

**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, 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.*

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**REPLY MEMORANDUM OF LAW  
IN FURTHER SUPPORT OF RELIEF DEFENDANT/DEFENDANT  
LYNN A. SMITH'S MOTION PURSUANT TO FEDERAL RULE OF  
CIVIL PROCEDURE 56 FOR PARTIAL SUMMARY JUDGMENT**

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## INTRODUCTION

Relief Defendant/Defendant Lynn A. Smith (“L. Smith”) submits this Reply Memorandum of Law to clarify the issues before the Court. L. Smith’s motion for summary judgment and supporting Memorandum of Law demonstrate with citations, and specific evidence, that the SEC has not created a genuine issue of material fact to support the allegations against L. Smith as a Relief Defendant.

L. Smith’s motion for summary judgment is focused exclusively on the allegations in the Second Amended Complaint (“SAC”) in her capacity as a Relief Defendant. L. Smith’s motion for summary judgment does not address the issues of ownership and control of the Stock Account. Instead, L. Smith’s motion for summary judgment questions whether the SEC has set forth admissible and conclusive evidence that establishes whether L. Smith is an appropriate Relief Defendant. As this Court has repeatedly held, the SEC has the burden of proving that, L. Smith as a Relief Defendant: (1) received ill-gotten gains; and (2) does not have a legitimate claim to the assets in the Stock Account. SEC v. Cavanaugh, 155 F.3d 129, 136 (2d Cir. 1998); Dkt.321 (the “Cavanaugh analysis”).

## PRELIMINARY STATEMENT

Since the SEC bears the ultimate burden of proof in this case, the SEC can only avoid partial summary judgment in favor of L. Smith by submitting competent evidence of fact which, if accepted by the Court, would establish or create a material issue of fact that requires adjudication by a jury trial. Judge Sharpe’s holding in a previous Order has made clear that:

A “nominal” or “relief” defendant is “a person who can be joined to aid the recovery of relief without an assertion of subject matter jurisdiction only

because [s]he has no ownership interest in the property which is the subject of the litigation.” SEC v. Cherif, 933 F.2d 403, 414 (7th Cir. 1991)... Federal courts have jurisdiction over and “may order equitable relief against” a relief defendant in a securities enforcement action if she: “(1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds.” SEC v. Cavanaugh, 155 F.3d 129, 136 (2d Cir. 1998) (citation omitted).

Dkt.321 at p.5.

L. Smith elected to move for summary judgment because the SEC has failed to come forward with specific evidence that creates a genuine issue of material fact in relation to both elements of the Cavanaugh analysis. The SEC, however, incorrectly assumes that the Cavanaugh analysis has already been satisfied based on a single preliminary injunction determination. The SEC’s belief is simply off the mark and fictitious. Judge Sharpe has previously held that the preliminary injunction determination has not triggered the law of the case doctrine. Dkt.321 at p.5. Moreover, the SEC also misinterprets L. Smith’s argument now before the Court in their statement that:

Lynn Smith’s argument that she has a legitimate claim to the Stock Account rests on her assertion that “[t]he SEC has made no effort to allege what source of funds constitute ill-gotten gains, the dates the funds were allegedly transferred, or the accounts from which they were transferred. L. Smith Br. at 9. In fact, the SEC has submitted detailed evidence showing every transfer into and out of the Stock Account from its inception in 1991 to April 2010.

*See*, SEC Memo. Of Law in Opposition to L. Smith’s Motion for Summary Judgment dated August 11, 2014 at p.8.

This statement by the SEC is erroneous for multiple reasons. First, the SEC has not “submitted detailed evidence showing every transfer into and out of the Stock Account from its inception” as the Commission has suggested. Second the SEC fails to recognize that Lynn Smith’s Stock Account was created prior to 1991. *See*, L. Smith Memo. Of Law in Response to Plaintiffs’ Motion for Summary Judgment at p.7-10. Third, the SEC deceives the Court with its incorrect characterization of L. Smith’s position. L. Smith’s main brief clearly sets forth that:

Lynn Smith now moves the Court for partial summary judgment because the SEC has not created a genuine issue of material fact as to whether she is an appropriate relief defendant that: (a) received assets into her stock account which contained ill-gotten gains, and (b) does not have a legitimate claim to those assets. Accordingly, Lynn Smith respectfully submits that no issue of fact remains that establishes a direct cause of action against her in her capacity as a relief defendant.

*See*, Memo. Of Law In Support of L. Smith's Motion for Summary Judgment, dated July 2, 2014 at p.1.

The fourth reason, and most compelling, is that the SEC's alleged "detailed evidence showing every transfer into and out of the Stock Account from its inception in 1991 to April 2010" has absolutely nothing to do with either of the elements in the Cavanaugh analysis. The alleged "detailed evidence showing every transfer into and out of the Stock Account" does not establish that money L. Smith received was ill-gotten gains, nor does it establish whether L. Smith provided consideration. Furthermore, the "detailed evidence" also does not show every transfer in and out of the Stock Account as the SEC has suggested. The "detailed evidence showing every transfer into and out of the Stock Account" is also not admissible because the SEC's expert witness, Kerri L. Palen, has not been disclosed pursuant to Court Order.

