock, could it not?

A. Send money to MSTF under what vehicle?

Q. Well, I am asking you. Either a loan or a direct purchase of stock in MSTF?

A. Are you saying that -- so those are two different types of transactions. Are you saying that buying stock?

Q. Buying stock in MSTF?

A. Buying stock in MSTF.

Q. Yes. Permitted transaction or not?

A. Buying stock in a related entity.

Q. An affiliate?

A. Hmmm.

Q. You don't know?

A. I don't know. I would have to look at the PPM to answer that question.

Q. Well, when you made the bold face statement here yesterday that the Funds' money couldn't go to MSTF, you failed to take into consideration that under some circumstances transfers can be made to MSTF; is that a fair statement?

A. The characterization of the payments that was made was that they were loans from the Funds to MSTF. And, yes, you are correct that they could have purchased an asset from MSTF.

Q. Wasn't one of the primary purposes, by the way, of MSTF, itself, to buy McGinn, Smith preferred stock? Do you know that as you sit here?

A. Yes.

Q. So if the use of proceeds for the PPM, for the private placement memorandum, of MSTF which we have not looked at yet, if the use of proceeds allowed the use of money in MSTF to purchase $1,500,000.00 of McGinn, Smith cumulative preferred stock, would you agree that that is a legitimate transfer of money from MSTF?

A. Yes.

Q. Okay, and with respect to the PPM, which we haven't looked at, and we might depending on where we go

from here. Page five of the MSTF PPM, the company, MSTF, can also invest in other public and private securities deemed by management to be credit worthy. What does that mean to you?

A. That management would perform an analysis of the risks and rewards of a transaction and make an investment accordingly or not make an investment.

Q. Who was management in this case?

A. Mr. McGinn and Mr. Smith.

Q. So the obligation was Mr. McGinn and Mr. Smith in all these funds and in MSTF to make those credit worthy affiliate decisions, correct?

A. Yes.

Q. Or not only in affiliates but in any enterprise, correct?

A. In any controlled enterprise?

Q. Yes.

A. Yes.

Q. So getting back to my original question, when you said yesterday that money could not flow from the Four Funds into MSTF and that what happened back in McGinn, Smith in 2009 was to disguise a payment, you made that statement without understanding, without having read the provisions of the PPM, which did, in fact, allow the managing members of those funds to -- and MSTF to take

association with McGinn, Smith did you review the PPMs involved in the Cable Funding/Cable Trust relationship?

A. No.

Q. At any time from August, September of 2006, through November of 2007, did you review the relationship between TDM Cable Funding and TDM Cable Trust 06?

A. No.

Q. Did you know, Mr. Rees, that the money in TDM Cable Funding from which the three hundred and fifty thousand dollar loan payments were made, came from a bridge loan to TDM Cable Funding before TDM Cable Trust ever came into being? Did you know that?

A. I was not aware of that.

Q. You were the lead accountant in the office at that time, were you not?

A. I was.

Q. And as the lead accountant, you had responsibility for making sure the books and records were accurate, complete, and correct, were you not?

A. That is correct is correct.

Q. At any time in fulfilling those responsibilities with respect to TDM Cable Trust, TDM Cable Funding, did you review the PPM to assist you in understanding the structure of those transactions so you could make accurate entries in the books and records?

A. I did not review the PPMs for those.
Q. Now, you have told us under oath today that you were told by David Smith to characterize the money that came from TDM Cable Funding to Mr. Smith, Mr. McGinn, and Mr. Rogers as loans, correct?
A. Yes.
Q. Have you ever testified about that subject before?
A. I spoke to FINRA about it.
Q. And you spoke to FINRA under oath, did you not?
A. Yes.
Q. And it was the same oath you have taken in this courtroom, wasn't it?
A. Yes.
Q. And that was in January of 2010, correct?
A. Yes.
Q. That was three years ago, correct?
A. Yes.
Q. A little closer in time to the events in question, correct?
A. Yes.
Q. And you have reviewed your testimony before FINRA in preparation to be a witness in this courtroom, have you not?
A. Correct.

the role of finance, but in our software program, I was able to create an expense account.

Q. In the context of this specific transaction involving the fee/loan issue, correct, you created an origination fee?

A. Yes.

Q. Now, you also referenced in that answer the trust. The trust was not in being at the time the money was loaned. It was not trust money. Did you know that?

A. I was unaware of that.

Q. Are you familiar with the PPM for MSTF?

A. I know it exists. I have not read it in its entirety.

Q. How about for MSA, do you have any knowledge of the structure of MSA?

A. I thought it was the holding -- the management company for the income note funds.

Q. Do you understand the relationship between MSTF and MSA?

A. Not with perfect clarity.

Q. How about any clarity?

A. I can't say that I know.

Q. Do you have an understanding of the agency relationship between MSTF and MSA?

A. That would have been disclosed in the PPM, which

I have not read.

Q. Is it fair to say that with respect to in all of the accounting entries that you were responsible for making in connection with the various entities under the McGinn, Smith umbrella, that you had not read any of the PPMs associated with those and had no idea of the structure of the PPMs, what was authorized and what was not authorized?

A. I -- my experience with PPMs was really to look to find out what the commissions were and other types of expenses. I have not read them cover to cover.

Q. Did you know who MSTF could loan money to?

A. They could invest in preferred stock of McGinn, Smith, and then make bridge loans.

Q. And they could make bridge loans as MSTF chose to make bridge loans, correct?

A. Yes.

Q. Were you aware that MSA would use MSTF as their agent for the purpose of making investments, securing loans, and loaning money?

A. I was not aware of that.

Q. Were you aware that the Four Funds, FIIN, FEIN, TAIN, FAIN, those four funds, could loan money to MSTF?

A. I did not know that.

Q. Did you know that the Four Funds and MSTF and MSA could repay loans to other entities affiliated and

related to the MS & Company umbrella?

A. I did not know that.

Q. Were you aware that it was a practice of Tim McGinn and Dave Smith to accrue their fees in order to protect investors?

A. I am not sure what you mean by that.

Q. Did you know that they didn't take fees when they could from these transactions?

A. I am sorry, say it again.

Q. Did you know that Tim McGinn and David Smith did not take fees they were entitled to from these transactions?

A. Yes.

Q. And when you don't take a fee, that is accruing the fee, isn't it?

A. If you record it on your books as a liability.

Q. And if you accrue those fees, those fees are still due and owing you, correct?

A. Correct.

Q. Are you aware that Tim McGinn and David Smith would use their accrued fees to secure the transactions between and among the various entities and related companies?

A. I wasn't aware.

Q. Were you aware that at one point in time fees

A. That's correct.

Q. And my question was this, you never read a PPM, private placement memorandum, for the trusts or for the funds, did you?

A. Not straight through, no.

Q. And so you knew or you know now after talking to the government that the PPMs, the private placement memorandum, are kind of a guide as to how the trusts and funds worked, would that be fair to say?

A. That's correct.

Q. And so nobody ever told you in the accounting business end of the company to go and read the PPMs and gain familiarity with them, is that fair to say?

A. Yes.

Q. And nobody ever told you to read or to look at the books and records of the company to see what the relationship was between operating companies and the trust and/or the funds, is that fair to say?

A. Yes.

Q. So when you get --

MR. DREYER: Withdrawn.

BY MR. DREYER, CONTINUED:

Q. So when you get an assignment, you are told you are going to do what again, you are going to track something?

Q. And that was not unusual in a broker-dealer business?

A. I wouldn't say in the broker-dealer business, but in the private placement, investment banking, capital structure business, no, it is quite familiar.

Q. All right. Let's turn to one of the paragraphs or allegations in the indictment that was dealt with in the first week or possibly the second week of this trial and concerns the so-called Kaplowitz meeting and your discussion with Brian Shea in what has become known as the Kaplowitz letter in this trial. Okay?

A. Yes.

Q. Do you know what I am talking about?

A. I do.

Q. First of all, do you recall Mr. Kaplowitz? I believe he wore a bow tie here.

A. He generally does, yes.

Q. Okay, and you recall Mr. Kaplowitz's testimony?

A. I do.

Q. Do you recall Mr. Roper's testimony?

A. I do.

Q. Do you recall Mr. Wolf's testimony?

A. I do.

Q. Do you recall Mr. Danovitch's testimony?

A. I do.

Q. With respect to Mr. Kaplowitz's testimony that you and he met in the conference room of Gersten, Savage on a particular night in October of 2009, was he talking about the same meeting that led to the preparation of the Kaplowitz letter?

A. No, Jay was confused.

Q. All right, and Mr. Roper, who testified that he met you in the same conference room and talked about partnership rollups, was he talking about anything that we are talking about in this trial?

A. No, he was confused also.

Q. What were they referring to?

A. They were referring to -- I can only -- I guess there is a little bit of an assumption here, but --

Q. Well, you had a meeting with them?

A. We had a meeting with them a year before.

Q. You talked about partnership?

A. And we talked about restructuring the Funds. I had some ideas. I was bouncing some ideas off of them. I am sure that's the meeting they were talking about, yes.

Q. What is a rollup, what would that have meant just to clarify what he was talking about?

A. Well, he was talking about basically -- and, quite frankly, I don't even remember discussing that concept, but we certainly discussed the Funds. What they

both said we were addressing was a sort of a master limited partnership rollup where you bring in new equity capital and then you roll up some of the existing entities. And they generally would get a diminished equity role. And the new investors would get, you know, a more substantial role. But to be honest with you, if that concept was discussed, it was not extensively discussed.

Q. And it was not in 2010?

A. 2009.

Q. 2009.

A. No, it was not.

Q. How about Mr. Danovitch, did he get any part of it right?

A. Mr. Danovitch was the only one that got it right, yes.

Q. What was his role in the meeting?

A. Mr. Danovitch mentioned when he came and he testified -- I am sorry -- that he was asked to get involved in the provision or providing documentation to FINRA, and that they were going to review it. And I believe he specifically said he was asked to look at what role FINRA could engage in in terms of non-broker activities. In other words, how far did they reach in terms of having ability to look at books and records.

Q. All right. Going back to the Friday night that

Mr. Kaplowitz was referring to when he was trying to discuss a meeting, where did the meeting actually take place?

A. The meeting took place at Jay's home on the upper east side.

Q. Not in the office?

A. Not in the office.

Q. Now, Mr. Shea testified, Brian Shea?

A. Yes.

Q. And Mr. Shea, in part, provided you with information that led to the meeting with Mr. Kaplowitz; is that correct?

A. Part of the meeting was to address the issues that Mr. Shea raised, yes.

Q. So let's try to put the wrong meetings out of the picture here and reconstruct this. I am going to ask you first of all, when did Mr. Shea first come to you and identify a problem to you that led to this discussion?

A. Well, my recollection is not that Mr. Shea came to me, but that it was in September of 2009. We were both working in the evening, which that particular year we spent a lot of evenings working long hours. We were dealing with FINRA and other things.

And I stopped by Brian's office and he was dealing with some of the books and records. And he was

basically telling me that things were in difficult shape. He was having a hard time dealing with them. And at that time, you know we just started --

Q. Was he talking about the books and records?

A. Books and records, yes.

Q. What specifically did he say?

A. Well, he said that they are a disaster.

MS. COOMBE: Objection. Hearsay.

THE COURT: Overruled.

A. That I have to reconstruct a lot of them, go back. There is a lot of mis-entries. There is a lot of entries that have never been completed.

So I said, well, how long is this going to take you? He said, you know, I have been working for three months, and I am barely making a dent. I encouraged him to keep going. And then I specifically said, well, you know, tell me some of the problems.

My recollection is, it was at that time, and he said, well, you know, a lot of these problems are a result of we are getting the transactions or the notification of the transactions or the bank records late. We don't -- Cooper doesn't know where to put them. And looking back, it doesn't look like Rees did either. And, you know, he asked me to sort of try to have Tim take a little more time with these guys to demonstrate how they are going.

And I said, well, you know, give me an example. And so then he talked about, you know, MSTF. And he showed me the preferred payments.

Q. What has become to be known as the preferred customers?

A. Yes.

Q. What did he say and what did you say?

A. Well, he just said --

MS. COOMBE: Objection. Hearsay.

THE COURT: No. He testified. And this is defense. Overruled.

A. He basically said, you know, I don't understand this. Cooper has come to me. You know, evidently Tim is directing these payments to the Fisher group, etcetera. I said, well, I am very familiar with the Fisher payments. We have agreed on that. We had a meeting with Bert (phonetically). He also pointed out Mr. Cornacchia. I said I am not familiar with Mr. Cornacchia. It was something I didn't know was happening, but I was very familiar with the Fisher payments and, you know...

Q. If Mr. Shea, Brian Shea, testified in this courtroom that you had a reaction to his comments about the preferred payments, do you recall what that is, do you recall what your reaction was?

A. Well, I won't say that word, but my reaction

was --

Q. Were you surprised?

A. I was surprised and basically said, look, I am familiar with these payments, but they are not supposed to be coming from MSTF. It was my understanding that they were to be coming from MS Funding. So I was surprised at that.

And quite frankly, I was not comfortable with it, not for any reason of legality or evidence or anything else. I just -- Mr. McGinn used the word optics, probably a word I wouldn't have chosen, but the appearance of it did not sit well with me. And I expressed that. So it was shortly thereafter where we had to deal with that. And that came about, Mr. McGinn and I were both at an arbitration in Philadelphia. In fact, the name Chang just came up recently, and that is where we were.

Q. Pull the microphone just away from you.

A. Oh, I am sorry. Is that better?

Q. That is better.

A. So we were both at the Chang arbitration. And during the Friday, the last Friday of that arbitration, I was in the hallway. And as I passed by the plaintiff and their counsel, I hear the plaintiff say to her clients, the Changs, the FINRA is very interested in this case, and they called me last night to ask me how it was going and what we

were doing.

And so I knew that was inappropriate because there is supposed to be a difference between the enforcement division and the auditing division. So I went to Mr. Franceski, and I told him -- that was our counsel in there. And he said it is totally inappropriate. I am going to raise it at the arbitration, but I don't think anything will happen.

Well, Mr. McGinn and I were not terribly pleased with that answer. So during the break, we called Mr. Kaplowitz. And I told him what had been going on, and Jay thought it was outrageous. He thought we should basically move for a dismissal, ask for another hearing. Anyway, I am probably telling you more than you need to know.

But the reason that's important is because at the conclusion of that, as Tim and I were driving back from Philadelphia, I said, you know, Jay wants us to come down next week to talk about this FINRA issue. I said why don't we stop in New York on the way. I said we really need to talk about this MSTF issue because I am not comfortable, and I want some advice. So that's how we ultimately found ourselves at Jay's home on that Friday night.

Q. All right, and what happened at the meeting, the Friday night meeting?

A. Well, the meeting probably took place for, you know, a couple of hours. Jay had just arrived home. His wife came home. He had the kids, you know, had a drink together, chatted a little bit. He was on his way to his summer home. I think it was out in Montauk. He was leaving that night. So we had, you know, maybe an hour to talk about it.

Q. Did you talk about the preferred payments at all?

A. We talked about both issues. You know, the first issue -- he said that's when Danovitch comes in because that was his area, and he wanted to get him involved.

And on the preferred payments, we talked about it, and it was pretty evident that -- I have been in sales a long time, I know when somebody is getting it. I knew Jay wasn't getting it. So I said, look, why don't I write it up for you tomorrow. I will go into the office --

Q. What he wasn't getting was the complex issues that actually we have talked about?

A. Yes. So, you know, there is a lot of moving parts. And so I went back the next day. My recollection is we went into the office fairly early. Mr. McGinn was there. Mr. Cooper was there. I think Mr. Shea was there, although I can't swear to that. And we basically started

to work through the problems.

And then as I worked with this, I put this summary, if you will, this letter as we introduced it, and faxed it out to Jay with the idea that he needed that because he was scheduled to conference call the next morning on Sunday. And that's where Wolf came in because we had Wolf on the call, Roper on the call, Danovitch on the call. I think he left maybe three guys in the firm that weren't going to bill me. So with that, we had a call the next day.

Q. Putting Danovitch aside, because he was talking about the FINRA issue, we want to go right to this MSTF issue. After the Saturday meeting, what, if anything, did you do, the Saturday meeting in Albany with Mr. McGinn and Mr. Cooper?

A. Well, you know, I was waiting for Jay's counsel the next day, but, you know, I pretty much knew what had to be done, and I spoke to --

Q. Well, the jury -- what I am driving at here is the jury has seen an exhibit which is the Kaplowitz letter. When did you prepare the Kaplowitz letter?

A. I prepared the Kaplowitz letter that Saturday during the day starting in the morning, and we finished it -- I think I have seen the e-mail, that we faxed it to him around, late in the afternoon. I am not sure.

MR. DREYER: If we could put up GB31, the Government Exhibit GB31. Okay. If we can go to the next page. That's all right. We will use the written document here. The typed document, which starts on -- if you can go to the next page. I just want to find the end of it.

BY MR. DREYER, CONTINUED:

Q. These are done paragraph by paragraph, do you see that?

A. I do. You know, I broke my glasses last night, and I have Mr. Dreyer's. They are not working out. I have to sort of figure out a way to do this.

Q. I am going to show you the government version of GB31, which is actually -- you can hold it in your hand and look at it.

MR. DREYER: If we could go back to page one.

BY MR. DREYER, CONTINUED:

Q. And you can take us through it. And now I want to give you an opportunity, Mr. Smith, to go page by page and tell the jury what you were explaining to Mr. Kaplowitz?

A. Well, the first page is sort of a history of the entities involved. We talk about the transactions effected through McGinn, Smith Transaction Funding on behalf of McGinn, Smith & Company. Obviously that's the

broker-dealer. Capital Holdings, which was the administrative company and the trustees of a number of trusts, but in this case, we are talking about its role as the administer of the Funds. We talk about MS Advisors, which, as I have mentioned, was the managing member of the Funds, and then the four independent LLCs, which has been come to be known as the Funds.

Q. Okay.

MR. DREYER: If we could move to the next page.

BY MR. DREYER, CONTINUED:

Q. If you could just summarize what is contained in the first page, and then in the bottom part of the first page, which going to be reflected right later on in this exhibit, you begin to talk about the FINRA request for information. Okay. So tell the members of the jury about that first page, what you were intending to tell Mr. Kaplowitz?

A. Am I moving on beyond the summary, is that what you asked me, Mr. Dreyer?

Q. Well, we are in the history part.

A. Okay. So the history is, again, I talk a little bit about the Funds, itself, when they started to get some financial difficulties, which was late 2007. I talk about basically writing a letter to the investors and trying to

restructure the Funds, which we had done in the fall of 2008. I talked about how I had actually discussed that with Mr. Kaplowitz just to remind him.

The next page. I see here we talk about the fact that the arbitrations as a result of the deficiencies and the defaults in those funds started to arise. I talk about who was now representing us, which was Mr. Franceschi of Stradley Ronon. I am talking about the arbitration with Chang, which is now being held in Philadelphia.

I talk how FINRA has gotten involved, that both Tim and I have sat on the record for what is called an OTR, on the record review, interview, and I discuss the number of documentation we have had to give. I said we have supplied them with approximately thirty thousand pages of documentation, over twenty thousand e-mails. Asked for additional information for a large number of related entities, some going back as far as 1982.

The reason this summary is dealing with that is because as a result of the phonecall from the Chang arbitration with Mr. Kaplowitz and his sense that we needed to be getting more representation in dealing with FINRA because we had been pretty much dealing with them on our own, he felt, again, that maybe FINRA was moving a little bit beyond their authority. He wanted to take more control of the process, and so he had asked me to give him a little

background on that.

Q. Nevertheless on page four, which is page four that the jury is looking at, you began another paragraph by saying the transactions in question fall into three categories?

A. That is correct. And this is a result of when I went in on Saturday and sat down with Cooper, to a limited extent, I forget. I think Tim was there and involved to some degree, although I was pretty much managing the process. Again, I mentioned I am not so sure if Shea is there.

But at any rate, when we were doing this, we sort of started looking at all the books and the records and how the -- both MSTF and some of the Funds had become involved. And so there were three things that kind of came to mind that I thought needed some attention. And the first was the what were advances from MSTF to McGinn, Smith & Company. And I don't remember if it was Cooper, although I assume it was, who had mis-entered them. They were booked incorrectly. So I needed to address that.

