

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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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, 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/DRH)

*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.*

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**REPLY TO PLAINTIFF'S OPPOSITION TO DEFENDANT, GEOFFREY R. SMITH, TRUSTEE  
OF THE DAVID L. AND LYNN A. SMITH IRREVOCABLE TRUST U/A 8/04/04, DEFENDANT,  
GEOFFREY R. SMITH AND DEFENDANT, LAUREN T. SMITH'S MOTION FOR SUMMARY  
JUDGMENT**

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Submitted by:

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L. and Lynn A. Smith Irrevocable Trust  
U/A 8/04/04, Defendant Geoffrey R.  
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**PRELIMINARY STATEMENT**

The plaintiff has pled, in the second amended complaint, that David L. Smith and Lynn A. Smith fraudulently transferred 100,000 shares of Charter One stock to the Smith Trust in violation of Section 276 of the New York Debtor Creditor Law. (NYDCL Section 276) As pointed out in the defendant, Trust's motion for summary judgment, and in the defendant, Trust's response to the plaintiff's motion for summary judgment, the burden of proof upon the plaintiff to sustain this cause of action is a burden of clear and convincing evidence that there was actual, intentional fraud on behalf of the David L. Smith and Lynn A. Smith.

The Trust was created at a time when David L. Smith and Lynn A. Smith had liquid assets in excess of \$10,600,000.00 and owned substantial real estate worth additional millions of dollars. App. Ex. 206 (2004 Financial Statement). At the time the Trust was created, there was a prior claim against McGinn Smith as a brokerage firm. That claim was settled for approximately \$200,000.00 by a third party and no payment was made by David L. Smith. App. Ex. 250 (Ian Meyers Settlement Agreement and Release). At the time of the creation of the Trust, David L. Smith was earning substantial income and was flourishing as a broker and a principal of McGinn, Smith and Co., Inc.

There is absolutely no proof that Lynn A. Smith, in August of 2004, was aware of any claims against her husband, or his business. To the contrary, Lynn A. Smith had liquid assets in her own brokerage account of approximately \$7,000,000.00, co-owned multiple homes with her husband and had unrestricted access to sufficient assets to carry on a very comfortable lifestyle.

Most importantly, not one of the thirty-two counts contained in the superseding indictment in the criminal case against David L. Smith charges him with any knowledge of or participation in any wrongdoing prior to September of 2006. The criminal charges against David L. Smith allege fraudulent activity occurring between September 2006 and April of 2010. App. Ex. 6 (Superseding Indictment). These undisputed facts directly contradict the SEC's claims that the Smith Family Trust was formed in order to shield assets from creditors. There simply were not any creditors or potential claims when the

Trust was created in 2004. Any argument that David L. Smith anticipated creditors due to his illegal activity is simply not supported by the criminal charges in this matter.

At the time of the creation of the defendant Trust a unique tax provision allowed the sheltering of taxable gain. The Charter One Bank stock owned by Lynn Smith was being liquidated through the actions of Charter One Bank. The asset was about to become liquid and incur substantial income tax liabilities. The Trust was created, as set forth in the Trust documents and as testified to by the original Trustee, Thomas Urbelis, for the benefit of the adult children of the Creators, namely Geoffrey R. Smith and Lauren T. Smith, or their heirs, and to shelter the taxable gain about to be realized by Lynn A. Smith from income tax. App. Ex. 28 (Deposition Tr. T. Urbelis 11:17-25; 12:2-6; 22:6-8).

As set forth in detail in the defendant, Trust's motion for summary judgment, circumstantial evidence, or facts, which are consistent with either a valid nonfraudulent intent or a fraudulent intent, must be resolved in favor of the actor's intent being nonfraudulent.

The valid reason to create the Trust was to create a financial gift to the adult children of the Creators and to save substantial income taxes on the gains being realized by the monies inherited by Lynn A. Smith and prudently invested in Charter One stock. Dkt. No. 691 (Expert Opinion of D. Evans at 3) and Dkt. No. 704 (Aff. Geoffrey Smith at 7); App. Ex. 252 (Deposition Tr. Lynn Smith 23:17-24; 39:16-25; 40:2); App. Ex. 253 (Deposition Tr. Lynn Smith 42:10-13; 49:3-7).