#### **ARGUMENT**

#### **A TRIER OF FACT COULD CONCLUDE THAT L. SMITH HAS A LEGITIMATE CLAIM TO THE STOCK ACCOUNT.**

The Response by the SEC in opposition to L. Smith's motion for summary judgment only addresses half of the issues before the Court. Nowhere in the SEC's response to L. Smith's motion is the issue of whether L. Smith received "ill-gotten gains" even mentioned. Instead, the SEC has chosen to focus only on the issue of whether L. Smith has a legitimate claim to the Stock Account. *See*, SEC Memo. Of Law in Opposition to L. Smith's Motion for Summary Judgment, dated August 11, 2014 at p.8.

Contrary to the SEC's unfounded statement that "no trier of fact, however, could conclude that Lynn Smith has a legitimate claim to the Stock Account", the evidence before the Court unmistakably establishes otherwise. *Id.* L. Smith is perhaps the greatest victim of the McGinn & Smith Co. wrongdoing. A trier of fact could conclude that L. Smith has a legitimate claim to the Stock Account because she was simply an investor who lost a significant portion of her assets just like many others.

There are numerous other reasons why a trier of fact could conclude that L. Smith has a legitimate claim to the assets in the Stock Account. The Stock Account has been held in L. Smith's individual name since approximately 1970. After L. Smith's account was transferred to McGinn Smith & Co., she became a legitimate customer and investor of the company who made short term bridge loan financing investments into private companies that needed a capital infusion. Each transaction was based upon the recommendations of her stock broker, David L. Smith, who happened to also be her husband. L. Smith's broker of record maintained discretionary authority over her account and many others under his management. Each transaction was discussed with L. Smith and it is not uncommon for investors to grant their broker of record with discretionary authority. These facts alone do not mean that the stock broker of record was the owner of the Stock Account. Indeed, if it did, the SEC should expand its action to include the owners of the other fifteen discretionary accounts managed by David L. Smith. Lynn Smith must not and cannot be punished from the simple fact of her marriage. Additionally, when McGinn Smith & Co. switched clearing agents, L. Smith signed new account paper work with the new clearing agent firm, Bear Stearns. Again, that fact alone does not establish that the account was created in 1991. *See*, L. Smith Response in Opposition to SEC's Motion for Summary Judgment at p.8-10.

The SEC's assertion that "no trier of fact could conclude L. Smith has legitimate claim to the Stock Account" is based on unfounded conclusions the SEC believes the Court should reach based upon their twist of the facts. For the numerous reasons mentioned above, the SEC's twist misrepresents the facts, takes them out of context or only provides half of the facts. As discussed in the responsive brief to the SEC's motion for summary judgment, there are numerous and obvious reasons why a jury could easily determine L. Smith owned the Stock Account. *See*, L. Smith Memo. Of Law, dated August 11, 2014, at p.7-19.

**A. THE ADMISSIBLE EVIDENCE FROM JOHN D'ALEO IS SPECIFICALLY TAILORED TOWARDS THE ALLEGATIONS SET FORTH IN THE SECOND AMENDED COMPLAINT.**

A complaint drafted by the plaintiff must be non-conclusory and based on allegations on facts and believable under the rules of logic and circumstances to be considered well-pleaded. Ashcroft v. Iqbal, 556 U.S. 662 (2009). A plaintiff is required to prove the allegations that are set forth in the complaint. The SEC has also had two opportunities to amend their complaint to tailor the allegations against L. Smith as a Relief Defendant.

In this case, and given the allegations set forth in the SAC, the SEC's conclusions fail to identify specific evidence that satisfy the Cavanaugh analysis as to each transaction that the SEC has questioned. *See*, Dkt.334, at ¶81-87, ¶112-123, and ¶204. In response to the allegations in the SAC, L. Smith retained John D'Aleo. John D'Aleo is a well-respected Certified Public Account who has worked extensively in the Capital Region business community for decades. The Affidavit of John D'Aleo and his corresponding exhibits from the preliminary injunction hearing are specifically tailored towards the exact allegations in the SAC.



Additionally, and as more fully briefed in the Relief Defendant's Response to the SEC's separate motion for summary judgment, credibility is not to be assessed in a summary judgment motion. Credibility is to be determined by a trier of fact.

The SEC has ignored all of this and charged ahead in its crusade to attack the credibility of witnesses and experts that have been disclosed and lawfully utilized by the defense. For example, the SEC states in their Response that:

D'Aleo's opinion - which is the same unformed and unpersuasive opinion he offered during the preliminary injunction hearing – is so divorced from the factual record in this case that it should be rejected as completely unreliable.

*See*, SEC Memo. Of Law in Opposition to L. Smith's Motion for Summary Judgment, dated August 11, 2014 at p.8.