Q. Number two?

A. There were loans from the Funds to MSTF, which I also wanted to address. And then finally, which was the main reason that we had gone in, was the advances from MSTF to the, what is now known as the preferred customers.

Q. All right, and then could you read to the jury the next paragraph where it says items one and two, which of course would be the first two items that you just talked about, are what?

A. Right. Well, the item one is advances from MSTF to McGinn, Smith & Company. And item two was the loans from the Funds to MSTF. And I said they are of less concern to us. The loans from the Funds are supported by basically the fees, the assignment of fee income, money that was owed to us. So it was in effect a personal guaranty.

Q. At the moment in time when you wrote that, no regulatory body, United States Attorney's Office, Security and Exchange Commission had ever asked you about that relationship between an advance and a loan or a fee rather before; is that correct?

A. Let's see. This is -- I think that is correct, yes. I had the conversation with FINRA in -- well, that's pretty close to the time, you know, when that conversation that has been mentioned here in -- where the fees were mentioned, the loans. We were in the conference room. I am not sure exactly when that took place, but my sense is that was also in the fall of 2009. So it was probably contemporaneous around the same time.

Q. So what did you say to Mr. Kaplowitz?

A. At any rate, in looking at the books, my recollection is that Cooper had booked part of those monies from MSTF to McGinn, Smith initially as a loan. And now I have subsequently reviewed the books, and I see there is a loan category for McGinn, Smith, but there was nothing in it. But I can't imagine why I would have, in fact, characterized it as loans if he hadn't showed it to me as loans.

And I state here that, you know, they can't be loans. Not that MSTF couldn't lend money to McGinn, Smith & Company. They totally are a permitted transaction. That was the role of MSTF. They could make loans to companies. But in the brokerage business, you have to maintain certain net capital. And so if I had borrowed money from MSTF and I had lent the money in cash, it would have been fine. But you don't generally borrow money to leave it in cash. You borrow money to do something with it. The minute you either spend it or you acquire an asset that is a non-cash asset, you have to take it off your balance sheet. So what I am saying here is I knew it wouldn't be a loan. The company never borrowed because it would have impacted their net capital.

And then the other thing that had been on the books and records was that this money I think subsequently after it had been taken out of the loan category, it had

been booked as advisory fees. And, you know, I knew McGinn, Smith wasn't entitled to advisory fees from MSTF. So I was bringing that to the attention of Mr. Kaplowitz.

Q. All right, and these are things that you had found in the books and records of the broker-dealer, correct?

A. That's Saturday morning, yes.

Q. So you were addressing these items?

A. I was addressing these items.

Q. What was the next thing?

A. And then the -- you know, the next thing is when I was -- I had originally gone in the office for, which was my most concern. And, you know, I do use some fairly aggressive language here, but nonetheless, you know, I felt it was an inappropriate place for the monies that was supposed to come from MS Funding to come from. Mr. McGinn has given us an explanation, and it is a reasonable explanation, but on the other hand, I had a difference of opinion in terms of the appearances.

And so my sense was is that we had all along determined those payments were going to be made by our accrued fees, and, you know, I kind of go on to say why the hell did we do that? You know, why didn't we run it through MSTF? I used some language later on where I say that it was a fairly stupid thing to do.

Q. Next page. Go on.

A. And then, you know, from there I say I am looking to figure -- I am not accountant. I know what has to be done, but I am not sure how it actually has to be addressed on the books and records. And it is -- my goal is to basically square the books up with MSTF, pay them some return, which Mr. McGinn was going to anyway, and basically get that transaction over with.

Q. You say in the paragraph that's now on the screen, Jay has expressed a concern that repaying the monies at the same time that we are being asked to provide financial files looks like a cover-up. Do you see that?

A. Yes. That was from the night before as I was discussing this whole problem, I guess we will identify it as. And, you know, Jay was, as I said, I don't think he was getting it, but, you know, he was cautioning me, he said, look, you just -- not that I needed to be cautioned, but nonetheless that was his role as an attorney, that, you know, whatever you do, make sure it is transparent, make sure that it doesn't look like you are trying to in effect cover up the books and records.

Q. In fact, although we will get there in a moment, no entry was ever erased from the books and records; is that correct?

A. No, a new entry was made.

Q. And the transaction that you are referring to is completely traceable by anyone such as Geoff Smith, who knows how to read bank reports, etcetera, completely traceable by someone who knows what to look for; is that correct?

A. Even the government.

Q. So the point is Mr. Kaplowitz's concern about a cover-up had to do with the what, the changing of the financial records?

A. Well, to be honest with you, I think Jay was talking in a general sense. I mean, Jay doesn't have an accounting background, but, you know, from a legal standpoint he was offering me legal advice, which I had sought. That's the reason I had gone to see him. So it is maybe telling us that there is salt in the ocean that you don't do a cover up, but nonetheless, that was his advice.

Q. All right, and what you were asking him to do was help to you rectify a mistake; is that correct?

A. Yes, I wanted to be certain that, you know, first of all, it is always good to have another party that you discuss this with, although I suppose I would have thought I would have had attorney/client privilege and may have never come out, but nonetheless, yes, I wanted some advice as to how to deal with this.

Q. All right. Can you move on to the next page.

On that page, on page seven, you also say I seek a solution that calls for immediate restitution with some reasonable explanation for our behavior. Do you see that?

A. Yes, I do.

Q. And we are going to get to that in a moment because the prosecution has asked other witnesses in this case whether they are familiar with the September 2009 letter from FINRA in which they ask for documents and an explanation of any changes; is that correct?

A. We have seen that now, yes.

Q. All right. Anyway we can go on to the next page now. And you have the whole letter in front of you?

A. I do, yes.

Q. All right. So rather than relying on the letter now, why don't you continue on what's on the screen. You have the whole letter in front of you. Why don't you tell the members of the jury what you next proposed to Mr. Kaplowitz?

A. So what I basically was trying to do was to give him a summary of what I had discovered on that Saturday morning with the books and records, and I had seen where some of the monies that had come from MSTF had been correctly booked as MS Preferred Stock because, as has been testified several times through these proceedings, the -- one of the objectives and one of the missions of MSTF was

to purchase 1.5 million dollars worth of this new preferred. And what I had discovered is that they had, in fact, purchased a million four to date.

There had been an original million dollar booking back, I think, in May of 2008. And then there had been two subsequent purchases, one for two fifty and one for one fifty. So that was obviously entirely appropriate.

There was -- and then I say there was this offsetting payments of fifty thousand dollars which Cooper couldn't explain, but he said they were obviously a booking error, you know, they were simply offset and so that was not a problem.

Q. And the next page. Do you want to address the two seventy-five?

A. Yes, now we have got to address the two seventy-five.

MR. DREYER: Can we go back to eight, please?

A. So the one was -- that had jumped out at me was this two seventy-five. And, you know, in hindsight, I just missed it. It should have been for the Preferred Stock, but, you know, I have since looked at the books and records, and Cooper booked in entries before this two seventy-five as preferred and then after this two seventy-five as preferred, but for some reason didn't know

what to do with this.

And I don't know the history of whether he just saw -- whether he got instructions from somebody, saw bank statements. I have no idea. And it just didn't even occur to me that that obviously should have been two seventy-five. So what I said was, I said, look, it is not advisory fees. That much I know because they are not called for. And so I said since --

BY MR. DREYER, CONTINUED:

Q. In other words, there were no advisory fees due?

A. There was no advisory fees due to McGinn, Smith no. And so as I knew that the two seventy-five was all being covered by the MSA advisory fees, I said let's get this thing up and let's book it, and he then booked it as a loan from MSTF to MSA. That has been pointed out, testified both Grand Jury wise and even Ms. Daversa has testified that that wasn't -- once corrected, it did represent the proper designation. So he did correct that or did book that correctly.

Q. All right, and what ultimately became of the so-called preferred payment entries, the preferred customer entries. How did he deal with that?

A. Well, the preferred payment entries ultimately were offset with the MS Advisory fees. And it is as -- my son, Geoff, did a lot work and basically laid it out for

everybody, and I am not sure anybody can recall it because it is complicated, but actually the money that went from the Funds to MSTF, and we see some of these files, one hundred and fifty from FEIN, one seventy-five from FIIN, and two twenty-five from TAIN, that was actually a repayment of the loan from MSA to MSTF had been making on behalf of all the investors.

Now, the government has indicated I think when that testimony came up that they trotted out the loan documents, and those loan documents were, in fact, signed and put in place. But all the loan documents is doing, it is an asset offsetting the liability.

So the bottom line is, is that all of those preferred payments that were supposed to have been made by MSA, but were being made by MSTF as agent for got their money. The five hundred and fifty thousand dollars that came into MSTF stayed there. Even though it came in as a loan, it was offset, it was never paid back. So they had that five hundred and fifty thousand.

In February of 2010 when I was rounding out all of the guaranties, we journaled another one hundred and fifty thousand dollars in, so they got a total of seven hundred thousand dollars. And as Mr. McGinn testified at least once today and my son, Geoff, testified, the ultimate bill from the quote "preferred payments" with interest

amounted to six hundred and fifty-three thousand dollars. And so what we are looking at is a credit of forty-seven thousand dollars that is due from MSTF to MSA.

Q. All right, and let me ask you a few questions about the entries that were made. How did it come about that the entries were changed or made anew in the books and records? Did you ask somebody to do something?

A. Yes. I mean, that Saturday we had that discussion with Cooper and, again, I think Shea, but I am not certain. And, you know, as I looked at the exhibits that I sent to Kaplowitz, I was initially a little perplexed because the date on the exhibit is actually the day we were in there, on the 10th. So the only thing that makes sense to me, unless somebody points out something different, was that we actually made the changes that day, and then I sent them on to Kaplowitz. Because it looks like, as I reviewed those exhibits, they are all dated the 10th. So I think Cooper made the changes actually that day.

Q. So going to the specific entries, you didn't pick up a pencil yourself or do anything on the computer to change these entries, correct?

A. No, I wouldn't have had that capability.

Q. So you told Mr. Cooper and/or others in the accounting department what you think it should look like;

is that correct?

A. Yes, I had the discussion of what the purpose was, what was the -- how the loans and the coverages were supposed to be. And Cooper basically made the entry, which it is my belief now was the correct entry.

Q. All right. With respect to that, at any time, did you ever believe that you were giving Mr. Cooper or anyone else a direction to create a false document or a false entry?

A. Absolutely not.

Q. When FINRA conducted its on-the-record interviews, in fact, weren't other members of your office called to testify and give evidence?

A. Yes, they were.

Q. Including Mr. Shea?

A. Mr. Shea, Mr. Rees, Mr. Cooper.

Q. And no time --

A. No. I take that back. I don't think Mr. Cooper testified.

Q. Nevertheless, you never gave anyone in your office any direction not to cooperate or to withhold information or to explain how these changes were made; is that correct?

A. That's correct.

Q. You heard Mr. Shea testify in this court and at

FINRA. He said, in words or substance, that you never gave him a direction to make any fraudulent entries or to commit fraud; is that correct?

A. That's correct.

THE COURT: Okay. We will take our afternoon break now, members of the jury. Don't discuss the case amongst yourselves or anyone else, and we will be back in fifteen minutes.

Mr. Minor.

COURT CLERK: Court stands for the afternoon recess.

(Whereupon, a brief recess was taken.)

(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Mr. Dreyer, you may continue with your direct examination with Mr. Smith.

MR. DREYER: Thank you, Your Honor.

BY MR. DREYER, CONTINUED:

Q. Mr. Smith, you have had heard some testimony from accountants about adjusting entries. And is the entry that was made to reflect the correct transactions in the books and records on that Saturday an adjusting entry or is it some other type of entry would you say?

A. I don't have the accounting background. I think it is just a new entry.

specific expense, no.

Q. What was the purpose of the chart then if it didn't come from your loan accounts?

MS. COOMBE: Objection.

A. Well, that --

MR. DREYER: Withdrawn. Withdrawn.

BY MR. DREYER, CONTINUED:

Q. Let's turn to Firstline. You said before that you had familiarity with the trust; is that correct?

A. With the concept of the structure of the trusts, yes.

Q. So with respect to Firstline, did you have an understanding that Firstline was going on at the time that it was in 2007, May of 2007, etcetera?

A. Oh, sure.

Q. In fact, you knew members of your family had invested in it; correct?

A. That's right. I think both of my children invested in it, yes.

Q. How did it come that they invested in it, did you sell it to them?

A. No. Actually Geoff was working for the firm at that time, and he was managing both his own account and his sister's, and he was making those decisions.

Q. During the time that Firstline, the first raise

was going on in May, where were you and where was Mr. McGinn, if you understand what I mean? Was he living in the Albany area and --

A. Generally Tim, I don't know if it was as early as 2007, I think so, but he spent -- once he acquired his second home in Florida, you know, I can't -- I don't know if that was 2007 or 2008. I don't know.

Q. Did you have daily discussions with him?

A. But he was spending a lot of time in Florida until generally May 1st, and then he would come back. So I would say if you are using the May date, I would think he was probably back in the Albany area by then.

Q. Did you have daily discussions with him about what he was doing?

A. No. I mean, it wasn't like the old days when we first started and we actually worked out of the same office. We were actually on opposite sides of the office. Our lives had kind of move in different directions. That doesn't mean I didn't have discussions with him. Obviously he was my partner. We chatted a bit. I knew some of the things he was working on, but the days of us, you know, working on the projects specifically and intimately had gone. He was doing his thing, and I was doing my thing.

Q. Well, in connection with Firstline, did you personally know the witnesses who appeared here from

Firstline, have you ever had any contact with them?

A. No, I have never met them or talked to them or spoken to any of them.

Q. Have you ever had any contact with those witnesses who came here from Integrated Excellence?

A. No.

Q. Okay. So turning to Firstline. What did you know -- as far as you can recollect, what did you know about the company Firstline which was located in Utah, I believe, what did you know about that whole investment raise back in the May 2007 period?

A. I think I had -- Tim had shared the information with me that basically they were a company that he had done business with when he was running the public company. He explained the concept of how they marketed, that they had used basically students from BYU or surrounding companies, that they were often kids that had been on missions with Mormon missions and therefore had a fair amount of gumption, get up and go and knock on doors.

And that there was this, you know, selling period, that it was not a smooth selling cycle. And then obviously I understood the alarm business. But other than that, I didn't know anything specifically about Firstline.

Q. Did you ever work on a transaction?

A. No.

Q. Did you ever read the PPM?
A. Oh, I am sure I did.
Q. Did you ever discuss the PPM with any brokers, with Geoff, with Guzzetti, with anybody that you recall?
A. I don't, but if I sold it to any of my customers, I would have discussed it with them, but I don't recall if I had anybody in that transaction or not. I might have. I don't recall.
Q. Well, let's fast forward to the second tranche or the second investor raise, and that occurred in the fall of 2007; is that correct?
A. That's correct.
Q. In the fall of 2007, what did you know about any problems which existed between Firstline and a company called ADT?
A. Excuse me, I was not aware of any problems.
Q. Did you ever see any documents in connection such as attorney opinion letters?
A. No.
Q. E-mails?
A. No.
Q. Did Mr. Carr ever brief you as to what he was doing in Firstline?
A. No.
Q. When for the first time did you ever find out

that ADT had filed a lawsuit either in 2007 or early 2008 by way of an amendment that McGinn, Smith had been named as a party?

A. Six weeks ago.

Q. As the CEO of the company, did you ever receive any documents either by mail or by a process server or the Secretary of State of the State of New York in which your company was served?

A. I have no recollection of that whatsoever, no.

Q. All right. And in connection with the January 25th date that has been shown here to be the date on which Firstline filed bankruptcy in the State of Utah, had you ever heard that at that time, did Mr. Carr ever tell you?

A. Not at the time, no.

Q. All right. Did Mr. McGinn ever tell you?

A. No.

Q. All right. Now, you know from the proof that there was sales in Firstline going on through June of 2007 just from records that have been introduced; is that correct?

A. That's correct.

Q. Tell the jury as best you can recollect the circumstances under which you found out about the bankruptcy?

A. Well, I have been -- I had a very difficult time pinning down exactly when I knew. It is a wide gap. I clearly knew about it sometime in the spring of 2009 because I recall Mr. McGinn ramping up his discussions, and he started sharing with me that he was having this difficulty getting the bankruptcy group to, in effect, do what he wanted. So at that time, I obviously knew that there had been a bankruptcy. So that's in the spring of 2009.

I don't recall him ever telling me. My own recollection is I first heard about it from Brian Shea, but it is just something I am not going to take an oath here today and tell you when, but I can tell you that it was probably maybe late 2008 through the spring of 2009, but certainly not at first. I have no recollection of understanding that bankruptcy in the first six or seven months of 2008.

Q. Well, in the period of January of 2008 up through June of 2008, were you aware that there were sales going on in Firstline? They had been called post-bankruptcy sales, but I am just going to ask you, do you know if sales were going on?

A. You know, I mean, I have to say yes. I mean, I did read Mr. Guzzetti's e-mails as someone who had an interest in retail. Geoff was making some of the sales. I

chatted with Geoff a fair amount to see how he was doing. So it is inconceivable that he didn't share that information with me. I don't have a vivid recollection of it.

Q. Where was Geoff living at the time?

A. Geoff was in New York.

Q. So if he called you and said he was selling Firstline, and you knew that company had filed bankruptcy, what do you believe you would have told him?

A. I would not have permitted the sales knowing that it was bankrupt with anybody, whether it was Geoff or anybody. I mean, it is not anything that would have been allowed.

Q. Once you found out that the bankruptcy had occurred, and you say sometime -- you can't pin it down, but sometime in 2009, what is the chain of events that occur after that?

A. Well, I didn't even think about looking at post-bankruptcy sales. When we got into August of 2009, and Mr. Carr had drafted this letter, whether it was the letter that caused me or whether it was the discussion that they were -- because by this time I was having discussions a least a little bit with Mr. Carr and Mr. McGinn.

My recollection is I asked for a list of all the investors because they were getting ready to reach out to

investors to -- as Mr. McGinn was restructuring this rescue plan that we have all talked and heard about. And I got the list from Patty Sicluna as best I can remember it, and then I specifically sent her an e-mail or got an e-mail from her that basically broke out the list for those sales post January. And that's when it became vividly clear to me that there had been sales post the bankruptcy.

At which point I called Mr. McGinn. And I said something to the degree we have got a major problem here. This cannot stand, and we are going to have to do something about it. Subsequent to that, you know, they had this call which has been discussed. Obviously I got some feedback from some brokers, including my son. My son went -- had sold any number of these units and therefore had discussed it with his clients. And one of the clients, a fellow by the name of Radice had a particularly difficult time and made a request to get the money back. We satisfied that.

Q. A difficult financial time, you mean?

A. That's the way it was represented to me, yes. He was -- I think he was a commodities trader. He was having a tough time in the markets and needed money.

Q. And so you were present at the brokers meeting in or about September of 2009 when this was discussed, the one in Clifton Park?

A. I am quite certain I was on that call, yes,

and Traders Trust Company in the real estate arm. New York Business Development Corporation and many related lenders.

Q. And the point of your job when you worked for the bank was to memorialize, through loan documents, a loan from a bank, for example, either a commercial loan to a business or to a private citizen?

A. That's correct.

Q. And you brought that expertise with you to McGinn, Smith, correct?

A. Yes, sir.

Q. I want to start -- we will return to Firstline later on the issues that you have talked to Mr. Belliss about, but starting at the end of the process. In or about, as I understand it, September of 2009, you said there came a time when you were asked to prepare some promissory notes, is that your recollection?