The plaintiff further alleges that the defendant, Trust, engaged in fraudulent conveyances during the existence of the Trust. It is noteworthy that the real property located on the Sacandaga Lake, which was sold by Lynn A. Smith to the Trust, in exchange for \$600,000.00, is alleged to have been a fraudulent conveyance. However, this transfer fails under every analysis of the requirements regarding a fraudulent conveyance. A review of the Record reveals that the summer residence, previously inherited by Lynn A. Smith from her parents, was valued at \$600,000.00 by a licensed real estate broker prior to the conveyance. Dkt. No. 604 (Report of Receiver William Brown at Exhibit "E"); Dkt. No. 626-1 (Aff. Geoffrey Smith at 4). In addition, when the real property at Sacandaga Lake was sold, pursuant to a forced sale by Court Order by the Receiver, William Brown, some four years later, at a time when the real

estate market was depressed, the forced sale resulted in a value of the property at \$575,000.00. Dkt. No. 684 (Report of Receiver William Brown regarding sale). In brief, it is absolutely and conclusively proven that the transfer of the Sacandaga Lake summer home for \$600,000.00 was a transfer for fair market value and not, by its definition, a fraudulent conveyance.

The Plaintiff's accounting of the distributions from the Trust is factually flawed. The only payments out of the Trust were \$600,000.00 to Lynn A. Smith in exchange for the Sacandaga Lake real estate; \$200,000.00 investment in Capacity One Management, LLC in exchange for 49% ownership; \$7,500.00 to Lauren T. Smith as a lawful distribution to a beneficiary; \$21,500.00 to Geoffrey R. Smith as a lawful distribution to a beneficiary; and, \$95,000.00 to Geoffrey R. Smith as a lawful distribution that Geoffrey loaned to his father David to pay taxes. No other funds were paid out to any party and no funds were ever distributed to either Creator without receipt of equal consideration. App. Ex. 248 (G. Smith 11/16/11 Deposition Tr. at 113:5-9; 134:20-23; 144:9-25; 145:2-20).

These Trust distributions to its beneficiaries, Geoffrey R. Smith and Lauren T. Smith, as have been repeatedly referenced in the plaintiff and defendant, Trust's filings, were lawful distributions of funds, pursuant to the authority of the Trust. The investments (\$200,000.00 for 49 percent of Capacity One Management, LLC) and the real estate purchase (\$600,000.00 for the purchase of the Sacandaga Lake summer home) were also a valid exercise of the Trustee's authority, pursuant to the terms of the Trust documents. Dkt. 691 (Expert Opinion of David Evans at par. 16). Dkt. 321 at 25-26.

## **ARGUMENT**

### **POINT I**

#### **THERE IS AMPLE EVIDENCE THAT DAVID L. SMITH AND LYNN A. SMITH CREATED THE DEFENDANT, TRUST, FOR VALID, NONFRAUDULENT REASONS**

The plaintiff's burden of clear and convincing evidence that the Creators of the Trust acted with actual fraudulent intent has not and cannot be met. Under New York Law, for actual fraudulent conveyance, actual intent to defraud must be proven by clear and convincing evidence. U.S. v. McCombs, C.A.2 (N.Y.) 1994, 30 F.3d 310, on remand 928 F. Supp. 261. Actual intent to defraud, of the

kind required in order to set transfer aside as having been made with actual intent to hinder, delay or defraud creditors, must be based on fact and cannot rest on mere suspicion. In re Kovler, 2000, 249 B.R. 238, supplemented 253 B.R. 592, corrected 329 B.R. 17.

The plaintiff has claimed, and the Court has commented, that the timing of the Trust formation is suspicious. The Trust was created two (2) years prior to any alleged fraudulent misdeed by the defendant, David L. Smith. App. Ex. 6 (Superseding Indictment). The Trust was created at a time that was not controlled by the Creators. Lynn A. Smith owned 100,000 shares of Charter One Bank stock. The bank was being taken over and those shares were being liquidated, which would have created a taxable event for Lynn A. Smith. The Trust was created at that time to provide a lawful tax avoidance opportunity and as a legacy for the Smith children. The timing of the formation of the Trust was directly related to the buy-out of Charter One and was not under the control of Lynn A. Smith. The timing of the creation of the Trust two (2) years prior to any alleged misdeeds of David L. Smith and five (5) years after the alleged writing of the letter seized during the criminal prosecution of David L. Smith is neither suspicious, nor an indication of any intent on behalf of either Lynn A. Smith or David L. Smith.

The Creators' intent is sufficiently evidenced by the Trust documents themselves setting forth the intent of the Creators of the Trust. App. Ex. 226 at 1. The Trust was created for the benefit of the adult children of the Creators and/or their heirs.