L. Smith brings to the Court's attention that the SEC themselves have previously cited to Mr. D'Aleo's testimony, exhibits and opinions in their response to L. Smith's Interrogatories. *See*, Plaintiff's Response to Interrogatory No. 3, dated February 24, 2011. Now at this late hour, the SEC claims "D'Aleo's opinion... is... uninformed and unpersuasive [.]". *See*, SEC Memo. Of Law in Opposition to L. Smith's Motion for Summary Judgment, dated August 11, 2014 at p.9. If D'Aleo's opinion and testimony is "uninformed and unpersuasive" why would the SEC refer to it as a "list of facts that Plaintiff contend[s] or believe[s] supports Plaintiff's allegation that monies allegedly received by Smith were ill-gotten gains or illegal profits resulting from the Defendant's fraud"? Thus, it should become apparent to the Court that the SEC, once again, has completely contradicted themselves.

Additionally, Mr. D'Aleo's 82 pages of testimony at the preliminary injunction hearing, the corresponding exhibits he created and drafted, combined with the accompanying statement from his Affidavit he "prepared a summary and compilation of the deposits and withdrawals of the assets in Lynn A. Smith's individual brokerage account since 1999...examined various bank

records, checks, and promissory notes in connection with the account...[and] traced the flow of funds going in and coming out of Lynn Smith's brokerage account from 1999 through 2010", collectively demonstrate that Mr. D'Aleo is certainly not "uninformed and unpersuasive" as the SEC has suggested. In other words, Mr. D'Aleo's flawless reputation in the Capital Region business community and beyond speaks for itself.

**B. THE KERRI PALEN DECLARATION IS NOT ADMISSIBLE.**

An expert witness is one who is allowed to provide opinion testimony at trial based upon their specialized knowledge, training or experience in order to assist the fact finder in reaching a decision. Federal Rule of Evidence 702. Under Federal Rule of Civil Procedure 26(a) (2) each party is required to disclose the identity of any person who may be used at trial as an expert witness. Rule 26(a) (2) further provides that disclosure shall "be accompanied by a written report prepared and signed by the witness." *Id.* The rule states that "these disclosures shall be made at the times and in the sequence directed by the court". *Id.* Federal Rule of Civil Procedure 37(c)(1) provides that a party who, without substantial justification, fails to disclose information required by Rule 26, shall not be permitted to use as evidence at trial the information not disclosed.

In response to L. Smith's motion for summary judgment and in support of their own separate motion, the SEC attempts to blindsides the entire defense counsel with the two Declarations of Kerri L. Palen, dated July 8, 2014, and August 7, 2014, respectively. The Palen Declarations are authored by an expert Certified Public Accountant and Certified Fraud Examiner who "provides professional...advice...in financial analysis". Declaration of Kerri L. Palen, dated July 8, 2014 at ¶2-3. None of the conclusions and opinions in the Palen Declaration have been previously disclosed as required by Magistrate Hummel's January 22, 2014 scheduling Order. The Palen declaration "review and analysis" arrives at the opinion and conclusion that:

During this time period, [for the period June 18, 2003 through April 16, 2010] over \$2 million was transferred from the Stock Account. A majority of the funds transferred from the stock account were used to pay personal expenses relating to the Smith's primary and vacation homes and country club expenses.

*See*, Declaration of Kerri L. Palen, dated July 8, 2014 at ¶80.

Not only are the Palen Declarations inadmissible, they are also not complete. The Palen Declaration fully admits "I am unable to verify that all the transactions in the Stock Account prior to August 28, 1999 are included in Exhibit 25". Declaration of Kerri L. Palen, dated July 8, 2014 at ¶78. However, the SEC has submitted that "[i]n fact, the SEC has submitted detailed evidence showing every transfer into and out of the Stock Account from its inception in 1991 to April 2010". SEC Memo. Of Law in Opposition to L. Smith's Motion for Summary Judgment, dated August 11, 2014 at p.8. Once again, the SEC's statement is not accurate.

The Palen Declarations are not complete because each declaration ignores the consideration previously furnished by L. Smith. For example, the very first transaction in the Palen Declaration dated August 7, 2014 is a \$1,777,222.22 payment from Capital Center Credit Corp. That payment was the result of a bridge loan made to FIIN through Capital Center Credit Corp. on August 18, 2003 for \$1,750,000. The next five transactions in question by the August 7, 2014 Palen Declaration total a payment of \$2,015,556.00. This payment was also the result of a bridge loan made to FIIN on October 1, 2003 for \$2,000,000. These investments were legitimate and should not impact the Court's analysis as to whether "Lynn Smith has a legitimate claim to the assets in the Stock Account" whatsoever.

**CONCLUSION**

For the foregoing reasons the Court should determine that a genuine issue of material fact does not exist as to whether: (a) Lynn Smith received ill-gotten gains and (b ) Lynn Smith has a “legitimate claim” as to the assets inside the Stock Account. Accordingly, the Court should grant partial summary judgment in favor of Lynn Smith which dismisses the claims against her in her capacity as a relief defendant.

Dated: August 27, 2014

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