A. Yes.

Q. And who asked you to prepare the promissory notes?

A. Brian Cooper.

Q. And based on your direct, that's what happened, you dealt with Mr. Cooper and the promissory notes were prepared?

A. Well, I didn't really -- he really dealt with my secretary, but I provided a template for the notes.

Q. Well --
A. I didn't actually draft any of them.
Q. You didn't draft them, but you did have an understanding from speaking with Mr. Cooper that he had relied on the books and records of McGinn, Smith to give you the transaction that was going to be recorded in the promissory notes, correct?
A. Yes.
Q. That was your understanding?
A. Yes.
Q. You are not telling this jury that at any time you, as an attorney, assisted anybody in back dating documents, are you?
A. No. I felt that -- I was told that these reflected the accounting records that had been in existence, and they were created contemporaneously with the transactions, and that the notes just mirrored what was already in the accounting records.
Q. Even though the notes said May of 2006 -- or October of 2006, rather, you knew that you were preparing or supervising the preparation of a promissory note after September of 2009, correct?
A. Yes.
Q. And Mr. Belliss asked you on direct did you assist in the preparation of back dated documents, and I am

now asking you directly. Did you believe that you were back dating documents to anybody at McGinn, Smith?

A. No.

Q. And the reason for that, you have long experience in the preparation of documents as a lawyer, correct?

A. Yes.

Q. And isn't it generally the proposition as you know it that a lawyer can create a document memorializing an early transaction as long as he reflects in the document the original transaction and the date of the preparation of the document, correct? Isn't that black letter law?

A. I am not so sure, but, yes. I mean, these notes did not say that they were created or signed as of a certain date or something like that.

Q. And that was the mistake, wasn't it?

A. Yes.

Q. And you take responsibility for that mistake also, correct?

A. Yes. Although, you know, I didn't think it was necessary because they reflected entries that were already made in the records. So the information was already established.

Q. It is also correct that all of your conversations were with Mr. Cooper, and you never spoke to

Smith Advisors?

A. My interpretation would be that it was -- I am paying for the advice that McGinn, Smith is giving me.

Q. And would you agree that the advisory fee would be something that would be earned to McGinn, Smith?

A. Yes.

Q. Almost like a salary, so to speak?

A. Yes, like a fee, basically.

Q. And would you want to know what they did with that advisory fee?

A. Down to a detailed level, that doesn't really concern me or wouldn't have affected my investment choices certainly.

Q. Sure. So if they used their advisory fees to pay for things such as rent or payroll, would that have affected your investment in TAIN?

A. I don't think that's what I consider an advisory fee, to pay rent. I am not sure advisory fees would be used to pay operating expenses of a business.

Q. Would you agree that it would be a fee earned to an entity as far as offering and overseeing the investment on an annual basis?

A. Yes.

Q. And you invested in the Firstline Trusts, and that was back in November of 2007?

A. Correct.
Q. And your broker was Don Anthony?
A. Correct.
Q. Did you pretty much follow his advice, if he suggested an investment to you that he thought was good, would you take his advice when considering whether or not to invest?
A. Yes, that's the way I worked.
Q. And regarding the Firstline investment, at the time, did you understand that you were investing in an entity that provided services for alarm contracts?
A. Yes.
Q. And did you go over the private placement memorandum with Mr. Anthony?
A. I believe that that was mailed to me, and I read it, and we didn't go over it in any great detail.
Q. Okay, and was there anything else that Mr. Anthony -- how did Mr. Anthony describe the investment to you other than it had to do with alarm contracts?
A. My basic connotation of these private placement notes, if that's what we are calling them, were that they were more secure investments or safe investments than investing in stocks and mutual funds.
Q. And did he explain to you that the difference between a private placement such as Firstline versus a

Smith?

A. Yes, sir.

Q. Did you receive an envelope from McGinn, Smith, and you pulled it out and it showed how much money you had in the account, do you recall that?

A. Yes, sir, I recall that.

Q. And did you or your wife, if you know, read the statement from month to month or did you do what a lot of people do and pitch it in the basket?

A. Well, some of that too. I am sorry to say.

Q. Okay. So moving forward now to the two investments that you made, one in Firstline and one in Luxury Cruise. With respect to the Luxury Cruise investment, did you understand from Mr. Feldman's description of the product how it was that McGinn, Smith was going to make money through Luxury Cruise and then how you would make it?

A. No, sir. I had never gone through anything like that.

Q. All right. Well, there is a letter that Mr. Belliss showed you which talked about a lag between -- in the cruise line industry, when the cruise line wants to advertise that they are taking a cruise to the Carribean in the summer, they want people to come in and book their trips, correct, would that be a fair statement?

said that there was a really good opportunity in some notes. So then I moved some money over into a note.

Q. Did you ultimately make some investments in McGinn, Smith products?

A. Yes, I think that was the first one. And then it had done so well, I moved everything over, pretty much everything over into the notes as they came available.

Q. Moving forward to the fall of 2007, do you recall any discussions with Bill Lex about an investment called Firstline?

A. I don't -- didn't remember the names of these.

Q. Would you have asked to see a prospectus or a private placement memorandum describing the investment before you made any investments?

A. He provided me with a twenty, thirty page document that went all through everything, but I basically followed the recommendation and advice based on the fact that was -- it seemed to be such a secure thing with the ADT type security things around the country, and I don't understand all those things.

Q. Let me show you Exhibit GA-8. Doctor Crist, a screen is going to come up right in front of you. There should be a computer screen up that has the first page of the exhibit. And what is that document, Doctor Crist?

A. Firstline Trust 07 Series B placement

memorandum.

Q. Do you know what this document generally does for a prospective investor?

A. No. I am afraid that these are complex to me, and I spent a great deal of time in my own field, and I rely on the people who are knowledgeable.

Q. Did you end up making an investment in Firstline Trust 07 Series B?

A. Yes, I believe I did.

Q. I am going to show you exhibits -- I will start with Exhibit GF-57. Doctor, we should have page one of the exhibit up on screen. Is it fair to say that is the investment ticket for your purchase of seventy-five thousand dollars of Firstline Trust 07 Series B with a settlement date of October 28, 2007; is that correct, Doctor?

A. Yes.

Q. And you had invested in the junior contract certificates at eleven percent due October 1, 2012; is that right?

A. Yes.

Q. If we go back and look at the private placement memorandum, that should come up on the screen. At the top half there, Doctor, do you see again at the bottom of the highlighted section, sixty-month maturity term and eleven

A. It's a d/b/a.
Q. When was that business established?
A. In 2006.
Q. Okay, and you mentioned that you were a long time client of Mr. McGinn?
A. Yes.
Q. And you invested in some entities as far as back as 1981?
A. 1981 was the first investment.
Q. Generally how did those investments go, were they generally successful?
A. I think we did better than most. We had more positive than we had negative. Nobody picks them perfectly. You don't expect that. Overall we had a successful run.
Q. Okay. And you said back in 2002 you sold your Fish Fry business. Was it for 1.2 million dollars?
A. It was $1,175,000.00.
Q. That is pretty good. And so you invested, I think you mentioned, one hundred and seventy thousand dollars from the sale of your business into FIIN, into the entity FIIN in 2003?
A. Yes.
Q. And did you read the private placement memorandum concerning FIIN?

A. Not fully, no.

Q. Were you aware that there were some fees that would come -- that would go to McGinn, Smith Advisors as part of an advisory --

A. I can't fully recall.

MS. OWENS: Can we pull up Exhibit GC-1, please. If you could please go to page seven. And if you could go to where the bullets are and just make that a little bigger, please.

BY MS. OWENS, CONTINUED:

Q. Okay, and, Mr. DeLeonardis, do you see the second bullet where it says: Pay our managing member a portfolio management fee of one percent of the aggregate principal amount?

A. Yes, I see that.

Q. Okay, and so it looks like it is -- and then above it, it says, two percent principal amount of the notes per year over the term of the notes?

A. Yes, I see that.

Q. And then the third bullet, it says, a quarter of the -- or a quarter percent of the aggregate principal amount?

A. Yes, I see that.

Q. So this section of the PPM -- and you mentioned you didn't really read it; is that correct?

A. That's correct. I did not read it.
Q. So -- but this portion is in there where it says they are taking out certain fees?
A. Yes, it is in there.
Q. And one of them and they include management fees. And if I told you that the managing member was McGinn, Smith Advisors, would that sound correct to you?
A. It is possible, yes, they had various names.
Q. Okay. Do you understand what an advisory fee is?
A. Yes.
Q. And it is basically just a fee that is going to the managing member for managing the investment; is that correct?
A. That's correct.
Q. Now, so that -- so it is basically earned to McGinn, Smith Advisors; is that correct?
A. It is earned, yes.
Q. And if that money went to pay payroll, would that be something that you would want to know?
A. Depends on which payroll. If it is payroll that is just for the advisors or the payroll for the whole company.
Q. Well, if the money is going to the managing member, it is a fee that's earned, would it matter what

investments. But at that same time I was planning to retire. I had my retirement funds in another investment, a manager's portfolio, and wanted to move those into McGinn, Smith as well.

Q. Okay, and you told Mr. Belliss before that the private placements primarily had to do with some alarm contracts?

A. Yes.

Q. Home alarm contracts and security systems in people's houses; is that correct?

A. Yes.

Q. Did you think that the economic crisis would have an effect on that?

A. Well, I remember having conversations along these lines with Dave. And Dave said it was one of the few things that people will not get rid of in an economic crisis. People have a tendency to hold on to certain things. And their security systems were one of the things they would hold on to.

Q. Okay, and Mr. Belliss showed you a number of the private placement memorandum. Did you read all of those when you received them?

A. Not all of them. I skimmed them, and I went through the purposes and the interest rates and the summaries, I would say.

Q. And did you read the PPM for Integrated Excellence Jr. Trust 08?

A. No, I did not read the whole thing.

Q. Did you understand that you were investing in a private placement?

A. Yes, I did.

Q. And did you understand that generally one of the requirements to invest in a private placement that's not offered on the public market is that the investor generally needs to be accredited?

A. No, I wasn't familiar with all of that, but...

Q. Do you recall filling out a questionnaire?

A. Yes, I filled out a questionnaire.

MS. OWENS: And, Mr. Kittelson, could you please pull up Government's Exhibit GM-45.

BY MS. OWENS, CONTINUED:

Q. This is the purchaser questionnaire for individuals. Integrated Excellence Junior Trust 08, and then go down a little bit to the handwriting. Is that your handwriting?

A. No, it is not.

Q. It might be Mr. Smith's?

A. Yes.

Q. Okay, and then if we could go to the next page.

MR. BELLISS: Judge, I object on relevance.

Smith?

A. Yes, sir.

Q. Did you receive an envelope from McGinn, Smith, and you pulled it out and it showed how much money you had in the account, do you recall that?

A. Yes, sir, I recall that.

Q. And did you or your wife, if you know, read the statement from month to month or did you do what a lot of people do and pitch it in the basket?

A. Well, some of that too. I am sorry to say.

Q. Okay. So moving forward now to the two investments that you made, one in Firstline and one in Luxury Cruise. With respect to the Luxury Cruise investment, did you understand from Mr. Feldman's description of the product how it was that McGinn, Smith was going to make money through Luxury Cruise and then how you would make it?

A. No, sir. I had never gone through anything like that.

Q. All right. Well, there is a letter that Mr. Belliss showed you which talked about a lag between -- in the cruise line industry, when the cruise line wants to advertise that they are taking a cruise to the Carribean in the summer, they want people to come in and book their trips, correct, would that be a fair statement?

dollars a year in my life.

Q. Okay. But as far as your net worth, did you fill out a questionnaire?

A. I did not.

Q. And did you understand that you were investing in some cable contracts, I believe what is known as a triple play deal?

A. I understood that someone I trusted told me that this was a good investment.

Q. But --

A. I would leave the bulk of that decision to him.

Q. So just so I understand correctly, so you were not aware of specifically what the entity was investing in?

A. Well, it was in the papers. It said, you know, cable company. I think telephone. It was explained to me that they went into communities in Florida and set this networking up, I guess.

Q. Sure. And you mentioned that you are self-employed, you build homes?

A. I do.

Q. And then back around this time in 2008, 2009, was your business affected by the economic crisis?

A. I would say barely, seeing as I am a sole proprietor, and I only work with a couple of guys. So I was in some demand because I wasn't a contractor. I was a

conjunctive and prove in the disjunctive, even in the context of conspiracy cases.

THE COURT: Okay. I will summon the jury to answer their question. I will answer the question, the specific question, no because as been set forth, and I will also advise the jury that this question does not apply to the remaining counts in the indictment.

Larry, summon the jury.

And, of course, defense counsel both have an objection to the ruling by the Court to preserve the record, which is a very interesting question, which could easily have been avoided.

(Whereupon, the proceedings were held in open court in the presence of the Jury.)

THE COURT: Members of the jury, I have you question, and I will quote it for the record:

Judge Hurd, we the jury have a question regarding Count 1 and the wording of "and" as in, quote, "mislead investors and FINRA," parentheses, page twenty-four and twenty-eight of my charge. Does it have to be both investors and FINRA for all elements of this count? Signed by your Foreman.

The one word answer to this question is no. It can be one or both. And also, this only applies to Count 1. The remaining counts, you will note, only discuss

investors.

Does that answer your question?

All right. You may be excused to continue deliberations.

(Whereupon, the Jury continues deliberations on February 1, 2013, at 1:05 p.m.)

THE COURT: Mr. Minor.

COURT CLERK: Court stands in recess.

(Whereupon, a brief recess was taken.)

(Whereupon, the proceedings were held in open court in the presence of the Jury at 4:30 p.m..)

THE COURT: I understand you wish to continue deliberations on Monday?

JURORS: Yes.

THE COURT: Okay, fine. Nine o'clock. Okay. We will have you come back nine o'clock on Monday. We have to do this, of course, because the courthouse is not open tomorrow or Sunday.

Here is the rules though when you come back on Monday. The three alternates, I think you will go into the library. It may be a little bit better surroundings for you, and you are still needed though in case somebody gets ill over the weekend.

But when you come back on Monday, don't

Ex 13

Ex 3

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Privileged and Confidential

July 1, 2008

David Smith
McGinn Smith & Company, Inc.
99 Pine Street
Albany, New York 12207

RE: Possible Exemptions from Registration under the Investment Company Act (the "Act")
Our File No: 7730-027

Dear David:

You have asked us to review the current status of the various income note funds ("Funds") managed by MS Advisors, LLC through McGinn, Smith & Co., Inc. (jointly "MS") and to consider whether those Funds might be exempted from registration under the Act. You have provided us with a portfolio analysis ("Portfolio Analysis") for the following Funds: Third Albany Income Notes, LLC, First Advisory Income Notes, LLC, First Independent Income Notes, LLC and First Excelsior Income Notes, LLC. The Portfolio Analysis, prepare by David Rees, the comptroller for McGinn, Smith & Co, Inc. sets forth the name of the entity to which funds were lent or disbursed, a description of the nature of the entities' business and the form of the security received (eg. promissory note/ bridge loan, etc.).

You have asked us to consider the various grounds pursuant to which the Funds may seek to avoid registration under the Act. You have advised us that MS believes that the Funds are engaged in the business of making commercial loans and providing business credit (the "Business") and are not engage in the business of investing, reinvesting, or trading in securities.

In conducting our review we have analyzed the applicable provisions of the Act and the following accompanying materials:

(a) The Portfolio Analysis and the descriptions set forth therein (Exhibit A);

(b) A description of the Funds' Business, employing, as an illustrative example, the FAIN Confidential Private Placement Memorandum (Exhibit B);

(c) A description of CapitalSource, Inc.'s Business from CapitalSource's registration statement on Form S-1 (Exhibit C);

(d) Certain excerpts from James Schell's treatise on Private Equity Funds (Exhibit D); and

(e) Various no-action letters (Exhibit E);

Brief Answer

Based on the foregoing and as described in more detail below, the Funds may reasonably argue that under Section 3(b)(1) the Funds are primarily engaged in the Business (the business of making commercial loans and providing business credit) and are not engaged in the a business of investing, reinvesting, owning, holding, or trading in securities and thus are not subject to registration. Furthermore, the Funds do not appear to be engaged in the business of issuing redeemable securities and the Fund's Business appears to fit within the definition of primarily making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services. Accordingly, the Funds may also reasonably argue that they fall under Section 3(c)(5) and are therefore not required to register.

Detailed Analysis

To determine whether the Funds' activities fall within the exemptive provisions of Section 3(b)(1) and/or Section 3(c)(5), we have obtained the Portfolio Analysis and related financial information from MS and relied upon that material, as well as a description by MS' management of the Funds' ongoing businesses. We have not reviewed the various transactions consummated by the Funds with the investors' funds received by each. A more detailed description of the applicable provisions of the Act as construed and interpreted by no-action letters and commentary and considered in light of the described Business of the Funds follows.

Section 3 of the Act defines the types of issuers which are investment companies and the circumstances when issuers are exempt from the provisions of the Act. These definitions of what constitute an investment company must be read in the alternative. In other words, absent an exemption, if an issuer meets one of these definitions of an investment company, the issuer must

register under the Act. Under Section 3(a)(1)(A), if an issuer is, or holds itself out as being engaged primarily in the business of investing, reinvesting, or trading in securities, then it is an investment company, which requires registration. This determination requires a fact based analysis. Schell, at 8-38.16.

In its PPM[1], FAIN states: it "has been formed to identify and acquire various public and/or private investments, which may include, without limitation, debt securities, collateralized debt obligations, bonds. . . ." These would seem to be "securities" within the meaning of Section 2(a)(36) of the Act. See Gins Capital Corp. no action letter at page 76,665 and Northwestern Ohio Building and Construction Trades Council no action letter at 79,006. FAIN may be viewed as holding itself out to identify and acquire investments, or "holding" securities (a permissible activity) as opposed to investing, reinvesting, or trading securities (each activity of which would require registration). See Schell at 8-38.17 and Centex at 77,163-2. Accordingly, since it appears that the Funds are actually engaged in the business of holding securities, the Funds have a reasonable and tenable argument that each Fund is not an investment company under Section 3(a)(1)(A)[2].

Under Section 3(a)(1)(C), if an issuer is engaged in the business of investing, reinvesting, owning, holding, or trading in securities and owns investment securities having a value exceeding 40 percent of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis, then it is an investment company, which is required to register. Note that the activities that are a predicate for establishing an investment company under Section 3(a)(1)(C) (owning or holding investment securities) are broader than the predicate activities under Section 3(a)(1)(A). Thus, the Funds' activities of identifying and acquiring investments fall within the language of Section 3(a)(1)(C).

"Investment Securities" include all securities other than (a) securities of majority-owned subsidiaries (which are not investment companies); (b) Governmental securities; and (c) securities issued by employees' securities companies. Under Rule 3a-1 promulgated under the Act, if no more than 45% of a company's assets consist of, and no more than 45% of such

[1] We have been advised by management that the PPM's for the Funds were substantially similar in the description of the reason for formation and of the business to be engaged in.

company's net income after taxes is derived from, certain types of investment securities, then the company is exempt from registration under the Act. For the purposes of the Rule, in addition to the previously mentioned excluded securities (i.e. Governmental securities), securities of companies controlled by the issuer are not included in the percentage calculation. "Control" is presumed to exist if the company beneficially owns more than 25% of the voting securities of another company. See Schell at 8-38.20-21.

We do not have sufficient financial information to determine whether the Funds would be exempt from registration under Section 3(a)(1)(C) or Rule 3a-1.

Even if an issuer is viewed as an investment company under Section 3(a)(1)(C), the issuer can still maintain that it is not an investment company under Section 3(b)(1) (an issuer primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities). Section 3(b)(1) seems to be one of the bases relied upon by CapitalSource in asserting that it is not an investment company. CapitalSource 8-K, dated July 23, 2007 at 3-4.

The analysis of whether an issuer is primarily engaged in a business other than that of investing, etc. is based on all the facts and circumstances. See Automotive Insurance Co., Ltd. no action letter at 77,255. According to the Commission, in determining the issuer's principal business, the principal relevant considerations are:

(a) the issuer's historical development;

(b) its public representations of policy;

(c) the activities of its officers and directors;

(d) the nature of its present assets; and

(e) the sources of its income.

Hereth, Orr & Jones Inc. Equity Sharing Program no action letter at 78,761 (citing Tonopah Mining Company of Nevada); Schell at 8-38.16. If an issuer desires certainty as to the availability of an exemption under Section 3(b)(1), the issuer may seek an exemptive order under Section 3(b)(2). See Mallory Randall Corporation no action letter at 77,598.