A secondary intent of the Creators in establishing the defendant, Trust, was the lawful avoidance of the income tax burden created by the sale of the Charter One stock and the pending liquidation of that stock at a substantial gain to Lynn A. Smith. Lynn A. Smith had inherited the funds utilized to purchase the Charter One stock and had a very low basis in that stock. The stock increased in value multiple times and, at the time of the takeover of the Charter One Bank, Lynn A. Smith would have been faced with a substantial income tax burden. In August of 2004, a unique tax avoidance provision was available under the United States Internal Revenue Code authorizing the creation of a Private Annuity Trust to avoid the payment of income taxes and to avoid and/or defer the payment of gift taxes. IRS Revenue Ruling 69-74; Dkt. No. 691 (Expert Opinion of D. Evans at 7). The Trust Creators, David L. Smith and Lynn A. Smith,

taking advantage of this lawful tax avoidance provision, and hoping to pass the tax savings and other funds onto their lawful heirs, created the defendant, Trust.

Prior to the creation of the Trust, the creators had annuity schedules run to establish that the growth of the assets held by the Trust would be sufficient to fund annuity payments to the creators while still preserving the principal of the Trust to fund the gift to their children of the benefits of the inheritance their mother received from her parents, namely the value of the Charter One stock. Dkt. No. 619 (Expert Opinion of D. Evans Exhibit "E"); App. Ex. 249 (Depo. Tr. G. Smith 122:11-20; 136:17-25; 137:2-3). This planning by the Creators of the Trust demonstrates their intent to pass the principal to their children. The inclusion of the provisions in the Trust documents allowing the Trustee to invade the Trust or terminate the Trust for the benefit of the children Beneficiaries is further evidence of this intent.

The Creators' intent is further evidenced by the analysis of the Annuity obligations and the intended operation of the Trust. Attached is an affidavit of the Trustee regarding the analysis of the market conditions from 2010 to present. The analysis used by the Creators (Id.) and the analysis done now by the Trustee (Affd. of G. Smith annexed as Exhibit "A") verify that if the Trust had not been seized at the request of the SEC there would have been sufficient funds earned with the most conservative investments to meet the annuity obligations and to also pass the original corpus on to the named beneficiaries. Only the interference of the SEC has prevented the Trust from meeting its original lawful purpose.

The creation of the Trust for a lawful, valid, nonfraudulent purpose has been established by the testimony of Lynn A. Smith, the opinions of David L. Evans and cannot be realistically contested in anyway by the plaintiff. Dkt. No. 619 (Expert Opinion of D. Evans).

The plaintiff claims that the alleged "confession" or letter seized from the residence of David L. Smith in the criminal case is somehow an admission of fraudulent intent in the instant action. This is not the case. The letter was written at a time remote from the creation of the Trust and had nothing to do with the Trust. The Plaintiff's use of the letter is just an example of how desperate the Plaintiff is to attempt to find something to base their argument on.



A reading of the letter written by David L. Smith at a point in time several years remote from the Trust creation indicates that he was attempting to advise his partner, Timothy McGinn, that things had to be made right. There is no evidence that this letter was ever disclosed to Lynn A. Smith, nor is there any evidence, or even a suggestion, that she was aware of the issues raised in the letter.

The letter does not set forth any indication of a scheme, or plan, to defraud creditors, nor does it set forth any indication of intent to transfer, or hide, assets from present or future creditors. The letter indicates that the author, David L. Smith, was unhappy with the products being advanced by his partner, Timothy McGinn, and a plea to Mr. McGinn to make things right. Neither the letter, nor any of the actions undertaken by David L. Smith at any time up to his indictment, indicate any intent to secret assets or to engage in conduct which would defraud creditors.

Plaintiff bases their claim of a fraudulent transfer involving the creation of the Trust upon the alleged intent of David L. Smith at the time the Trust was created. For the reasons set forth herein, the intent of David L. Smith has been addressed and does not meet the plaintiff's burden. Importantly, as discussed above, there is no allegation that David L. Smith was involved in any scheme, fraud or other wrongdoing prior to September of 2006, two years after the trust was created. In addition to the foregoing, the Court is respectfully reminded that the assets utilized to create the Trust were assets solely in the possession of Lynn A. Smith and were directly traceable to her inheritance from her parents as more fully set forth herein. As Lynn A. Smith was a co-creator of the Trust and Lynn A. Smith was the owner of the asset utilized to fund the Trust, the intent of David L. Smith is irrelevant as a matter of law. The assets of Lynn A. Smith were beyond the reach of David L. Smith's creditors at that time.

There is no evidence in the entire record that Lynn A. Smith had any knowledge of her husband's business dealings nor is there any evidence of Lynn A. Smith's intent to defraud any of David L. Smith's creditors.