(... continued)

[2] See also, Gins Capital Corp. no action letter (relief denied for company acting as a personal financing agency by making loans to individual borrowers) and The Australian Industry Development Corp. no action letter (relief denied for a company selling short term promissory notes).

Based upon the Fund's statement in the PPM concerning its business, the Portfolio Analysis and the assertions set forth above from MS management as to the nature of the Business, we have a description of the Funds' business which could reasonably permit it to fall within the above delineated relevant considerations.

By way of analogy, the description of CapitalSources' business contained in its Form S-1 (Exhibit C) is useful precedent. [INSERT SHORT DESCRIPTION HERE]

CapitalSource relied on Section 3(c)(5) to claim an exemption from registration under the Act[3]. Under this section, any issuer who is not engaged in the business of issuing redeemable securities and is primarily engaged in one or more of the following businesses:

(a) purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable and other obligations representing part or all of the sales price of merchandise, insurance, and services;

(b) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchaser of, specified merchandise, insurance, and services; and

(c) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate,

is exempt under the Act.

A "redeemable security" under Section 2(a)(32) is generally any security, with respect to which any holder thereof, upon presentation, can obtain his proportional share of the issuer's current net assets or its cash equivalent. The Funds' notes, since they are only redeemable at the option of the applicable Fund, are not redeemable securities under the Act. See Citytrust at 78,188 and Medidentic Mortgage Investors at 79,026.

Concerning the types of businesses that paragraphs (a) and (b) would apply to, the SEC has stated that these paragraphs were added to the Act at the urging of two major sales finance companies to exclude them and other companies similarly situated from the Act. Thus, the test is whether the companies seeking to fall under either paragraph (a) or (b) are engaged in sales financing. See World Evangelical Development, Ltd. no action letter at 81,697. Equipment

[3] Since the client has informed us that each of the Funds has over 100 investors, Section 3(c)(1) is not being considered; similarly, because each of the Funds was offered to "accredited investors" rather than "qualified purchasers", Section 3(c)(7) is not being considered.

financing and large scale project financing seem to be permissible businesses under paragraphs (a) and (b). See State of Israel no action letter at 78,292-78,293.

The Funds' can reasonably argue that their businesses appear to be of the types generally described in paragraph (a) or (b), and, with regard to certain of the transactions, paragraph (c) (a business of purchasing or otherwise acquiring mortgages or other liens on or interests in real estate).[4]

Conclusion

Based upon the foregoing it is our conclusion that the Funds can reasonably argue that they were not and are not currently subject to the registration requirements of the Act because the nature of their business falls within one or more of the exemptive provisions. However, given that the SEC's analysis is based on all the facts and circumstances, there can be no assurance that the Commission will accept the Company's view of its business and agree that the Company need not register as an investment company.

We trust that the above is sufficient for your present purposes. If you require any additional information or wish to discuss any of points raised above, please call us at your convenience.

Best regards,

GERSTEN SAVAGE LLP

By: James D. Fornari
A Member of the Firm

Cc: Eric R. Roper, Esq.
Jay M. Kaplowitz, Esq.
John H. Riley, Esq.

[4] We will be requesting a sampling of the underlying transaction material to permit us to confirm the descriptions set forth in the Portfolio Analysis.

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,
LYNN A. SMITH, GEOFFREY R. SMITH, Trustee
of the David L. and Lynn A. Smith Irrevocable Trust
U/A 8/04/04, GEOFFREY R. SMITH, LAUREN
T. SMITH, and NANCY McGINN,

Case No.: 1:10-CV-457

(GLS/CFH)

Defendants,

LYNN A. SMITH and NANCY McGINN,

Relief Defendants, and

GEOFFREY R. SMITH, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,

Intervenor.

DEFENDANT DAVID L. SMITH'S MEMORANDUM OF LAW IN OPPOSITION OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND CROSS MOTION FOR SUMMARY JUDGMENT ON DAMAGES

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Dated: August 11, 2014

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TABLE OF AUTHORITIES

Defendant David L. Smith respectfully submits this Memorandum of Law and Counterstatement of Material Facts in Opposition to Plaintiff's Motion for Summary Judgment and in Support of Defendant's Cross-Motion for Summary Judgment on Damages, pursuant to Rule 56 of the Federal Rules of Civil Procedure and Local Rule 7.1(a)(3) of the United States District Court for the Northern District of New York.

PRELIMINARY STATEMENT

Plaintiff's Motion for Summary Judgment against Mr. Smith improvidently seeks to have this Court ignore the fundamental differences between this case and the parallel criminal case, *United States v. McGinn and Smith*, 1:12-cr-00028 (DNH).[1] The issues in each case are not identical and therefore plaintiff's Motion for Summary Judgment cannot establish collateral estoppel against Mr. Smith. Plaintiff's Motion further ignores Mr. Smith's fourteen acquittals of the charges in the Superseding Indictment ("SI") which contradict many of the grounds upon which the SEC seeks summary judgment. The charges in the SI and convictions primarily relate to transactions involving the Trust Offerings, while plaintiff's Second Amended Complaint ("SAC") focuses its claims on the Four Funds. Moreover, of the Trust Offerings at issue in the criminal case, the SAC only specifically addresses the Benchmark 09 Trust, TDMM Cable Trust 09, TDM Verifier 08 Trust, and the Firstline Trusts. Mr. Smith was acquitted of several of the charges related to these Trust Offerings. The interplay between Mr. Smith's acquittals and convictions is from the criminal case is complex and is further complicated by plaintiff's attempt to translate them to the SAC on a collateral estoppel basis. It simply cannot be done.

Should the Court finds summary judgment for plaintiff based on collateral estoppel grounds, the same doctrine should be applied against the plaintiff in a finding for damages. The

[1] Mr. Smith filed his Notice of Appeal on the convictions and sentencing on August 16, 2013.

Honorable David N. Hurd issued a restitution order finding that based upon a preponderance of the evidence, the total loss to investors is $5,748,722.00, and therefore, Mr. Smith cross moves for summary judgment that the damages should be limited to this amount.

STATEMENT OF UNDISPUTED FACTS

Mr. Smith incorporates his Responses to Plaintiff's Statement of Material Facts and his Statement of Additional Facts in Opposition to Plaintiff's Summary Judgment Motion into his Memorandum of Law.

LEGAL STANDARD

It is well established that summary judgment may not be granted unless "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c); *see also Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Gallo v. Prudential Residential Servs. Ltd. Partnership*, 22 F.3d 1219, 1223 (2d Cir. 1994). The "burden of demonstrating that no material fact exists lies with the moving party." *Rojas v. Roman Catholic Diocese of Rochester*, 660 F.3d 98, 104 (2d Cir. 2011), *cert denied*, 132 S. Ct. 1744 (2012). The non-moving party carries only "a limited burden of production," in demonstrating "'more than some metaphysical doubt as to the material facts,'" and provide 'specific facts showing that there is a genuine issue for trial.'" *Powell v. Nat'l Bd. of Med. Exam'rs*, 364 F.3d 79, 84 (2d Cir. 2004) (*quoting Aslanidis v. U.S. Lines, Inc.*, 7 F.3d 1067, 1072 (2d Cir. 1993)).

The trial court is "carefully limited to discerning whether there are any genuine issues of material fact to be tried, not to deciding them." *Gallo*, 22 F.3d at 1224. "In determining whether summary judgment is appropriate, a court must resolve all ambiguities and draw all reasonable

inferences against the moving party." *SEC v. Tandem Mgt.*, 2001 U.S. Dist. LEXIS 19109 at *24 (Nov. 21, 2001 S.D.N.Y.). Thus, "[s]ummary judgment is inappropriate when the admissible materials in the record 'make it arguable' that the claim has merit," or "[w]here an issue of material fact cannot be resolved without observation of the demeanor of witnesses in order to evaluate their credibility." *Redd v. N.Y. State Div. of Parole*, 678 F.3d 166, 174 (2d Cir. 2012) (internal quotation marks omitted). The court must discern whether "the evidence presents a sufficient disagreement to require a submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251-52 (1986).

ARGUMENT

I. COLLATERAL ESTOPPEL DOES NOT APPLY TO PLAINTIFF'S CLAIMS BECAUSE THE ISSUES IN THE CIVIL AND CRIMINAL PROCEEDINGS ARE DISTINGUISHABLE.

It is acknowledged that the doctrine of collateral estoppel "prevents parties from litigating issues that have already been decided in prior actions." *SEC v. Grossman*, 887 F. Supp. 649 (S.D.N.Y. 1995); *see also Nevada v. United States*, 463 U.S. 110, 129-30 (1983). "To strike an appropriate balance between the competing concerns for fairness on the one and hand and efficiency on the other, courts have imposed a number of prerequisites to assure that the precluded issue, whether or not correctly resolved, was at least carefully considered in the first proceeding." *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 304 (2d Cir. 1999).

For the collateral estoppel bar to apply: (1) the issues in both proceedings must be *identical*; (2) the issues in the prior proceeding must have been actually litigated and actually decided; (3) there must have been a full and fair opportunity for litigation in the prior proceeding; and (4) the issue previously litigated must have been necessary to support a valid

and final judgment on the merits." *Id.* at 305 (emphasis added). Trial courts have broad discretion in applying the doctrine of collateral estoppel. *See Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 331 (1979).

A. The Issues Related to the Convictions and the Claims in the SAC Are Not Identical.

The SEC fails to show that the issues related to Mr. Smith's convictions are identical to the issues related to its First, Second, Third, and Fourth Claims for relief and ignores the significance of Mr. Smith's fourteen acquittals and the key differences between the SI and the SAC. Specifically, Mr. Smith was acquitted of Counts Two, Three, Four, Five, Six, Seven, Eleven, Twelve, Thirteen, Fifteen, Sixteen, Eighteen, Nineteen, and Twenty of the SAC. *See* Plaintiff's App. Exs. 6 & 10. The acquittals related to the following entities: Firstline Trusts (Counts Two through Six, Eleven through Thirteen, Fifteen); Integrated Excellence Trust (Count Seven, Eighteen); TDM Luxury Cruise Trust (Count Sixteen); McGinn Smith Transaction Funding ("MSTF") (Count Nineteen); and TDMM Cable Jr. Trust (Count Twenty). *See* Plaintiff's App. Exs. 6 & 10.

Although Mr. Smith is currently appealing his convictions, the convictions were limited to the following entities: MSTF (Counts Eight and Nine); Firstline (Count Ten); Integrated Excellence (Fourteen and Seventeen); TDM Verifier Trust (Counts Twenty-One and Twenty-Two); Fortress Trust (Count Twenty-Three through Twenty-Six); conspiracy (Count One); and the tax charges (Counts Thirty through Thirty-Two). *See* Plaintiff's App. Exs. 6 & 10.

Upon a plain reading of the SAC and SI, there are numerous differences related to the allegations and the entities involved, primarily that the SAC's claims primarily relate to the Four Funds, "FIIN", "FAIN", "TAIN", and "FEIN", with specific discussion only to the TDMM Cable, Verifier, Benchmark, and Firstline Trusts. *See* Plaintiff's App. Ex. 6, Dkt. No. 25. Other

than within a general statement of the Trust Offerings, the SAC fails to mention MSTF, Integrated Excellence, and the Fortress Trust within its SAC, three of the entities that relate to Mr. Smith's convictions. *See* Dkt. No. 25. Mr. Smith's sole conviction involving to the Firstline Trusts (Count Ten) is strictly related to a letter that was mailed to investors in September 2009, nearly two years since Firstline's initial offering, while he was acquitted on all other counts related to Firstline. *See* Plaintiff's App. Exs. 6, 10, 70.

The acquittals and the jury's mixed verdict on even the same Trust Offerings are sufficient to raise a material issue of fact. When further coupled with the substantial differences in issues between the SI and SAC, there is no identity of issues, and collateral estoppel does not apply.

B. The Issues Related to the Conspiracy Conviction Are Ambiguous and Must be Resolved in Favor of Mr. Smith.

Further, based on Judge Hurd's jury instruction, it is unclear how the jury came to the conviction of Mr. Smith related to the conspiracy matter as the jury was instructed to that the conspiracy charge could be related to investors or FINRA. *See* Plaintiff's App. Ex. 6, Smith Additional SMF, ¶ 13. Therefore, it is impossible whether Mr. Smith's verdict related to investors and FINRA or to FINRA only, which would not raise collateral estoppel grounds for any of plaintiff's claims.

To the extent that there are any ambiguities between the issues determined in the criminal case and the claims in the SAC, any ambiguities are construed in favor of the party defending a summary judgment motion. *See In re Adelphia Communs. Corp. Sec. & Derivative Litig.*, 2005 LEXIS 43300 (S.D.N.Y. Aug. 16, 2005). As the Court must apply a careful analysis in applying collateral estoppel, the distinctions between the SI and the SAC in conjunction with the

acquittals handed down by the jury in the criminal case preclude the application of collateral estoppel with respect to the First, Second, Third, and Fourth Claims in the SAC.

II. SHOULD COLLATERAL ESTOPPEL APPLY, THE DOCTRINE LIMITS CIVIL DAMAGES TO JUDGE HURD'S $5.7 MILLION RESTITUION ORDER RELATED TO INVESTOR LOSSES.

Mr. Smith maintains that the doctrine of collateral estoppel does not apply to the SEC's claims, however to the extent the Court finds in favor for plaintiff, equity requires that the disgorgement amount be limited to Judge Hurd's restitution order limiting investor losses to $5,748,722.00.[2] *See* Plaintiff's App. Ex. 6. The SEC cannot argue that collateral estoppel applies to Mr. Smith's convictions and then seek damages in excess of the restitution order related to the same convictions. For the same reasons the SEC argues that collateral estoppel applies to Claims One, Two, Three, and Four, its same arguments should equally apply to the damages it seeks.

A. The Restitution Amount Has Been Determined by a Preponderance of the Evidence.

The Mandatory Victims Restitution Act ("MVRA") provides "that in sentencing a defendant convicted of a felony committed through fraud or deceit, the court must order the defendant to pay restitution to any identifiable person directly and proximately harmed by the offense of conviction." *United States v. Reifler*, 446 F.3d 65, 113 (2d Cir. 2006); *see* 18 U.S.C. §3663A(a)(2). The MVRA requires "the sentencing court to direct the probation officer to prepare a presentence report containing 'information sufficient for the court to exercise its discretion in fashioning a restitution order,' including, 'to the extent practicable, a complete accounting of the losses to each victim." *United States v. Reifler*, 446 F.3d 65, 113 (2d Cir.

[2] Mr. Smith is not waiving his right to appeal the convictions and sentencing, he is only raising this arguments for the purpose of his Summary Judgment Motion papers.

2006); citing 18 U.S.C. §3664(a). "Any dispute as to the proper amount or type of restitution shall be resolved by the court by a preponderance of the evidence." 18 U.S.C. § 3664(e).

B. The SEC Failed to Assert Its Position Related to Investor Loss Amount at Sentencing.

The United States Probation Office of the Northern District of New York advanced a total loss amount to investors of $6,336,440.00. *See* Plaintiff's App. Ex. 26 at 5. Although Mr. Smith advocated that the loss amount related to the criminal convictions could not be properly calculated, Judge Hurd accepted the probation officer's recommendation of loss amount to investors. *See* D. Smith's Statement of Additional Facts, ¶¶ 4, 8. While sentencing is an open court proceeding and allows for victims and advocates for the defendant to submit recommendations prior to sentencing, it should be noted that neither the SEC nor any investors assert a loss amount or challenge the loss amounts proposed by the United States Probation Office, United States Attorney's Office, or Mr. Smith, despite their opportunity to do so. *See* D. Smith's Statement of Additional Facts, ¶¶ 3-6. Based upon the submissions received, Judge Hurd determined the loss amount by a preponderance of the evidence. *See* Plaintiff's App. Ex. 26 at 5.

Should the Court finds that the SEC has satisfied its burden with respect to the collateral estoppel on the criminal convictions, the rules of equity demand that it is applied to the restitution order as well. Should the Court find in favor of the SEC, it is respectfully submitted that it has already found for the first prong of the inquiry, that the issues in both proceedings are identical. Similarly, the restitution amount to investors has been actually litigated and decided pursuant to Judge Hurd's Order and sentencing proceedings, thereby providing a full and fair opportunity for litigation in the prior proceeding; and the restitution order became a final

judgment on the merits as of August 13, 2013. *See* Plaintiff's App. Ex. 10; *SEC v. Monarch Funding Corp.,* 192 F.3d 295, 305 (2d Cir. 1999).

C. The Maximum Penalty the SEC May Seek is Limited to the Restitution Order.

The SEC fails to meet its burden with respect to the $124 million in damages it seeks and advances no evidence that supports its calculation of damages. Judge Hurd's restitution Order alone creates a genuine issue of material fact as to the damages amount and therefore, any determination in excess of the $5,748,722.00 amount, especially the amount the SEC advances which is over twenty times the United States Probation Office and Judge Hurd found by a preponderance of the evidence, could not be determined by summary judgment. *See* Plaintiff's App. Ex. 10.

III. THE PLAINTIFF'S MOTION FOR DISGORGEMENT IS MOOT.

Disgorgement is a remedy that "forces a defendant to account for all profits reaped through his securities law violations and to transfer all such money to the court." *SEC v. Cavanaugh,* 445 F.3d 105, 117 (2d Cir. 2006). "The primary purpose of disgorgement is not to compensate victims or punish the wrongdoer, but rather 'to prevent wrongdoers from unjustly enriching themselves through violations'". *SEC v. Haligiannis*, 470 F. Supp. 373, 384 (S.D.N.Y. 2007), *citing SEC v. Cavanaugh*, 445 F.3d 105, 117 (2d Cir. 2006). In calculating the disgorgement amount, a court must make "a reasonable approximation of profits casually connected to the violation." *SEC v. Haligiannis,* 470 F. Supp. 2d 373, 384 (S.D.N.Y. 2007).

Should the doctrine of collateral estoppel to plaintiff's claims, plaintiff's motion for disgorgement of at least $124 million is moot. Judge Hurd already has determined the loss of amount to investors in the criminal matter to be $5,748,722.00. *See* Plaintiff's App. Ex. 10. The Judgment further provided special instructions indicating that "The Court orders that any cash

value of the assets collected thus far by the Receiver, William J. Brown, appointed by the Court in this case may be deducted from the total restitution amount and may be distributed to the victims by the Receiver as such assets are available for distribution, and for as long as the Receiver is in operation." *See* Plaintiff's App. Ex. 10.

As stated by plaintiff, "[a]s of June 27, 2014, the Receiver has assets totaling $20,882,652 . . . [and t]he Receiver estimates that additional recoveries may increase to $6 to $ 8 million . . . ." Plaintiff's MSJ, dated July 8, 2014, Dkt. No. 708-1 at 14; Plaintiff's App. Ex. 3 at ¶ 5. To the extent that the Receiver has already collected well over the $5,748,722.00 restitution amount to be distributed to investors upon further order from this Court, the SEC's claim for disgorgement is moot in that its remedy has already been ordered by a prior proceeding and Order, and the Receiver has collected funds in excess of the investor loss amount.

IV. GENUINE ISSUES OF MATERIAL FACTS EXIST AS TO PLAINTIFF'S REMAINING CLAIMS.

Plaintiff has not met its burden in proving that no genuine issues of material facts exist for its Sixth Claim for Relief related to Section 5(a) and (c) of the Securities Act. The SEC acknowledges that the alleged violations of Sections 5(a) and (c) of the Securities Act were not charged in the SI or an issue that was raised at the criminal trial. *See* Plaintiff's MSJ, dated July 8, 2014, Dkt. No. 708-1 at 13. Plaintiff improperly assumes that the Four Funds were investment companies and subject to Regulation D. The Four Funds were not investment companies but specialty finance companies designed to provide financing, primarily in the form of debt, to emerging growth companies and did not require registration. D. Smith's Statement of Additional Facts, ¶ 14. Additionally, there were a number of investors in the Four Funds who may be deemed "unaccredited" however the purchase of the notes were done by a family member who was accredited. D. Smith's Statement of Additional Facts, ¶ 15. Therefore, the SEC has failed

to satisfy its burden and summary judgment cannot be granted as to plaintiff's Sixth Claim for Relief.

V. PLAINTIFF'S MOTION TO ENJOIN MR. SMITH FROM FUTURE SECURITIES LAWS IS MOOT BASED ON MR. SMITH'S OFFER OF SETTLEMENT.

Mr. Smith previously consented to an Offer of Settlement barring him from the securities industry in the SEC's Administrative Proceeding and therefore any further grant of relief is moot. *See* Plaintiff's App. Ex. 61. Any further relief would serve no purpose.

CONCLUSION

For the foregoing reasons, Plaintiff's Motion for Summary Judgment against David L. Smith should be denied, or alternatively, defendant's cross-motion for summary judgment on the issue of damages should be granted.

Respectfully submitted,

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/s/

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In re Adelphia Communs. Corp. Sec. & Derivative Litig.

United States District Court for the Southern District of New York
August 22, ***2005***, Decided ; August 23, 2006, Filed
03 MD 1529 (LMM)

Reporter: 2005 U.S. Dist. LEXIS 43300; 2006 WL 2463355

IN RE ADELPHIA COMMUNICATIONS CORPORATION SECURITIES AND DERIVATIVE LITIGATION; THIS MEMORANDUM AND ORDER APPLIES TO Nos. 03-CV-5750, 03-CV-5751

Prior History: *In re Adelphia Communs. Corp. Sec. & Derivative Litig.*, ***2005*** U.S. Dist. ***LEXIS*** 17134 (S.D.N.Y., Aug. 16, ***2005***)

Counsel: **[*1]** For Los Angeles County Employee Retirement Fund, Plaintiff (1:03-cv-05750-LMM): Brian C. Lysaght, O'Neill Lysaght & Sun LLP, Santa Monica, CA; Megan D. McIntyre, Grant & Eisenhofer, PA, Wilmington, DE; Stuart M. Grant, Graham,Miller,Neandross,Mullin & Roonan,LLC, New York, NY.

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James R. Brown, Defendant (1:03-cv-05750-LMM), Pro se, Coudersport, PA.

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For Franklin Strategic Income Fund, Franklin Custodian Fund-Income Fund, FIST-Franklin Convertible Securities Fund, FTVIPT-Strategic Income Fund, FTIF-Franklin High Yield Fund, FTVIPT-Franklin Income Securities Fund, FTIF-Franklin Income Fund, Franklin Age High Income Fund, FIVIPT Franklin High Income Fund, Redwood CBO, Franklin Institutional High Yield Fixed Income Fund, Franklin Multi-Income Fund, FIST-Franklin Total Return Fund, Plaintiffs (1:03-cv-05751-LMM): Brian C. Lysaght, O'Neill Lysaght & Sun LLP, Santa Monica, CA; Megan D. McIntyre, Stuart M. Grant, Grant **[*3]** & Eisenhofer, PA, Wilmington, DE.

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For Peter L. Venetis, Defendant (1:03-cv-05751-LMM): Jeffrey T. Golenbock, Golenbock Eiseman Assor Bell & Peskoe LLP, New York, NY; Michael J. Partos, Los Angeles, CA.

For Dennis P. Coyle, Leslie J. Gelber, Pete J. Metros, Erland E. Kailbourne, Defendants (1:03-cv-05751-LMM): Howard M. Privette, Thomas L. Taylor, III, Los Angeles, CA.

For Deloitte & Touche LLP, Defendant (1:03-cv-05751-LMM): Gwyn D. Quillen, Marshall B. Grossman, Roland K. Tellis, Water Garden, Santa Monica, CA; Katherine B. Forrest, Max R. Shulman, Cravath Swaine & Moore, L.L.P., New York, NY.

Judges: Lawrence M. McKenna, U.S.D.J.

Opinion by: Lawrence M. McKenna

Opinion

MEMORANDUM AND ORDER

McKENNA, D.J.,

This action is part of a multi-district securities litigation pending before this Court. *In re Adelphia Commc'ns Corp. Sec. & Derivative Litig.,* No. 03 MD 1529.

In the instant case, the Los Angeles County Employees Retirement Association ("LACERA"), which is Plaintiff in the individual action No. 03-CV-5750, **[*4]** and the Franklin Strategic Income Funds and other associated funds ("Franklin"), which are Plaintiffs in the individual action No. 03-CV-5751, (collectively, "Plaintiffs"), have brought this action against Defendants John J. Rigas, Timothy J. Rigas, James P. Rigas, and Michael J. Rigas, all of whom were directors and/or senior officers of Adelphia Communications Corporation ("Adelphia") at all relevant times until May 2002. (LACERA Am. Compl. PP 17-21; Franklin Am. Compl. PP 16-20.) Plaintiffs have also named as defendants: outside directors of Adelphia (i.e. those directors who are not Rigases); Deloitte & Touche LLP; Banc of America Securities LLC; and Salomon Smith Barney Holdings, Inc. (LACERA Am. Compl. PP 22-30; Franklin Am. Compl. PP 21-27.) [1]

[*5] Plaintiffs allege against the Rigas family directors: violations of Sections 10(b), 18, and 20(a) of the Securities Exchange Act of 1934, *15 U.S.C. §§ 78j*, *78r*, *78t(a)*; violations of Sections 11 and 15 of the Securities Act of 1933, *15 U.S.C. §§ 77k*, *77o*; allegations of common law fraud under California law; and violations of *California Corporations Code §§ 1507*, *25400(d)*, *25500*, *25504*, and *25504.1*, all arising out of statements made by defendants regarding the financial condition of Adelphia. (LACERA Am. Compl. PP 339-581; Franklin Am. Compl. PP 315-467.) Plaintiffs now move for partial summary judgment against John J. Rigas and Timothy J. Rigas ("Defendants" or "the Rigases") on the claims of violations of *Sections 10(b)* and *18* of the Securities Exchange Act of 1934, violations of *Section 11* of the Securities Act of 1933, and common law fraud (LACERA Am. Compl. Counts 1, 4, 8, 13; Franklin Am. Compl. Counts 1, 3, 5, 9), based on the criminal convictions of John and Timothy Rigas, *see United States v. Rigas, 2004 U.S. Dist. **LEXIS*** 23206, No. 02 CR 1236, 2004 WL 2601084, **[*6]** at *1 (S.D.N.Y. Nov. 15, 2004) (listing judgments of conviction against John and Timothy Rigas after a jury rendered a verdict on July 8, 2004). (*See also* Special Verdict Form, Counts 3, 5, 8, 11-15, *United States v. Rigas,* No. 02 CR 1236 (S.D.N.Y. July 8, 2004).) For the reasons set forth below, the motion is granted in part and denied in part.

I. Background

LACERA is a California public pension fund providing retirement, disability, and death benefits to eligible Los Angeles County employees and their beneficiaries. (LACERA Am. Compl. P 16.) The Franklin Strategic Income Fund and other associated funds are affiliated with Franklin Templeton Investments, a large private investment management firm. (Franklin Am. Compl. P 15.) Between May 1998 and June 2002, Plaintiffs collectively purchased approximately $ 381 million in debt securities issued by Adelphia and its subsidiary Arahova Communications Corporation; Plaintiffs held those securities until March 2002 (LACERA) and June 2002 (Franklin). (LACERA Am. Compl. PP 1, 16; Franklin Am. Compl. PP 1, 14-15, 45-50.) Plaintiffs allege they made these purchases based upon false and misleading information. (LACERA Am. Compl. **[*7]** PP 1-2; Franklin Am. Compl. PP 1-2.) At all relevant times, John J. Rigas was the founder, President, Chairman, Chief Executive Officer, and a director of Adelphia; his son, Timothy J. Rigas, was the Executive Vice President, Chief Financial Officer, Chief Accounting Officer, Treasurer, and a director of Adelphia. (Franklin Am. Compl. PP 16-17.)

On March 27, 2002, Adelphia revealed that billions of dollars in off-balance sheet debt had not been disclosed in its prior filings with the Securities and Exchange Commission ("SEC") or related financial reports. Subsequently, Adelphia made other announcements revealing additional problems, all of which caused the trading price of Adelphia's securities to drop precipitously. (Franklin Am. Compl. PP 8-9, 95-149; Indictment PP 44-197, *United States v. Rigas,* 02 CR 1236 (S.D.N.Y. Sept. 23, 2002).)

Plaintiffs allege that the Rigases made numerous false or misleading public statements concerning Adelphia's financial condition, including statements or omissions about its off-balance sheet debt, leverage, operating performance, compliance with debt covenants, and related party transactions that were included in press releases,

[1] The outside directors moved to dismiss plaintiffs' claims on statute of limitations grounds. This Court granted in part and denied in part that motion, granting plaintiffs leave to replead. *In re Adelphia Communs. Corp. Sec. & Derivative Litig.,**2005*** U.S. Dist. ***LEXIS*** 17134, No. 03 MD 1529, ***2005*** WL 1981566 (S.D.N.Y. Aug. 16, ***2005***). Deloitte & Touche and Salomon Smith Barney also moved to dismiss plaintiffs' claims on statute of limitations grounds. This Court granted in part and denied in part that motion, granting plaintiffs leave to replead. *In re Adelphia Communs. Corp. Sec. & Derivative Litig.,**2005*** U.S. Dist. ***LEXIS*** 14444, No. 03 MD 1529, ***2005*** WL 1679540 (S.D.N.Y. July 18, ***2005***), *reconsid. denied,**2005*** U.S. Dist. ***LEXIS*** 16282, ***2005*** WL 1882281 (S.D.N.Y. Aug. 9, ***2005***).

Form 10-K, 8-K, **[*8]** and 10-Q filings, proxy statements, Registration Statements, and related Prospectuses. (Franklin Am. Compl. PP 51-149.) [2]

Plaintiffs claim they overpaid for Adelphia securities, as the securities' prices were inflated due to Defendants' failure to disclose material information; when Defendants revealed this previously undisclosed material information, the price of the securities dropped sharply, resulting in significant financial loss to Plaintiffs. (LACERA Am. Compl. PP 8-9; Franklin Am. Compl. PP 8-9.)

The United States Attorney for the Southern District of New York initiated a criminal action against John J. Rigas, Timothy J. Rigas, Michael J. Rigas, **[*9]** James R. Brown, and Michael C. Mulcahey for: (1) conspiracy to commit wire fraud, commit bank fraud, commit securities fraud, make false and misleading statements in SEC filings, and falsify company records; (2) securities violations under *Section 10(b)*; (3) wire fraud; and (4) bank fraud -- all based on facts almost identical to those alleged in the Complaints at hand. *See United States v. Rigas, 258 F. Supp. 2d 299, 301-03 (S.D.N.Y. 2003)*. (*See also* Indictment PP 198-211). After a jury trial, John and Timothy Rigas were convicted of conspiracy to: commit bank fraud, commit securities fraud, make or cause false statements to be made in SEC filings, and falsify Adelphia's records. (Special Verdict Form, Count 1). They were also convicted of securities fraud in connection with the common stock of Adelphia. (*Id.,* Count 2.) In addition, John and Timothy Rigas were convicted of 14 distinct counts of securities fraud in connection with specific debt securities, including the following which were purchased by Plaintiffs: Adelphia 9.875% Senior Notes due March 1, ***2005***; Adelphia 9.875% Senior Notes due March 1, 2007; Adelphia 8.375% Senior Notes due February 1, 2008; **[*10]** Adelphia 7.75% Senior Notes due January 15, 2009; Adelphia 7.875% Senior Notes due May 1, 2009; Adelphia 9.375% Senior Notes due November 15, 2009; Adelphia 10.875% Senior Notes due October 1, 2010; and Adelphia 10.25% Senior Notes due June 15, 2001. (*Id.,* Counts 3, 5, 8, 11-15.) They were also convicted on counts of bank fraud. (*Id.,* Counts 22-23.) The convictions were entered as final judgments on June 30, ***2005***. [3]

Plaintiffs argue that this Court should grant partial summary judgment against the Rigases, based on their criminal convictions, on the *Section 10(b)*, *Section 11*, *Section 18*, and common law fraud claims. Plaintiffs do not seek summary judgment on the issue of damages.

II. Standard

A. Summary Judgment

Summary judgment should be granted only ″if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, **[*11]** if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.″ *Fed. R. Civ. P. 56(c)*; *Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)*. A dispute regarding a material fact is genuine ″if the evidence is such that a reasonable jury could return a verdict for the nonmoving party.″ *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)*.

Once the moving party establishes a prima facie case demonstrating the absence of a genuine issue of material fact, the nonmoving party has the burden of presenting ″specific facts showing that there is a genuine issue for trial.″ *Fed. R. Civ. P. 56(e)*. The nonmoving party must ″do more than simply show that there is some metaphysical doubt as to the material facts,″ *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986)* (citations omitted), and ″may not rely on conclusory allegations or unsubstantiated speculation,″ *Scotto v. Almenas, 143 F.3d 105, 114 (2d Cir. 1998)* (citations omitted). A court **[*12]** ″must resolve all ambiguities and draw all reasonable inferences in favor of the party defending against the motion.″ *Eastway Constr. Corp. v. City of New York, 762 F.2d 243, 249 (2d Cir. 1985)*.

B. Collateral Estoppel

Plaintiffs seek to use Defendants' criminal convictions to invoke offensive collateral estoppel and prevent Defendants from relitigating their liability in this civil case. Collateral estoppel bars the ″relitigation of an issue of law or fact that was raised, litigated, and actually decided by a judgment in a prior proceeding between the parties, if the determination of that issue was essential to the judgment, regardless of whether or not the two proceedings are based on the same claim.″ *N.L.R.B. v. United Tech. Corp., 706 F.2d 1254, 1260 (2d Cir. 1983)* (citations omitted). ″Because mutuality of estoppel is no longer an absolute requirement under federal law, a party other than the Government may assert collateral estoppel based on a criminal conviction. *Gelb v. Royal Globe Ins.*

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[2] A complete recitation of the allegations at issue is unnecessary, as they are substantially similar to those contained in the Consolidated Class Action Complaint discussed in this Court's May 27, ***2005*** Memorandum and Order. *In re Adelphia Commc'ns Corp. Sec. & Derivative Litig.,* No. 03 MD 1529, ***2005*** WL 1278544, at *1-4. (S.D.N.Y. May 31, ***2005***).

[3] Criminal defendants Michael J. Rigas and Michael C. Mulcahey were acquitted on all counts. (Special Verdict Form, Counts 1-23.)

Co., 798 F.2d 38, 43 (2d Cir. 1986) (citations omitted). The doctrine is designed to "promote judicial economy." Whimsicality, Inc. v. Battat, 27 F. Supp. 2d 456, 462 (S.D.N.Y. 1998) **[*13]** (citations omitted).

To apply offensive collateral estoppel, a court must find that "(1) the issues in both proceedings are identical, (2) the issue in the prior proceeding was actually litigated and actually decided, (3) there was full and fair opportunity to litigate in the prior proceeding, and (4) the issue previously litigated was necessary to support a valid and final judgment on the merits." United States v. Hussein, 178 F.3d 125, 129 (2d Cir. 1999) (quotations and citations omitted); *see* Gelb, 798 F.2d at 44. Trial courts have "broad discretion" in applying the doctrine of offensive collateral estoppel. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 331, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979).

"It is settled that a party in a civil case may be precluded from relitigating issues adjudicated in a prior criminal proceeding . . . ." Mishkin v. Ageloff, 299 F. Supp. 2d 249, 253 (S.D.N.Y. 2004) (citing United States v. Podell, 572 F.2d 31, 35 (2d Cir. 1978)) (other citations omitted). "In a civil case, it is appropriate to estop a party from relitigating issues actually and necessarily decided as part of a prior criminal judgment **[*14]** and conviction, in part because '[t]he government bears a higher burden of proof in the criminal than in the civil context.'" SEC v. Namer, 2004 U.S. Dist. ***LEXIS*** 19611, No. 97 Civ. 2085, 2004 WL 2199471, at *4 (S.D.N.Y. Sept. 30, 2004) (quoting Gelb, 798 F.2d at 43).

III. Discussion

Plaintiffs argue that the Rigases' convictions alone suffice to establish liability and that Plaintiffs should be awarded partial summary judgment on their Section 10(b), Section 11, Section 18, and common law fraud claims on all elements except damages. The first inquiry, however, is deciding whether collateral estoppel applies to Plaintiffs' civil claims.

A. Use of Collateral Estoppel

As previously stated, in order to apply collateral estoppel to Plaintiffs' civil claims, this Court must find that: (1) the issues in both proceedings are identical; (2) the issue in the prior proceeding was actually litigated and actually decided; (3) defendants had a full and fair opportunity to litigate in the prior proceeding; and (4) the issue previously litigated was necessary to support a valid and final judgment on the merits. Gelb, 798 F.2d at 44.

The court will first address **[*15]** the last threeGelb prongs, as Plaintiffs have clearly met those. Under prong two of *Gelb,* there can be no question that *United States v. Rigas* actually litigated and actually decided the facts necessary to reach a verdict on the Section 10(b) claims as they pertained to the Rigases' misrepresentations about Adelphia's financial condition. Similarly, under prong three, there is no question as to whether the Rigases had anything other than "a full and fair opportunity" to litigate the issues in the criminal case. The Rigases do not argue that they were deprived of any opportunity to vigorously put forth a defense in the criminal action, which is "presume[d to have taken] place in accord with the procedural and constitutional safeguards accorded to criminal defendants in United States District Courts." *See* Namer, 2004 U.S. Dist. ***LEXIS*** 19611, 2004 WL 2199471, at *5. As to the final prong, Defendants argue that because both John and Timothy Rigas have filed appeals of their criminal convictions, their convictions are not final. (Defs.' Opp'n 18.) However, "the pendency of a criminal appeal generally does not deprive a judgment of its preclusive effect." United States v. Int'l Bhd. of Teamsters, 905 F.2d 610, 621 (2d Cir. 1990) **[*16]** (quotations and citation omitted); *see also* Petrella v. Siegel, 843 F.2d 87, 90 (2d Cir. 1988); Namer, 2004 U.S. Dist. ***LEXIS*** 19611, 2004 WL 2199471, at *8 (applying collateral estoppel despite pending appeal). [4] This same analysis of the last three prongs applies to application of collateral estoppel to all civil claims asserted here by Plaintiffs.

[*17] The inquiry as to the first *Gelb* prong is more complex. Under the first prong, the Court must first decide what findings were actually made by the criminal jury. Plaintiffs argue that the Court should look to the criminal indictment to assess which issues were decided in the criminal case (Pls.' Reply 2-5), and Defendants argue the Court should look only to the Special Verdict Form (Defs.' Opp'n 8-13). This Court finds both positions incorrect.

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[4] Defendants argue that this Court should exercise its discretion and deny the application of collateral estoppel due to principles of fairness and equity. First, Defendants argue that judicial economy would not be promoted by the application of collateral estoppel only as against John and Timothy Rigas and not against the other Rigases because the allegations against all of the Rigases are identical, and during discovery the remaining defendants will seek the same discovery and evidence regardless of whether partial summary judgment is awarded here. (Defs.' Opp'n at 17-18.) Although Defendants are correct that discovery will have to take place regardless, Defendants miss the point that judicial economy is promoted any time a defendant or issue is removed from a case. Second, Defendants argue that this Court should deny collateral estoppel due to the risk that that the criminal jury may have been wrong. Defendants cite to an Ohio state court case to support their argument. (*Id.* at 18-19 (citing Phillips v. Rayburn, 113 Ohio App. 3d 374, 680 N.E.2d 1279 (Ohio App. 1996))). That decision itself admits, however, that it is "contrary to the trend in federal courts." *See* Phillips, 113 Ohio App. 3d. at 381. Federal courts routinely apply collateral estoppel based on jury verdicts. *See, e.g.,* Namer, 2004 U.S. Dist. ***LEXIS*** 19611, 2004 WL 2199471.