The plaintiff further alleges that the transfer of the Sacandaga Lake summer residence real estate was somehow a fraudulent conveyance in spite of the fact that the property was transferred for fair market value. In order for the Court to find that the Creators of the Trust, engaged in fraudulent conveyance, the

Court must find “actual intent”, as distinguished from intent presumed by law, to hinder, delay or defraud creditors. NYDCL §276, *See In Re Jacobs*, 394 B.R. 646, 658 (Bankr. E.D.N.Y. 2008). The SEC has the burden of proving actual intent and “such intent must be demonstrated by clear and convincing evidence.”

*Id.*

It is noteworthy that the Sacandaga Lake summer home was inherited by Lynn A. Smith from her parents. It is also noteworthy that the Smith Family, over the years that they had owned it, had substantially improved the property.

The Smith Family had a financial and emotional attachment to this property and wanted to maintain the property within the Family. At this time, the Court had seized assets of Lynn A. Smith and David L. Smith making it impossible for them to meet their monthly obligations and to pay ongoing mounting legal fees necessary for David L. Smith to defend himself in the criminal proceeding. It was a valid exercise of the Trust’s authority, as set forth in the Trust document, for the Trust to purchase real property at its fair market value. Lynn A. Smith was in need of funds, but wished to keep the Sacandaga Lake summer home in the Family. It was, therefore, a natural, valid, lawful transfer for Lynn A. Smith to deed the Sacandaga Lake real estate to the Trust in exchange for its fair market value of \$600,000.00. There is absolutely no evidence of fraudulent intent, nor is there any evidence that this was a fraudulent conveyance, as that term is defined by the New York State Debtor Creditor Law and its cases. *Id.*

As pointed out by the plaintiff, NYDCL Section 278 affords the Trust, and its beneficiaries, a valid affirmative defense in this action. The Trust’s present counsel was not the counsel of record at the time the answer was served or discovery exchanged. Notwithstanding, the plaintiff has anticipated this affirmative defense and has addressed it in its papers. The plaintiff has, therefore, clearly established that there is no prejudice to the plaintiff by a late amendment of the defendant, Trust’s answer to include the affirmative defense afforded to the Trust, and its beneficiaries, under NYDCL Section 278. The Court, in its sound exercise of judicial discretion, may authorize the defendant, Trust to raise these issues at the time of trial, as the issues surrounding this affirmative defense would clearly be questions of fact before the jury.

**POINT II**  
**THERE WERE NO FRAUDULENT CONVEYANCES**  
**RELATIVE TO THE ESTABLISHMENT OR OPERATION**  
**OF THE SMITH TRUST**

The plaintiff claims that they are relying upon New York Debtor Creditor Law Section 276 to establish that the Trust was created by the fraudulent transfer of the proceeds from the sale of the Charter One stock at the inception of the Trust, and/or that the conveyance of the family Sacandaga Lake property by the Trust was a fraudulent conveyance. However, the plaintiff argues throughout their Memorandum that they are attempting to pierce the Trust and seize the Trust assets on the theory that David L. Smith so controlled the Trust subsequent to its creation that he made it his alter ego. The facts and the Record do not substantiate this claim. More importantly, this claim was never pled in the plaintiff's second amended Complaint, nor was it disclosed in plaintiff's discovery responses.

As set forth in the finding in preliminary proceedings, all transfers and stock transactions within the Trust were properly handled by the Trustee following requests by the beneficiaries. Simply put, David L. Smith was the broker of record for the Trust and engaged in various transactions with the express knowledge and consent of the Trustee. All transactions were made with the written authority of the Trustee, and distributions were made by the Trustee, in his discretion, and at the request of the beneficiaries, in accordance with the Trust provisions and the provisions of the EPTL, App. Ex. 283 (Deposition Tr. T. Urbelis 16:22-25; 17:2).

The intent of the Creators and the validity of the underlying Trust document have been discussed at length in defendant, Trust's Memorandum in support of this motion, and in defendant's opposition to plaintiff's motion for summary judgment, particularly in the light of the In Re Vebeliunas, 332 F.3d 85 (2d Cir. 2003) case. As discussed, the Vebeliunas Court found that the debtor in that case was not the equitable owner of the Trust at issue despite the fact that he may have benefited from the Trust by living at the Trust property without paying rent and taking deductions on he and his wife's income taxes for real estate taxes relating to Trust property. The Court reasoned that although debtor benefited from the Trust,

these benefits “flowed jointly to him and his wife” and did not confer “control of the Trust or transfer . . . ownership in [Trust property to debtor].” Id.