The allegations in the Rigases' criminal indictment mirror those in the LACERA and Franklin Amended Complaints. The Rigases were charged with 15 separate counts of securities fraud, one for each class of Adelphia debt securities (Indictment, Counts 2-16), and Plaintiffs purchased 8 of these classes (LACERA Am. Compl. P 16; Franklin Am. Compl. P 15). In reaching their verdict, the jury expressly found that in connection with the purchase or sale of each of those securities, John and Timothy Rigas ″employed a device, scheme or artifice to defraud,″ ″made an untrue statement of a material fact or omitted to state a material fact which made what was said under the circumstances, misleading,″ and ″engaged in an act, practice, or course of business **[*18]** that operated, or would operate, as a fraud or deceit upon a purchaser or seller.″ (Special Verdict Form, Counts 2-16.) These are all violations of *Section 10(b)* of the Securities Exchange Act of 1934, *15 U.S.C. § 78j*, and Rule 10b-5, *17 C.F.R. § 240.10b-5*. (*See id.*) The Special Verdict Form did not ask the jury whether the government had proven its case with respect to each and every alleged misrepresentation set forth in the Indictment. (*See id.*) Neither did it ask the jury to identify the particular misrepresentation, omission, or deceptive conduct that served as the basis for each of the counts. Defendants argue that as such, the Verdict Form only demonstrates that the jury found that John and Timothy Rigas made only one misleading statement of material fact with respect to each of the identified securities, and that it is impossible to know which of the alleged conduct or misrepresentations contained in the indictment served as the basis for the securities fraud convictions. (Defs.' Opp'n 10.)

When applying collateral estoppel, a court must be ″mindful of the reality that the basis upon which the . . . verdict was reached **[*19]** usually cannot be demonstrated with certainty.″ *United States v. Clark, 613 F.2d 391, 402 (2d Cir. 1979)* (citation omitted). Often, as here, a criminal verdict does not indicate which of the allegations charged in the indictment were actually found to have been engaged in, beyond a reasonable doubt, by the defendants, ″since all of the acts charged need not be proved for conviction.″ *See Emich Motors Corp. v. General Motors Corp., 340 U.S. 558, 569, 71 S. Ct. 408, 95 L. Ed. 534 (1951)*.

″Under these circumstances what was decided by the criminal judgment must be determined by the trial judge hearing the [civil] suit, upon an examination of the record, including the pleadings, the evidence submitted, the instructions under which the jury arrived at its verdict, and any opinions of the courts.″ *Id.; see Ashe v. Swenson, 397 U.S. 436, 444, 90 S. Ct. 1189, 25 L. Ed. 2d 469 (1970)*. The Court's ″task is to determine 'whether a rational jury could have grounded its verdict upon an issue other than that which [Plaintiffs] seek to foreclose from consideration.'″ *United States v. Russotti, 717 F.2d 27, 35 (2d Cir. 1983)* (quoting *Ashe, 397 U.S. at 444*). This inquiry must **[*20]** be conducted ″in a practical frame and viewed with an eye to all the circumstances of the proceedings. Any test more technically restrictive would, of course, simply amount to a rejection of the rule of collateral estoppel in criminal proceedings . . . .″ *Ashe, 397 U.S. at 444* (quotations and citation omitted). A court should not ″strain[] to postulate hypertechnical and unrealistic grounds on which the jury could conceivably have rested its conclusions.″ *United States v. Mespoulede, 597 F.2d 329, 333 (2d Cir. 1979)* (quotations and citation omitted). Using these principles, courts in this district have repeatedly looked beyond indictments when applying collateral estoppel. *See, e.g., Everest, 466 F. Supp. 167, 173 (S.D.N.Y. 1979)* (examining record in criminal case to apply collateral estoppel to SEC's civil claims based on defendant's previous criminal conviction); *Namer, 2004 U.S. Dist. **LEXIS** 19611, 2004 WL 2199471, at *5-7* (looking at indictment to determine that allegations in civil complaint were identical to those decided in criminal case).

Here, based on a review of the trial record, court opinions, Indictment, Special Verdict Form, and **[*21]** Jury Instructions, this Court finds that the most reasonable conclusion is that the jury found that the Rigases engaged in an ongoing and pervasive fraudulent scheme, in furtherance of which the Rigases made numerous material misrepresentations and omissions and engaged in other fraudulent conduct. The criminal case ″center[ed] on an approximately three-year period in which Defendants allegedly engaged in a pattern of criminal conduct designed to conceal or minimize Adelphia's increasingly precarious financial condition and the Rigas family's improper use of Adelphia funds for personal purposes.″ *United States v. Rigas, 258 F. Supp. 2d at 302-03*. By its very nature, concealment of the information rendered false all of Adelphia's financial statements, SEC filings, and other public statements relating to its financial condition during the three-year period alleged in both the Plaintiffs' Amended Complaints and the Indictment. It would be unrealistic for this Court to find that the Rigases' convictions on 15 counts of securities fraud with the purchase or sale of 15 different securities were based on a finding of only one single false statement in one single document.

[*22] The above analysis only determines the first portion of the first *Gelb* prong, i.e. what the jury found in the criminal case. The second portion, i.e. whether what the criminal jury found is identical to the facts alleged in the individual civil claims, must be addressed on a case by case basis for each civil claim, which the Court does in the following section.

B. Application to Individual Civil Claims

1. Section 10(b) Claim

By proving a criminal violation of *Section 10(b)* of the 1934 Securities Exchange Act and *Rule 10b-5* against the Rigases at trial, the government has proven beyond a reasonable doubt that the Rigases: ″(1) made a material misrepresentation or material omission as to which [they] had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities.″ *SEC v. Monarch Funding Corp., 192 F. 3d 295, 308 (2d Cir. 1999)* (citation omitted). [5]

[*23] To establish civil liability under *Section 10(b)* and *Rule 10b-5*, Plaintiffs must prove, by a preponderance of the evidence, that Defendants: ″'(1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that plaintiffs' reliance was the proximate cause of their injury.'″ *In re Adelphia Commc'ns Corp. Sec. & Derivative Litig., 398 F. Supp. 2d 244, 248* (quoting *In re IBM Corp. Sec. Litig., 163 F. 3d 102, 106 (2d Cir. 1998))*. The only elements for civil liability not proven in the Rigases' criminal trial are Plaintiffs' reliance and causation. These issues were neither litigated nor posed to the jury.

Plaintiffs acknowledge that a finding of reliance cannot be based on the criminal conviction (Pls.' Mem. 4-5), but argue that because their 10(b) claim includes a claim that Adelphia's financial statements omitted material facts necessary to make the statements not misleading, they need not prove reliance (Pls.' Mem. 11-12; Pls.' Reply 6-10). ″Reliance is established by a rebuttable presumption which exists in cases, such as the instant one, **[*24]** in which defendant[s have] failed to disclose material information to [plaintiffs] . . . .″ *In re Ivan F. Boesky Sec. Litig., 848 F. Supp. 1119, 1124, 1125 (S.D.N.Y. 1994)* (citing *Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972))*. The 10(b) violations established by the Rigases' criminal convictions, and those alleged by Plaintiffs, indisputably derived in part from the Rigases' failure to disclose material information. (LACERA Am. Compl. PP 63-115; Franklin Am. Compl. PP 51-96; Indictment PP 44-197.) Thus, there is a rebuttable presumption that Plaintiffs relied on Defendants' nondisclosure and omissions.

In addition, reliance is presumed where a plaintiff is the purchaser of a security and has demonstrated a ″fraud on the market.″ *Basic, Inc. v. Levinson, 485 U.S. 224, 243, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988)*. Courts regularly apply the ″fraud on the market″ doctrine when deciding motions for summary judgment. *See, e.g., In re Ivan F. Boesky Sec. Litig., 848 F. Supp. at 1124-26*; *In re Gaming Lottery Sec. Litig., 2001 U.S. Dist. **LEXIS*** 2034, No. 96 Civ 5567, 2001 WL 204219, at *17 (S.D.N.Y. Mar. 1, 2001). ″The fraud on the market **[*25]** theory holds that in an open and developed securities market, the price of a company's stock is determined by the available information regarding the company and its business [and that m]isleading statements will therefore defraud

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[5] Section 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78j*, reads in relevant portion:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, reads in relevant portion:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> . . .
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

purchasers of stock even if the purchasers do not directly rely on the misstatements." *In re Adelphia, 398 F. Supp. 2d at 256* (quotations and citation omitted). "The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations." *Basic, 485 U.S. at 241-42* (quotations and citation omitted).

In the case at hand, more than $ 6.9 billion in Adelphia debt securities, and those of its subsidiaries, were "registered with the SEC and were traded in the over-the-counter market for such securities by dealers in New York, New York and elsewhere." (Indictment P 37.) At all relevant times, Moody's Investors Services, Inc. and Standard & Poor's Ratings Services "periodically published their credit ratings and analyses of Adelphia and its debt securities, which were routinely relied upon by investors in connection with **[*26]** the purchase and sale of Adelphia securities." (*Id.* P 39.) As the market for Adelphia debt securities was efficient during the relevant period, Plaintiffs are entitled to a presumption of reliance. *See In re Gaming, 2001 U.S. Dist. **LEXIS** 2034, 2001 WL 204219, at *17* (citing *Basic, 485 U.S. at 243*).

Defendants have furnished no evidence to rebut these presumptions. However, Defendants argue that Plaintiffs' motion should be denied as premature pending the completion of required discovery. (Defs.' Opp'n 4-7.) Defendants contend that in order to adequately respond to Plaintiffs' motion they need discovery on the following: the timing and amount of Plaintiffs' alleged securities purchase, entities that comprise Plaintiffs, as well as the issues of reliance and loss causation. (Defs.' Opp'n 4-7.) This Court agrees.

This Court has stayed discovery pursuant to the Private Securities Litigation Reform Act, pending disposition of the numerous motions to dismiss filed by various defendants. Order, *In re Adelphia Commc'ns Corp. Sec. & Derivative Litig.*, No. 03 MD 1529 (Dec. 15, 2003). Due to the stay, Defendants have no ability to rebut the presumptions of reliance, **[*27]** as all documents and information attesting to Plaintiffs' reliance are within the exclusive control of Plaintiffs. It would be fundamentally unfair to find that Defendants did not rebut the presumptions without giving them an opportunity to find evidence to rebut them. [6]

Thus, Plaintiffs are granted summary judgment as to the first three elements of their 10(b) claim, and denied summary judgment as to the last two elements. This Court grants Plaintiffs leave to renew their **[*28]** motion as to the element of reliance after Defendants have had a full opportunity to take discovery and can respond to Plaintiffs' motion based on the fruits of discovery. [7]

2. Section 11 Claim

Section 11 of the 1933 Securities Act allows purchasers of a registered security to sue certain enumerated parties when false or misleading information is included in a registration statement. [8] "Under *Section 11*, a plaintiff need not prove that the defendants acted with scienter; 'he need only show a material misstatement or omission . . . .'" *In re Initial Public Offering Sec. Litig.*, 241 F. Supp. 2d 281, 336 (S.D.N.Y. 2003) (quoting *Herman & MacLean v. Huddleston, 459 U.S. 375, 382, 103 S. Ct. 683, 74 L. Ed. 2d 548 (1983)*). *Section 11* "'places a relatively minimal burden on a plaintiff.'" *Id.* (quoting **[*29]** *Herman, 459 U.S. at 382*). A reasonable reading of the Rigases'

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[6] Plaintiffs argue that they have sufficiently proven reliance through the affidavits, annexed to their Memorandum of Law, that attest to their reliance upon Adelphia's annual and quarterly financial statements, as contained in the Registration Statements and related prospectuses, Forms 10-K, 10-Q, and 8-K, proxy statements, and press releases. (Pls.' Mem. 12 & n.8 (citing Banks Aff., Schweitzer Aff., Esser Aff., Takaha Aff.).) However, this Court will not rely on those affidavits until Defendants have had an opportunity to take discovery.

[7] The Court will not address the final element of plaintiffs 10(b) claim -- that plaintiff's reliance was the proximate cause of their injury -- as the issue of Plaintiffs' reliance remains outstanding.

[8] Section 11, 15 U.S.C. § 77k(a) provides in relevant part:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue--
>
> (1) every person who signed the registration statement;
>
> (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted . . . .

convictions establishes that most of Adelphia's financial statements for 1999 through 2002 were materially false and misleading. These materially false and misleading financial statements were incorporated into the respective Registration Statements at issue here. The jury was presented evidence of an ongoing conspiracy by the Rigases, which included these misstatements. Additionally, as the Rigases are both signatories to the registration statements at issue and directors of Adelphia, they are within the parties enumerated in *Section 11* against whom a plaintiff can bring a *Section 11* claim.

[*30] Accordingly, Plaintiffs are entitled to summary judgment finding the Rigases liable under *Section 11*.

3. Section 18 Claim

To establish civil liability under *Section 18* of the 1934 Securities Exchange Act, Plaintiffs must prove that: "(1) a false or misleading statement was contained in a document filed pursuant to the Exchange Act (or any rule or regulation thereunder); (2) defendant[s] made or caused to be made the false or misleading statement; (3) plaintiff[s] relied on the false statement; and (4) the reliance caused loss to the plaintiff[s]." *In re Alstom SA Secs. Litig., 406 F. Supp. 2d 433, 478 (S.D.N.Y. **2005**)* (citation omitted). [9]

[*31] In this case, a reasonable reading of the Rigases' convictions establishes that most of Adelphia's financial statements for 1999 through 2002 were materially false and misleading. These materially false and misleading financial statements were incorporated into Adelphia's Form 10-Ks, which were filed with the SEC during the relevant time period.

Section 18 requires actual, or what has sometimes been referred to as "eyeball," reliance. *Id. at 479* (citing *Heit v. Weitzen, 402 F.2d 909, 916 (2d Cir. 1968))* (other citations omitted). Reliance cannot be presumed as in a *Section 10(b)* claim; a plaintiff must actually have read and relied on the filed document. *In re Alstom, 406 F. Supp. 2d at 479* (citing *Heit, 402 F.2d at 916*) (other citations omitted). As per the above discussion regarding Plaintiffs' 10(b) claim, the Court will not enter summary judgment until Defendants have had an opportunity to take discovery regarding the issue of reliance and can respond to Plaintiffs' motion based on what is learned in discovery. Plaintiffs are given leave to renew their motion once this discovery has taken place.

Thus, summary **[*32]** judgment is granted on behalf of Plaintiffs on the first two elements of the *Section 18* claim, and denied on the last two elements.

4. Common Law Fraud

To establish civil liability for common law fraud under California law, [10] a plaintiff must show: "(1) a misrepresentation (false representation, concealment, or nondisclosure); (2) knowledge of falsity (or scienter); (3) intent to defraud, i.e., to induce reliance; (4) justifiable reliance; and (5) resulting damage." *Robinson Helicopter Co., Inc. v. Dana Corp., 34 Cal. 4th 979, 990, 22 Cal. Rptr. 3d 352, 102 P.3d 268 (Cal. 2004)* (citation omitted). These are the same basic elements of a *Section 10(b)* claim. *Cf. Mishkin, 299 F. Supp. 2d at 254* (finding convictions under *section 10(b)* establish elements of common law fraud claim under New York law).

As per the discussion regarding Plaintiffs' *10(b)* claim, Plaintiffs are granted summary judgment as to the first three **[*33]** elements of their common law fraud claim and are given leave to renew their motion once discovery has taken place.

IV. Conclusion

For the reasons stated above, Plaintiffs' motion for summary judgment is granted in part and denied in part, with leave to renew their motion as stated above.

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[9] Section 11, 15 U.S.C. § 78r(a) provides in relevant part:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

[10] Defendants do not contest that California law applies here. (See Defs.' Opp'n 15-16.)

So Ordered.

Dated: August 22, ***2005***

New York, New York

Lawrence M. McKenna

U.S.D.J.

SEC v. Tandem Mgmt.

United States District Court for the Southern District of New York
November 13, 2001, Decided ; November 21, 2001, Filed
95 Civ. 8411 (JGK)

Reporter: 2001 U.S. Dist. LEXIS 19109; 2001 WL 1488218

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, - against - TANDEM MANAGEMENT INC., et al., Defendants.

Disposition: **[*1]** Branston's motion to dismiss denied. SEC's motion for summary judgment on claims one through five granted. Sixth claim for relief dismissed as moot.

Counsel: For SECURITIES AND EXCHANGE COMMISSION, plaintiff: Richard H. Walker, Securities and Exchange Commision, New York, NY.

Judges: JOHN G. KOELTL, USDJ.

Opinion by: JOHN G. KOELTL

Opinion

OPINION AND ORDER

JOHN G. KOELTL, District Judge:

The plaintiff Securities and Exchange Commission ("SEC") alleges that the defendant William F. Branston [1] **[*3]** violated Section 17(a) of the Securities Act of 1933 (the "Securities Act"), *15 U.S.C. § 77q(a)*, *Section 10(b)* of the Securities Exchange Act of 1934 (the "Exchange Act"), *15 U.S.C. § 78j(b)*, SEC *Rule 10b-5* promulgated thereunder, *17 C.F.R. § 240.10b-5*, Sections 204, 206(1), 206(2), 206(4) and 207 of the Investment Advisers Act of 1940 (the "Advisers Act"), *15 U.S.C. §§ 80b-4*, *80b-6(1)*, *80b-6(2)*, *80b-6(4)*, *80b-7*, and Rules 204-2, 206(4)-1 and 206(4)-4 promulgated thereunder, 17 C.F.R. §§ 275.204(2), *275.206(4)-1*, *275.206(4)-4*. The SEC seeks a permanent injunction prohibiting **[*2]** Branston, directly or indirectly, singly or in concert, from violating these federal securities laws. [2] (Compl. at 31.) There are currently two motions pending before the Court. Branston, having now been convicted of related criminal charges, moves pro se to dismiss the complaint against him pursuant to *Rule 12(b)(6) of the Federal Rules of Civil Procedure* on the grounds that the claims are barred by laches and the statute of limitations and are now moot. The SEC moves for summary judgment against Branston pursuant to *Rule 56 of the Federal Rules of Civil Procedure* based on collateral estoppel as a result of Branston's criminal conviction.

I.

When considering a motion to dismiss, the Court "'must accept the material facts alleged in the complaint as true and construe all reasonable inferences in the plaintiff's favor.'" *Gant v. Wallingford Bd. of Education, 69 F.3d 669, 673 (2d Cir. 1995)* (considering a motion to dismiss pursuant to *Fed. R. Civ. P. 12(b)(6)*) **[*4]** (quoting *Hernandez v. Coughlin, 18 F.3d 133, 136 (2d Cir. 1994)*). The complaint alleges the following facts, which the Court accepts as true for the purposes of Branston's motion to dismiss.

Since its inception in November 1991, and continuing through at least the filing of the complaint in 1995, Branston was the President and Chief Investment Officer of Tandem Management Inc. ("Tandem"), an investment adviser registered with the SEC. (Compl. PP 13, 14.) [3] Tandem's primary business was to provide investment

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[1] The SEC originally brought this action against Tandem Management Inc. ("Tandem"); Branston, the President, Chief Investment Officer and part owner of Tandem; and Eugene B. Deveney and Peter S. Alsop, who were also officers and part owners of Tandem. The Court has already entered a final default judgment against Tandem and a final judgment by consent against Alsop. See Default Judgment dated May 16, 2001; Final Judgment of Permanent Injunction and Other Equitable Relief by Consent Dated August 12, 1997. The SEC is currently pursuing settlement negotiations with Deveney. (See SEC's Motion for Summary Judgment and Permanent Injunction ("Pl.'s Br.") at 3 n.2.) Branston is thus the only defendant at issue in the current motions.

[2] The SEC originally sought a number of other remedies, including preliminary injunctive relief, a freeze of assets, civil penalties and disgorgement of any illicitly obtained funds. (See Compl. at 31-32.) The Court granted the SEC a preliminary injunction and other interim equitable relief on October 11, 1995. Branston was later convicted on related criminal charges, and his sentence included an order of restitution and a civil assessment. See Section I, infra. In light of these developments, the SEC has abandoned its request for civil penalties and disgorgement and now seeks only a permanent injunction against future violations of the securities laws. (See SEC's Opposition to Branston's Motion to Dismiss the Complaint ("Pl.'s Opp.") at 6-7; Pl.'s Br. at 23-24.)

[3] Branston owned one third Tandem until mid-1993, when he acquired a 50% interest in the company. (Compl. P 14.)

advisory services to individual and institutional investors. (Compl. PP 13, 17.) Branston was also the general partner of one of Tandem's advisory clients, Parallax Group L.P. (″Parallax″). (Compl. PP 5, 14.)

Beginning in or around November 1991 and continuing through 1995, Branston entered into a scheme with Eugene B. Deveney and Peter S. Alsop, who were **[*5]** also officers and owners of Tandem, to convert to their own use at least $ 1 million of their clients' assets. (Compl. PP 2-4, 6, 19-39, 47-57.) The primary method of conversion arose out of their use of a number of ″soft dollar″ credit agreements that Tandem entered into with various broker-dealers. (Compl. P 2.) Under these arrangements, Tandem agreed to cause its clients to pay a specified commission for executing purchases and sales of securities for those clients' accounts, and the broker-dealers agreed to set aside a portion of these commissions as ″soft dollar″ credits, or rebates usable to pay for specified ″soft dollar″ services such as investment research used in connection with the transactions made for these clients' accounts. (Compl. PP 19, 21.) A number of the broker-dealers agreed to use these soft dollar credits to pay Tandem directly upon receipt of invoices for any soft dollar services that Tandem either performed or obtained in connection with these clients' accounts. (Compl P 19.)

Throughout the period when these agreements were in effect, Branston knowingly or recklessly participated in a scheme to convert his clients' funds in five different but overlapping manners **[*6]** related to soft dollar arrangements. First, from November 1991 until at least January 1995, Branston, Alsop and Deveney caused Tandem to submit identical invoices to different broker-dealers or submit identical invoices to the same broker-dealer on multiple occasions. (Compl. PP 24(a), 25.) Second, from June 1992 until at least August 1994, Branston, Alsop and Deveney altered invoices to obtain money in excess of what they paid for actual soft dollar services and to conceal their multiple billing practices. (Compl. PP 24(b), 25.) Third, from August 1992 until at least April 1995, Branston, Alsop and Deveney submitted a number of invoices for expenses that Tandem was not in fact obligated to pay. (Compl. PP 24(c), 25.)

Fourth, from June 1993 until at least April 1995, Branston, Alsop and Deveney participated, singly and in concert, in a practice of submitting numerous invoices for the exclusive services of a vendor named ″First Call,″ which services Tandem neither paid for nor received. (Compl. P 24(d), 25.) Fifth, Deveney entered into one soft dollar credit arrangement (the ″Kickback Agreement″) with a broker-dealer under which Tandem agreed to cause clients to pay this broker-dealer **[*7]** a higher brokerage commission for soft dollar credits in return for a kick back of over half the amounts paid in commissions, which were then used to pay for various expenses including personal expenses for Branston and Deveney. (Compl. PP 27-29.)

Throughout this period, and despite knowledge of these soft dollar credit arrangements, Branston knowingly or recklessly signed and filed a number of forms with the SEC (the ″Forms ADV″) claiming that neither he nor Tandem had any arrangements, oral or written, whereby they would receive cash or any other economic benefit from a non-client, such as a broker-dealer, in connection with advisory services. (Compl. PP 33-39.) These Forms ADV also described Tandem's research and investment practices in a false and misleading manner and declared that Tandem managed $ 134 and $ 320 million in assets at different times, when Tandem never managed more than $ 40 million. (Compl. PP 35, 36, 38.)

Throughout Tandem's existence, Branston also knowingly or recklessly participated in a scheme to distribute false and misleading information to prospective clients and investors concerning Tandem's performance history and assets under management. (Compl. PP **[*8]** 58, 59.) These materials included marketing brochures that misrepresented the historical rates of return that clients had obtained under various trading strategies offered by Tandem and brochures indicating that Tandem managed $ 320 million in assets. (Compl. P 59(a)-(e).) On one occasion, Branston knowingly directed a Tandem employee to submit false information of this same kind to the publisher of a directory of money managers, which resulted in the publication of an inflated ranking of Tandem as among America's ″Top 20 Money Managers.″ (Compl. P 59(e).) Branston used this publication and these false marketing materials to obtain investment advisory clients who would agree to pay increased commissions for soft dollar credits and to maintain prior clients in these arrangements. Branston also used false materials to cause at least six investors to purchase interests in Parallax. (Compl. PP 60-61.)

Based on these allegations, the SEC filed the present complaint on October 2, 1995. The subsequent history is a matter of public record and is undisputed.

After the complaint was filed, the United States Attorney's Office began a grand jury investigation of Branston concerning many of the **[*9]** same activities alleged in the complaint. Because of this ongoing criminal investigation, the Court removed this case from its active calender on January 30, 1997 by closing it subject to reinstatement by any party at any time.

The grand jury investigation culminated in a sixteen-count indictment. Branston was found guilty by a jury on all

counts and a judgment of conviction was entered on September 27, 1999. See Judgment of Conviction at 1-2. Branston was sentenced principally to 37 months of imprisonment, 3 years of supervised release and $ 1,500,000 in restitution. See id. at 3, 6. The Court of Appeals dismissed Branston's appeal on June 26, 2000. See *United States v. Branston, 216 F.3d 1073 (2d Cir. 2000)*. The Supreme Court denied Branston's petition for a writ of certiorari on October 30, 2000. See *United States v. Branston, 531 U.S. 973, 148 L. Ed. 2d 320, 121 S. Ct. 415 (2000)*.

On January 8, 2001, the SEC moved to reopen this case, and the Court granted this motion on January 10, 2001. The current motions ensued.

A.

Branston argues that this case should be dismissed under the doctrine of laches. The doctrine of laches is inapplicable **[*10]** to governmental agencies seeking to vindicate public rights or interests. See *United States v. Summerlin, 310 U.S. 414, 416, 84 L. Ed. 1283, 60 S. Ct. 1019 (1940)*; *United States v. Re Pass, 688 F.2d 154, 158 (2d Cir. 1982)*. SEC civil enforcement actions ″serve the public interest in accomplishing voluntary compliance with the securities laws.″ *SEC v. Toomey, 866 F. Supp. 719, 724 (S.D.N.Y. 1992)* (internal citation and quotation marks omitted); see also *SEC v. Willis, 777 F. Supp. 1165, 1175 (S.D.N.Y. 1991)* (″The SEC [acts] in the public interest by attempting to enforce effectively the federal securities laws under its statutory mandate.″ (internal citation and quotation marks omitted)). The defense of laches is thus inapplicable to SEC civil enforcement actions seeking to enjoin future violations of the securities laws. See, e.g., *SEC v. Sarivola, 1996 U.S. Dist. LEXIS 7720*, *No. 95 Civ. 9270, 1996 WL 304371*, at *1 (S.D.N.Y. June 6, 1996); *SEC v. Thrasher, 1995 U.S. Dist. LEXIS 10775*, No. 92 Civ. 6987, 1995 WL 456402, at *6 (S.D.N.Y. Aug. 2, 1995); *Toomey, 866 F. Supp. at 725*; *Willis, 777 F. Supp. at 1174-75*. **[*11]**

In any event, laches is an equitable defense that requires proof of both (1) unreasonable and inexcusable delay in commencing an action and (2) resulting prejudice to the party asserting the defense. See , e.g., *Ikelionwu v. United States, 150 F.3d 233, 237 (2d Cir. 1998)*; *Stone v. Williams, 873 F.2d 620, 623 (2d Cir. 1989)*, reh'g granted and vac'd on other grounds, *891 F.2d 401 (2d Cir. 1989)*. Neither element is present here.

With regard to the first element, Branston does not argue that the SEC delayed in commencing this action. [4] He rests his argument, instead, on the contention that after the initial filing, the matter was closed without prejudice and that the SEC then moved to reopen the case on January 8, 2001, only after an allegedly unreasonable delay.

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It is not the amount of time that has elapsed but rather the reasonableness of the delay that is the focus of a laches inquiry. See, e.g., *United States v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America, AFL-CIO, 829 F. Supp. 608, 615 (S.D.N.Y. 1993)*. Whether a delay is reasonable is a fact-intensive question and can depend upon the particular circumstances of a case. See, e.g., *Tri-Star Pictures, Inc. v. Leisure Time Prods., B.V., 17 F.3d 38, 44 (2d Cir. 1994)*. Where, as here, the SEC brings a civil enforcement action that proceeds in parallel with a related criminal proceeding, it is often appropriate to stay the civil action pending resolution of the criminal proceedings. See, e.g., *SEC v. Pignatiello, 1998 U.S. Dist. LEXIS 8297*, *No. 97 Civ. 9303, 1998 WL 293988*, at *2, 4-5 (S.D.N.Y. June 5, 1998); *SEC v. Mersky, 1994 U.S. Dist. LEXIS 519*, No. Civ. A. 93-5200, 1994 WL 22305, at *2-6 (E.D. Pa. Jan. 24, 1994); *SEC v. Downe, 1993 U.S. Dist. LEXIS 753*, *No. 92 Civ. 4092, 1993 WL 22126*, at *12, 14 (S.D.N.Y. Jan. 26, 1993). Such a stay is particularly appropriate where ″a party under criminal indictment is required to defend a civil proceeding **[*13]** involving the same matter.″ *Volmar Distribs., Inc. v. New York Post Co., 152 F.R.D. 36, 39 (S.D.N.Y. 1993)*; see also *Trustees of Plumbers and Pipefitters Nat'l Pension Fund v. Transworld Mechanical, Inc., 886 F. Supp. 1134, 1138, 1140-41 (S.D.N.Y. 1995)*.

The delay that Branston complains of began when the Court closed this case on January 30, 1997 so as not to interfere with the related grand jury investigation of Branston that was pending at the time. See Order dated January 30, 1997. The Court did this in accordance with principles discussed above and ″subject to reinstatement by any party at any time.″ Id. The investigation of Branston ultimately culminated in a sixteen-count indictment, which was filed on February 12, 1997, and which ended in a conviction on all counts. The present case then remained closed while Branston timely but unsuccessfully appealed his conviction. The SEC moved to reopen this on January 8, 2000, about seventy days after

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[4] The complaint alleges activities beginning in or about November 1991 and continuing through October 2, 1995, the date on which the complaint was filed. It is unclear from the pleadings when the SEC first learned of these activities, but the SEC ordinarily must spend considerable time and energy investigating alleged violations before it can determine that a complaint is warranted. See generally SEC v. Rind, 991 F.2d 1486, 1492 (9th Cir. 1993). Because of these facts, and because the SEC commenced this action while Branston was still allegedly engaging in the violations identified in the complaint, Branston is correct not to argue that the SEC filed its complaint in an untimely manner.

the Supreme Court denied Branston's petition for a writ of certiorari to review his criminal conviction. During this period, Branston never indicated to the Court that removal of this case from **[*14]** the Court's active docket would prejudice him in any way, and a stay of these proceedings allowed Branston to focus his energies on his criminal defense, thus helping to ensure him a full and fair trial.

Hence, the SEC excusably refrained from attempting to reopen this case during the pendency of Branston's criminal proceedings. The SEC also moved to reopen this case in a reasonably diligent manner, once these proceedings were completed.

With regard to prejudice, Branston argues in a conclusory fashion that records and witnesses are unavailable because of the SEC's alleged delay. Branston does not identify any evidence that is actually missing, and much of the evidence relevant to this case is likely to consist either of documents that were produced at his recent criminal trial or testimony from witnesses who appeared in it. In any event, because this case should be decided as a matter of law based on collateral estoppel, as discussed below, there is no need for any evidence that may have grown stale. See Section II, infra. There is thus no prejudice to Branston arising from lost evidence in this case.

Branston argues that he has been prejudiced because he is now without **[*15]** funds to represent himself and is not in a position to defend himself in prison. However, the only possibly relevant delay that occurred here began after Branston was sentenced and after his financial position had already changed. This delay could not have caused the alleged prejudice.

In any event, Branston's present incarceration and financial situation are due not to any SEC inaction but to his criminal conviction, the costs of his defense and the substantial restitution order. Branston could not have been lulled into a false sense of security, or relied to his detriment on any SEC inaction, during this period because he knew that this case was only stayed and could be opened after the conclusion of the criminal proceedings. Branston also profited from a stay of this action during his criminal proceedings. He cannot now profit in equity from the fact that he has suffered the consequences of his own criminal conduct.

In sum, there are no grounds to dismiss the present action under the doctrine of laches.

B.

Branston argues that this case is time-barred under the relevant statute of limitations for SEC enforcement actions. The SEC responds that there is no statute of limitations **[*16]** applicable to SEC enforcement proceedings seeking only injunctive relief. In the alternative, the SEC argues that the only statute of limitations that may apply is the five-year period set forth in *28 U.S.C. § 2462* and that this provision does not bar the relief the SEC seeks.

The Court of Appeals for the Second Circuit has not yet decided what statute of limitations, if any, applies to SEC enforcement proceedings seeking only injunctive relief. The question arises because Congress has not set forth an explicit statute of limitations for SEC enforcement actions. See *SEC v. Lorin, 1991 U.S. Dist. LEXIS 10887*, No. 90 Civ. 7461, 1991 WL 576895, at *3 (S.D.N.Y. June 18, 1991). Statutes of limitations are nevertheless such a fundamental part of civil causes of actions that courts will ordinarily ″borrow″ the most analogous statute of limitations, usually from state law, in the face of such congressional silence. See, e.g., *Wilson v. Garcia, 471 U.S. 261, 266, 271, 85 L. Ed. 2d 254, 105 S. Ct. 1938 (1985)* (noting that a ″federal cause of action 'brought at any distance of time' would be 'utterly repugnant to the genius of our laws' (quoting *Adams v. Woods, 6 U.S. (2 Cranch.) 336, 342, 2 L. Ed. 297 (1805))*; **[*17]** see also *DelCostello v. International Brotherhood of Teamsters, 462 U.S. 151, 154, 158-63, 76 L. Ed. 2d 476, 103 S. Ct. 2281 (1983)*. [5] There is, however, an exception to this rule for actions brought by the government to enforce a public right or assert a public interest: ″An action on behalf of the United States in its governmental capacity . . . is subject to no time limitation, in the absence of congressional enactment clearly imposing it. Statutes of limitation sought to be applied to bar rights of the government, must receive a strict construction in favor of the government.″ *E.I. Dupont De Nemours & Co. v. Davis, 264 U.S. 456, 462, 68 L. Ed. 788, 44 S. Ct. 364 (1924)*; see also *Capozzi v. United States, 980 F.2d 872, 875 (2d Cir. 1992)*.

[*18] Although Congress has not passed a statute of limitations that governs SEC enforcement proceedings specifically, Congress has passed *28 U.S.C. § 2462*, which is a ″catch-all″ provision limiting the time within which the government and its agencies can pursue many civil enforcement actions. See *3M (Minnesota Mining and Mfg.) Co. v. Browner, 305 U.S. App. D.C. 100, 17 F.3d*

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[5] For implied private actions to enforce the securities laws, the Supreme Court has held that courts should borrow the one year/three year limitation period that governs express private causes of action under the securities laws. See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991). These time limitations are, however, inapplicable to federal enforcement proceedings. See SEC v. Sprecher, 1993 U.S. Dist. LEXIS 18116, Civ. A. No. 92-2860, 1993 WL 544306, at *2 (D.D.C. Dec. 16, 1993).

1453, 1461 (D.C. Cir. 1994) (noting that *§ 2462* applies to ″the entire federal government″). This catch-all provision states that:

> except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made on thereon.

28 U.S.C. § 2462.

The SEC argues that *§ 2462* is inapplicable to the present proceedings because the remedy the SEC seeks is not a ″civil fine, penalty, or forfeiture″ within the meaning of *§ 2462*. **[*19]** In this case, the only remedy that the SEC now seeks against Branston is an injunction prohibiting him from future violations of the securities laws. Courts have found that SEC suits for equitable and remedial relief, including requests for permanent injunctions and disgorgement, are not governed by *§ 2462* because they are not actions or proceedings for a ″penalty″ within the meaning of the statute. See, e.g., *SEC v. McCaskey, 56 F. Supp. 2d 323, 326 (S.D.N.Y. 1999)*; *SEC v. Schiffer, 1998 U.S. Dist. LEXIS 6339*, No. 97 Civ. 5853, 1998 WL 226101, at *2 (S.D.N.Y. May 5, 1998); *SEC v. Williams, 884 F. Supp. 28, 30 (D. Mass. 1995)*; *SEC v. Lorin, 869 F. Supp. 1117 (S.D.N.Y. 1994)*. [6] This is consistent with those cases that have held that *§ 2462* does not apply to equitable claims for injunctions that seek solely to restore the status quo before the alleged violations of a statute and to enjoin future violations. *United States v. Telluride Co., 146 F.3d 1241, 1247-48 (10th Cir. 1998)*; *United States v. Banks, 115 F.3d 916, 919 (11th Cir. 1997)*. However, the Court of Appeals for the District of Columbia Circuit has **[*20]** held that *§ 2462*'s five-year statute of limitations applied to an SEC administrative proceeding that resulted in a censure and six month disciplinary suspension of a securities industry supervisor. See *Johnson v. SEC, 318 U.S. App. D.C. 250, 87 F.3d 484, 486-92 (D.C. Cir. 1996)*. The Court held that the sanctions constituted a ″penalty″ within the meaning of *§ 2462*, relying in part on the collateral consequences of the sanctions.

It is unnecessary to decide **[*21]** whether *§ 2462* applies in this case because all of the activities alleged in the complaint occurred on or after November 1991, within five years of the time when the complaint was filed. The SEC thus filed this action before any statute of limitations expired, and the action is not barred by any statute of limitations.

C.

Finally, Branston argues that this case is now moot because of his imprisonment on the related criminal convictions and his lack of funds or assets. Branston argues, in effect, that his imprisonment and present financial position will independently prevent him from future securities laws violations, thus rendering the present action ″a waste of judicial time to pursue.″ (Def.'s Br. P 4.) The argument is frivolous.

With regard to Branston's incarceration, Branston was sentenced to a 37-month term of imprisonment on September 24, 1999, more than two years ago. He will thus be released in the foreseeable future. Although Branston's prison term will be followed by a period of supervised release, one condition of which is that he ″not, without the approval of the court or theprobation officer, engage in any capacity of employment venture involving investments, trading **[*22]** of securities, money-management or similar financial planning or advising,″ this period will only last for another 3 years. See Judgment of Conviction at 5. A permanent injunction would, by contrast, be effective after Branston's sentence has expired.

Branston's financial position also provides no assurance that he will not again seek investments in violation of the securities laws. As the SEC correctly notes, Branston's financial situation may even provide him with increased incentives to engage in future violations. In sum, neither Branston's criminal sentence nor his present financial condition render this action for a permanent injunction moot.

D.

Because there are no other grounds to dismiss the complaint, Branston's motion to dismiss is denied.

II.

The SEC moves for summary judgment pursuant to *Rule 56(c) of the Federal Rules of Civil Procedure*. The

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[6] A number of other courts, without addressing § 2462, have held that there is no statute of limitations applicable to SEC enforcement actions seeking only injunctive relief. See, e.g., SEC v. Rind, 991 F.2d 1486, 1491-92 (9th Cir. 1993); SEC v. Downe, 1994 U.S. Dist. LEXIS 2292, No. 92 Civ. 4092, 1994 WL 67826, at *1 (S.D.N.Y. March 3, 1994); Toomey, 866 F. Supp. at 724; SEC v. Bangham, 1991 U.S. Dist. LEXIS 19922, No. 89 Civ. 7910, 1991 WL 311922, at *1 (S.D.N.Y. Nov. 25, 1991); Willis, 777 F. Supp. at 1174.

standard for granting summary judgment is well established. Summary judgment may not be granted unless ″the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to **[*23]** a judgment as a matter of law.″ *Fed. R. Civ. P. 56(c)*; see also *Celotex Corp. v. Catrett, 477 U.S. 317, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)*; *Gallo v. Prudential Residential Servs. Ltd. Partnership, 22 F.3d 1219, 1223 (2d Cir.1994)*; *SEC v. Todt, 2000 U.S. Dist. LEXIS 2087*, No. 98 Civ. 3980, 2000 WL 223836, at *1-2 (S.D.N.Y. Feb. 25, 2000), aff'd, *7 Fed. Appx. 98, 2001 U.S. App. LEXIS 6042, 2001 WL 345151 (2d Cir. 2001)*. ″The trial court's task at the summary judgment motion stage of the litigation is carefully limited to discerning whether there are any genuine issues of material fact to be tried, not to deciding them. Its duty, in short, is confined at this point to issue-finding; it does not extend to issue resolution.″ *Id. at 1224*.