In the instant action, defendant has submitted an uncontroverted expert opinion, along with the consistent deposition testimony of all the defendants in this matter that the Smith Family Trust is a validly created trust funded by legitimate funds of Lynn A. Smith which she inherited from her father, not from ill gotten gains. The Trust was not created for the fraudulent purpose of shielding assets from creditors. There are no allegations that there were creditors or potential creditors or any allegations of wrong doing by David L. Smith until at least two years after the Trust was created. Neither David L. Smith nor Lynn A. Smith has received any benefit from the Trust to this day. The distributions from the Trust, of any nature, to the beneficiaries were fully authorized by the Trust document and by the Estates, Powers and Trusts Law. The distributions were not fraudulent and there has been no evidence submitted by the SEC, other than mere speculation, that the transfers were fraudulent.

The defendant, Trust, is aware that the Court has previously found that David L. Smith and/or Lynn A. Smith engaged in fraudulent behavior and has sanctioned them. It is uncontroverted that neither Geoffrey R. Smith nor Lauren T. Smith had any personal knowledge of the Annuity Agreement prior to it being brought to the attention of the Court and the parties during motion practice initiated by the plaintiff. Neither the Trust, by its current Trustee, Geoffrey R. Smith, nor the Trust beneficiaries, Geoffrey R. Smith and Lauren T. Smith, should be punished or sanctioned by the Court for any acts attributable to their parents. The sins of the parents should not be visited upon their children.

#### CONCLUSION

For the reasons set forth herein and for the reasons set forth in the defendant, Trust’s motion for summary judgment now pending, the defendant, Geoffrey R. Smith, Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/94, defendant, Geoffrey R. Smith and defendant, Lauren T. Smith’s motion for summary judgment should be granted; the stay imposed upon the Trust lifted; and, the action pending against the Trust dismissed.

Dated: Albany, New York

August 27, 2014

Respectfully submitted,

Linnan & Fallon, LLP

By           /s/ James D. Linnan          

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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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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, 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/DRH)

*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.*

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**AFFIDAVIT OF DEFENDANT/ INTERVENOR,  
GEOFFREY R. SMITH**

**GEOFFREY R. SMITH**, being duly sworn, deposes and says:

1. That I am the Trustee of the David L. and Lynn A. Smith Irrevocable Trust U/A 8/04/04.
2. Prior to my becoming Trustee, a Receiver was appointed by the Court.
3. The Receiver has prevented me, as Trustee, from prudently investing the funds associated with this Trust.
4. I graduated from Lehigh University in 2002 after receiving a B.S. in finance with

a concentration in accounting. After graduation, I passed the Series 7 and Series 63 examinations and became a licensed stock broker and registered representative. I have continued to pursue my professional education and received the prestigious title of Chartered Financial Analyst ("CFA") in 2009.

5. From April of 2010 through July of 2014, the Standard and Poor's 500 Index has had a total return of 79.593% and annualized returns of 14.771%.

6. At the time the Trust was seized by the Receiver, it had an approximate value of \$3,253,033.00.

7. If the Trust had been permitted to make prudent investments, consistent with the Standard and Poor's 500 Index, the Trust would have earned \$2,589,186.00 from April of 2010 to the present.

8. If the Trust had been permitted to grow, along with the stock market, it would only need an 8% return going forward from today to make the annuity payments required by the Private Annuity Trust Agreement.

9. The SEC, by its actions, has cost the Trust over \$2,500,000.00, in addition to the fees and expenses incurred by the Receiver.

10. Normal market returns, with prudent investments over the last four (4) years, would be sufficient to pay the annuity payments without any invasion of principle in the Trust.

11. As Trustee, I have the absolute authority under the Trust documents to terminate the Trust and distribute any remaining principle and/or interest to the beneficiaries of the Trust in my sole discretion.

12. The seizing of the Trust by the SEC, and the appointment of the Receiver, has rendered the Trust unable to make its obligations under the Annuity Agreement.

13. As Trustee, I wish to exercise my authority to carry out the ultimate terms and intent of the Trust, namely to distribute the funds attributable to my mother's inheritance from her



parents to the adult children of David L. Smith and Lynn A. Smith, namely, my sister, Lauren T. Smith and myself, Geoffrey R. Smith.

/s/Geoffrey R. Smith  
GEOFFREY R. SMITH

Sworn to before me this  
22nd day of August, 2014.

/s/Rachel Middleton  
Notary Public – State of Colorado

EXPIRES : 3/1/2016