The moving party bears the initial burden of ″informing the district court of the basis for its motion″ and identifying the matter that ″it believes demonstrates the absence of a genuine issue of material fact.″ *Celotex, 477 U.S. at 323*. The substantive law governing the case will identify those facts which are material and ″only disputes over facts that might affect the outcome of the suit under the governing **[*24]** law will properly preclude the entry of summary judgment.″ *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986)*. In determining whether summary judgment is appropriate, a court must resolve all ambiguities and draw all reasonable inferences against the moving party. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986)* (citing *United States v. Diebold, Inc., 369 U.S. 654, 655, 8 L. Ed. 2d 176, 82 S. Ct. 993 (1962)*); see also *Gallo, 22 F.3d at 1223*.

If the moving party meets its burden, the burden shifts to the nonmoving party to come forward with ″specific facts showing that there is a genuine issue for trial.″ *Fed. R. Civ. P. 56(e)*. Affidavits submitted in opposition to a motion for summary judgment, like affidavits submitted in support thereof, ″shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein.″ Id. With respect to the issues on which summary judgment is sought, **[*25]** if there is any evidence in the record from any source from which a reasonable inference could be drawn in favor of the nonmoving party, summary judgment is improper. See *Chambers v. TRM Copy Ctrs. Corp., 43 F.3d 29, 37 (2d Cir. 1994)*.

Where, as here, a pro se party is involved, the pro se party must be given express notice of the consequences of failing to respond appropriately to a motion for summary judgment. See *McPherson v. Coombe, 174 F.3d 276, 281 (2d Cir. 1999)*; *Vital v. Interfaith Med. Ctr., 168 F.3d 615, 620-21 (2d Cir. 1999)*; *Champion v. Artuz, 76 F.3d 483, 486 (2d Cir. 1996)*; *Ruotolo v. IRS, 28 F.3d 6, 8 (2d Cir. 1994)*. In this case, the SEC served a notice (the ″Notice″) advising Branston of the procedures for responding to a motion for summary judgment and the consequences of failing to respond. This Notice made Branston aware of the requirement to submit a response by filing sworn affidavits or other papers as required by *Rule 56(e)*. The Notice also attached a complete copy of *Rule 56* and advised Branston of the need to submit counter-evidence. The Notice stated that ″if you do not **[*26]** respond to the motion for summary judgment on time with affidavits or documentary evidence contradicting the facts asserted by the plaintiff, the court may accept plaintiff's factual findings as true. Judgment may then be entered in the plaintiff's favor without trial.″

Branston responded by letter stating only that ″the facts which the SEC now proposes are in serious dispute″ and ″are not resolved by collateral estoppel″ because ″they were not decided or at issue in the criminal matter.″ Undated letter from Branston to the Court. This statement is conclusory and could at most place into dispute those facts as to which Branston's personal testimony would be relevant and admissible. The fact that Branston is proceeding pro se does not preclude the Court from deeming facts set forth in the SEC's 56.1 Statement admitted where Branston has not produced any genuine evidence contraverting them. See *Smith v. Planas, 975 F. Supp. 303, 305 n.2 (S.D.N.Y. 1997)*. In any event, as discussed more fully below, the SEC's motion for summary judgment should be granted based on facts established in Branston's criminal proceedings.

A.

The SEC argues that it is entitled to summary judgment **[*27]** because the material facts in this case were established in Branston's criminal trial and because Branston is collaterally estopped from disputing those facts here. It is well settled that ″a criminal conviction, whether by jury verdict or guilty plea, constitutes estoppel in favor of the United States in a subsequent civil proceeding as to those matters determined by the judgment in the criminal case.″ *United States v. Podell, 572 F.2d 31, 35 (2d Cir. 1978)*; see also *Emich Motors Corp. v. General Motors Corp., 340 U.S. 558, 568-69, 95 L. Ed. 534, 71 S. Ct. 408 (1951)*. In order for collateral estoppel to apply, the Court must determine that ″(1) the issues in both proceedings are identical, (2) the issue in the prior

proceeding was actually litigated and actually decided, (3) there was full and fair opportunity to litigate in the prior proceeding, and (4) the issue previously litigated was necessary to support a valid and final judgment on the merits." *NLRB v. Thalbo Corp., 171 F.3d 102, 109 (2d Cir. 1999)* (internal citation and quotation marks omitted). In the present case, it is necessary to examine the six claims raised in the complaint **[*28]** to determine whether the facts needed to support these claims were necessarily established at Branston's criminal trial.

The SEC's first claim alleges that Branston violated Section 17(a) of the Securities Act, *15 U.S.C. § 77q(a)*, *Section 10(b)* of the Exchange Act, *15 U.S.C. § 78j(b)*, and *Rule 10b-5* promulgated thereunder, *17 C.F.R. § 240.10b-5* (collectively, the "antifraud provisions"). To establish a violation of *Section 10(b)* of the Exchange Act and *Rule 10b-5* thereunder, the SEC must prove that a defendant "(1) made a material misrepresentation or omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities." *SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999)* (citing *SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996)*); SEC v. Todt, 2000 WL 223836, at *7. Scienter "means intent to deceive, manipulate, or defraud, or at least knowing misconduct." *First Jersey, 101 F.3d at 1467* (internal citations omitted); see also *Aaron v. SEC, 446 U.S. 680, 64 L. Ed. 2d 611, 100 S. Ct. 1945 (1980)*; **[*29]** SEC v. Todt, 2000 WL 223836, at *9. Scienter may also be established through a showing of reckless disregard for the truth. See *SEC v. McNulty, 137 F.3d 732, 741 (2d Cir. 1998)*. Turning to Section 17(a) of the Securities Act, "essentially the same elements [as in *Section 10(b)* of the Exchange Act] must be established in connection with the offer or sale of a security." *First Jersey, 101 F.3d at 1467*.

The SEC's first claim is predicated on factual allegations concerning the five schemes to misappropriate "soft dollar" credits and commission rebates discussed above. See*Section I, supra.* At his criminal trial, Branston was convicted of four counts (counts eight through eleven) of fraudulently misappropriating "soft dollar" credits and commission rebates in violation of *15 U.S.C. §§ 80b-6* and *80b-17* and *18 U.S.C. § 2* on the basis of substantially the same allegations. (See Indictment PP 33-34; Judgment of Conviction at 2.) These convictions required proof that Branston (1) made a material misrepresentation or omission to an investment client, or used a fraudulent devise or business **[*30]** practice; (2) in his capacity as an investment adviser; and (3) did so willfully. See*15 U.S.C. § 80b-6*, *80b-17*. These activities also plainly occurred in connection with the purchase or sale and the offer or sale of securities to Branston's clients because the soft dollar credits and commission rebates were generated through actual securities transactions by Tandem's clients. Thus, all of the facts needed to establish the SEC's first claim, including a degree of scienter exceeding that required for civil liability, were necessarily established at Branston's criminal trial.

The SEC's second claim similarly invokes the antifraud provisions, but rests on allegations concerning Branston's alleged distribution of false advertisement materials causing at least six advisory clients to investment in the Parallax limited partnership. (See Compl. PP 60-61, 71-76.) Branston was the sole manager of Parallax, and its outside investors were passive investors, with no managerial role in the limited partnership. Under these circumstances, investments in limited partnership funds are "investment contracts" within the meaning of *Section 2(1)* of the Securities Act, **[*31]** *15 U.S.C. § 77b(a)(1)*, and *Section 3(a)(10)* of the Exchange Act, *15 U.S.C. § 78c(a)(10)*, which, in turn, qualify as "securities" under those provisions. See, e.g., *Luce v. Edelstein, 802 F.2d 49, 55 (2d Cir. 1986)*; *Mayer v. Oil Field Systems Corp., 721 F.2d 59, 65 (2d Cir. 1983)*.

At his criminal trial, Branston was convicted of one count (count seven) of false advertising by an investment adviser in violation of *15 U.S.C. §§ 80b-6(4)* and *80b-17* based on fraudulent activities, in particular the distribution of a brochure containing untrue statements of material fact designed to induce investment in Parallax. (See Indictment PP 31-32; Judgment of Conviction at 1.) These activities undisputedly occurred in connection with the offer or sale of securities, and Title *15 U.S.C. § 80b-6(4)* specifically prohibits an investment adviser from using the mails or any instrumentality of commerce "to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative." Thus, for the same reasons discussed in addressing the SEC's first claim, **[*32]** all of the facts needed to establish violations of Section 17(a) of the Securities Act, *15 U.S.C. § 77q(a)*, were necessarily established in supporting Branston's conviction on count seven for violating *15 U.S.C. §§ 80b-6(4)* and *80b-17*. [7]

[*33] The SEC's third claim alleges that Branston committed fraud against Tandem's advisory clients in

[7] The Indictment did not specify the number of investors, if any, who were actually defrauded by these brochures, and count seven did not require proof of any actual sales or purchases, as would be needed to establish violations of Section 10(b) of the Exchange Act, *15 U.S.C. § 78j(b)*, and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. As discussed more fully above, however, violations of these latter two provisions were established in connection with the soft dollar credit and commission rebate schemes alleged in claim one. The antifraud provisions are also similar in nature. An injunction against violations of all of the antifraud provisions would thus be justified on the basis of the conduct proven at Branston's criminal trial.

violation of Sections 206(1) and 206(2) of the Advisers Act, *15 U.S.C. §§ 80b-6(1)* & *(2)*, by presenting fraudulent marketing materials to potential investor adviser clients and misappropriating soft dollar credits and commission rebates. Branston was convicted of eight counts (counts two through five and eight through eleven) of violating those same provisions based on substantially the same factual allegations. (See Indictment PP 27-28; Indictment PP 33-34; Judgment of Conviction at 1-2.) The facts required to support these convictions are mirror images of those needed establish claim three.

The SEC's fourth claim alleges that Branston violated *15 U.S.C. § 80b-7* by signing and filing false Forms ADV, several of which contained false statements about Tandem's use of soft dollar agreements and two of which misrepresented Tandem's assets under management. (Compl. PP 31-38.) At his criminal trial, Branston was convicted of three counts (counts thirteen through fifteen) of violating this same provision for filing three of false Forms ADV **[*34]** identified in the complaint. (See Indictment P 38; Judgment of Conviction at 2.) The facts needed to support these convictions are identical to those needed to establish liability for claim four with regard to three of the four allegations raised.

Claim five alleges that Branston violated Section 206(4) of the Advisers Act, *15 U.S.C. § 80b-6(4)*, and Rules 206(4)-1 and 206(4)-4 thereunder, 17 C.F.R. 206(4)-1 & 4, by failing to disclose Tandem's true financial position to Tandem's clients and misrepresenting Tandem's historical performance and assets under management to potential clients. As discussed above, Branston was convicted of four counts (counts two through five) of violating these same provisions based on substantially the same factual allegations in the complaint. Branston was also convicted of one count (count six) of wire fraud in violation of *18 U.S.C. § 1343* for willfully and knowingly using a facsimile in interstate commerce to engage in a scheme to defraud by sending a false chart indicating the alleged historical rate of returns on some of the accounts managed by Tandem. (See Indictment PP 29-30.) The facts needed **[*35]** to support these convictions are identical to ones alleged in the SEC's fifth claim. [8]

The sixth claim, finally, alleges that Branston violated Section 204 of the Advisers Act, *15 U.S.C. § 80b-4*, and Rules 204-2 thereunder, 17 C.F.R. § 275.204(2), by failing to keep and maintain certain books and records, as required by the Investment Advisers Act. Branston was not convicted of any such violations at his criminal trial, and proof of failure to maintain records was not an essential part of any of his convictions. Hence, the SEC cannot establish its sixth claim by means of collateral estoppel.

[*36] In sum, Branston's criminal conviction required the actual litigation and decision of sufficient factual issues, identical to ones alleged in the first five (but not the sixth) claims in the complaint, to conclude that the facts needed to establish the SEC's first five claims have already been established in another proceeding. The only remaining issue concerning applicability of collateral estoppel is whether Branston had a full and fair opportunity to litigate these issues in his criminal proceedings. See *Thalbo Corp., 171 F.3d at 109*.

Branston argues that, as a matter of law, he did not have such a full and fair opportunity. Branston relies on *SEC v. Monarch Funding Corp., 192 F.3d 295 (2d Cir. 1999)*, in which the Court of Appeals found that a defendant in an SEC enforcement action was not necessarily collaterally estopped from relitigating facts developed in an earlier criminal sentencing proceeding. However, the facts at issue in Monarch were developed at the defendant's sentencing, not at his criminal trial, and this circumstance was critical to the Court's holding. As the Court of Appeals explained, sentencing hearings typically provide **[*37]** defendants with less procedural safeguards than civil proceedings. See *id. at 305*. A defendant's opportunities to present witnesses can be limited, and the Federal Rules of Evidence do not apply. See id. Moreover, ″the incentive to litigate a sentencing finding is frequently less intense, and certainly more fraught with risk, that it would be for a full-blown civil trial.″ *Id. at 305*. The Court of Appeals thus found that facts developed at a sentencing hearing may not always be developed after a sufficiently full and fair opportunity to litigate the issues to warrant application of collateral estoppel.

This case is different from Monarch. The facts at issue here were developed not at a sentencing hearing but at a criminal trial, where Branston faced severe penalties and had every incentive to contest vigorously the charges against him. Branston was also given the full panoply of criminal procedural safeguards, including a standard of proof that was more favorable to him than in these civil proceedings. Branston's trial, which was held before a jury, took considerable time and involved numerous witnesses and evidence. There is no basis in the **[*38]** record to question the fairness of the trial. In these circumstances, it is well-settled that facts necessary to support a criminal conviction have collateral estoppel effect in a subsequent SEC enforcement proceeding. See, e.g., *Sprecher, 1993 WL 544306*, at *1.

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[8] Branston was also convicted of one count (count one) of conspiracy to commit securities fraud based on substantially the same total set of allegations raised in the first five claims of the complaint. (See Indictment PP 1-26; Judgment of Conviction at 1.) This conviction further supports the application of collateral estoppel with regard to the facts already discussed.

The SEC is therefore entitled to summary judgment on its first five claims against Branston.

B.

The SEC seeks a permanent injunction on the basis of the securities law violations that have been established. SEC suits for permanent injunctions are creatures of statute. See *SEC v. Management Dynamics, Inc., 515 F.2d 801, 808 (2d Cir. 1975)*. Three statutes in particular give the SEC the authority to seek the relief in the present case: Section 20(b) of the Securities Act, *15 U.S.C. § 77t(b)*, *Section 21(d)* of the Exchange Act, *15 U.S.C. § 78u(d)*, and Section 209(d) of the Advisers Act, *15 U.S.C. § 80b-9(d)*. These provisions state that whenever it appears that a person has engaged or is about to engage in any acts or practices that would violate the provisions of the respective Acts or regulations passed thereunder, the SEC **[*39]** may "in its discretion, bring an action . . . to enjoin such acts or practices." *15 U.S.C. §§ 77t(b)*, *78u(d)*, *80b-9(d)*.

Because these actions are creatures of statute, the SEC need not establish irreparable injury or the inadequacy of legal remedies, as would be required in private injunction suits. See *Management Dynamics, 515 F.2d at 808*. The dispositive issue is simply whether there is a likelihood of future violations without an injunction. See, e.g., *First Jersey, 101 F.3d at 1477* (citing *CFTC v. American Board of Trade, Inc., 803 F.2d 1242, 1250-51 (2d Cir. 1986)*); see also *SEC v. Commonwealth Chemical Sec., Inc., 574 F.2d 90, 99 (2d Cir. 1978)*. Branston's past violations are relevant to this question but do not necessarily dispose of it. See, e.g., *SEC v. Commonwealth Chemical, 574 F.2d at 100* (stating that settled precedent in this Circuit establishes "the need for the SEC to go beyond the mere facts of past violations and demonstrate a realistic likelihood of recurrence"). Rather, past liability is one factor among others to be considered, including:

> the degree **[*40]** of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur.

SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1048 (2d Cir. 1976).

In this case, the facts established at Branston's criminal trial reveal not an isolated instance of misconduct but rather a complex pattern of fraud and deception spanning about four years. See *SEC v. Hasho, 784 F. Supp. 1059, 1110 (S.D.N.Y. 1992)* (finding a permanent injunction appropriate where past violations occurred repeatedly over a protracted period of time and the defendants consistently violated their clients' trust through a myriad of omissions, misrepresentations and other fraudulent devices). Branston personally obtained a substantial amount of money by engaging in these activities, and there is every indication that he would have continued engaging in them were it not for the SEC's intervention. See generally *Management Dynamics, 515 F.2d at 807* **[*41]** (noting that "cessation of illegal activity does not *ipso facto* justify the denial of injunction" and must be assessed under the circumstances of a case). Branston also committed these acts willfully, with a degree of scienter exceeding that needed for civil liability and far exceeding that needed for a permanent injunction. See *Universal Major, 546 F.2d at 1047* ("In SEC proceedings seeking equitable relief, a cause of action may be predicated upon negligence alone, and scienter is not required."). This is not a case of unwitting deception in the securities market resulting from an unsophisticated understanding of the securities laws, or a case where well intentioned and scrupulous registered representatives have allowed isolated violations to occur "out of an excessive zeal for fairness and accuracy." *SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 18-19 (2d Cir. 1977)*.

With regard to assurances that he will not violate the securities laws in the future, Branston has not made any. Branston was also convicted of perjuring himself to the SEC during its investigation. This fact suggests that he is at least capable of lying to governmental authorities, something **[*42]** that would have to be taken into consideration in assessing any assurances he might make.

Branston's past employment record similarly suggests that he may well seek to obtain investments after his term of supervised release has expired. If Branston's financial condition remains in its present state, he is likely to have strong incentives to violate the securities laws, and any occupation in these industries would provide him with the opportunity. All of these factors point toward the strong need for a permanent injunction.

The fact that Branston is currently serving his criminal sentence weighs somewhat in his favor. Branston's imprisonment cuts against the likelihood of future violations, at least in the near future. A permanent injunction may only have value after Branston has completed his three subsequent years of supervised release. Moroever, the probative value of conduct engaged in more than five years ago in establishing the likelihood of future violations some four years hence is much smaller than evidence of recent misconduct would be to imminent possible violations. Still, none of these facts undermines

the weight of the factors indicating that a permanent injunction is **[*43]** appropriate.

The Court has broad discretion to enjoin future violations of the securities laws upon a finding of past violations. See *SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972)*. In the present circumstances, there is a substantial likelihood of future violations, and a permanent injunction is warranted. Moreover, although the SEC has not established that Branston violated the record and book keeping requirements set forth in Section 204 of the Investment Advisers Act, 15 u.S.C. *§ 80b-4*, and Rule 204-2 thereunder, 17 C.F.R. § 275.204(2), lack of proper record keeping can help hide from view the very kinds of violations that have been established. It is thus reasonable under these circumstances to enjoin Branston from violating these provisions as well. See *id. at 1102-03*.

C.

While the SEC has not established that Branston is liable for the sixth claim, the SEC has established sufficient liability to obtain the complete relief it seeks. Therefore, the sixth claim for relief is dismissed as moot.

III.

For the foregoing reasons, Branston's motion to dismiss is denied. The SEC's motion for summary **[*44]** judgment on claims one through five is granted. The sixth claim for relief is dismissed as moot. Pursuant to *Fed. R. Civ P. 54(b)*, there is no just reason for delay in entering a final judgment against Branston. A final judgment will be entered incorporating the relief discussed **above.**

SO ORDERED.

Dated: New York, New York

November 13, 2001

JOHN G. KOELTL, USDJ