

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION :

Plaintiff, :

v. :

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, GEOFFREY R. SMITH, Individually and :
as Trustee of the David L. and Lynn A. Smith :
Irrevocable Trust U/A 8/04/04, :
LAUREN T. SMITH, and NANCY MCGINN, :

CASE NO. 1:10-CV-457
(GLS/CPH)

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. :

**OBJECTION TO RECEIVER’S MOTION FOR AN ORDER (I) APPROVING PLAN
OF DISTRIBUTION AND (II) AUTHORIZING INTERIM DISTRIBUTIONS**

Certain Investors, by and through their undersigned counsel, Weir & Partners LLP, object to the Receiver’s Motion For An Order (i) Approving Plan Of Distribution and (ii) Authorizing Interim Distributions (Doc. # 847) and say:

1. This Objection to the Receiver’s Motion (Doc. # 847) is made on behalf of certain

investors who invested in various investments sold through McGinn Smith & Company and its affiliated brokers (“McGinn Smith”) and who obtained a partial recovery from a third party (the “Third Party”). These investors are referred to in this Objection as the “Third Party Limited Recovery Investors”.

2. The Third Party Limited Recovery Investors are identified in Exhibit “A” to this Objection.

3. The Third Party Limited Recovery Investors obtained a partial recovery of their losses pursuant to a settlement agreement that is subject to a confidentiality agreement. The Third Party Limited Recovery Investors will be filing a motion to file certain of the details of the suit under seal in order to comply with their obligations under the aforementioned confidentiality agreement.

4. The amounts recovered from the Third Party by each Third Party Recovering Investor are such that, even if they are treated on par with all other investors who have not received any other recovery from a third party source, they will still only receive a partial recovery of their total investment loss.

5. Accordingly, if this Objection is sustained by this Court, no Third Party Recovering Investor will achieve a “double recovery.”

The Receiver’s Plan of Distribution

6. In his Plan of Distribution (the “Distribution Plan”), the Receiver proposes to reduce distributions from the McGinn Smith Estate to any investor that received any recoveries from any other source (referred to by the Receiver as a “collateral recovery”). In this respect, the Distribution Plan, at page 11 provides:

[T]he Receiver will reduce payments to such investor *to the extent necessary* to ensure that all allowed investor claims are treated

equally with respect to the percentage of their allowed claim amounts they recover from all sources as of the date of the payments. (Emphasis added).

7. The Distribution Plan does not specify the method or extent to which the Receiver proposes to reduce distributions to investors, including the Third Party Recovering Investor, who obtained any collateral recoveries.

Objection to Plan of Distribution

8. As further set forth in the Memorandum of Law accompanying this Objection, the Distribution Plan fails to comport with the equitable principles that guide receivership actions.

9. The Distribution Plan is vague and ambiguous—it fails to set forth sufficient information to permit the Third Party Recovering Investors, or other McGinn Smith investors, to fully understand how their claims will be treated.

10. The Distribution Plan fails to disclose the method or extent to which the Receiver will reduce receivership distributions on account an investor's collateral recovery, and which claims are to be paid or disputed, among other things.

11. To the extent the Receiver proposes to reduce an investor's distribution by a dollar-for-dollar amount equal to that investor's collateral recovery, such a proposal unfairly discriminates against the Third Party Recovering Investors.

12. Under the current Distribution Plan, many Third Party Recovering Investors may not receive any distribution from the McGinn Smith Estate. Third Party Recovering Investors are unduly punished for undertaking the significant time and expense to pursue recovery from sources outside of the McGinn Smith Estate.

13. The Distribution Plan encourages other McGinn Smith investors to hold off on initiating third-party claims until *after* the Receiver makes distributions. McGinn Smith

EXHIBIT “A”

Last Name	First Name
Barley	Judith
Berg	Corinne
Bove	Richard
Broast	Ronald & Linda
Coffin	Bruce
Conn	Judith
Connell	Kathleen
Courey	Kenneth M.
Crist	Henry
Dale	Mary
Delaney	John & Eleanor
Fair	Catherine
Gallo	Robert & Maureen
Ferrero	William C.
Gavin	George & Nancy
Glasgow	Katherine
Goodhart	John
Jones	Jeremy
Keddie	Phyllis
Kornberg	Arthur
Lex	Kathleen C. & William F.
Lex	George
Macfarlan	M. Reid & Nancy
Mayberry	Joseph & Mary
Monahan	Barbara
Moser	Janet
O'Brien	Maryann
Ockrymiek	Douglas
O'Shea	Ann
Paist, III	Stanley S.
Pavlishin	Paul & Dolores
Pirnat	Marilyn
Plado	Quintin
Rissinger	Fred & Carol
Rosenberry	Betty
Rotor	Marilyn
Seigford	William & Patricia
Smith	Arthur & Nancy
Stiles	Burton Richard
Sullivan	Linda

Tomas
Tovar
Wargo
Wetzel

Ruth
Alison
Monsignor Robert
John

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Relief Defendants, :

-and- :

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

Intervenor. :

**MEMORANDUM OF LAW IN SUPPORT OF OBJECTION TO RECEIVER'S
MOTION FOR AN ORDER (I) APPROVING PLAN OF DISTRIBUTION
AND (II) AUTHORIZING INTERIM DISTRIBUTIONS**

The Third Party Recovering Investors, by and through their undersigned counsel, hereby submit this Memorandum of Law in Support of the foregoing Objection to the Motion of William J. Brown, as Receiver (the "Receiver"), for an Order (I) Approving Plan of Distribution of Estate Assets and (II) Authorizing Interim Distributions.

BACKGROUND AND STATEMENT OF FACTS

This Objection to the Receiver's Motion (Doc. # 847) is made on behalf of certain investors who invested in various investments that were sold through McGinn Smith & Company and affiliated investors ("McGinn Smith") and who obtained a partial recovery from a third party (the "Third Party"). These investors are referred to in this Objection as the "Third Party Recovering Investors". The Third Party Recovering Investors are identified in Exhibit "A" to this Objection.

The Third Party Recovering Investors obtained a partial recovery of their losses pursuant to a settlement agreement that is subject to a confidentiality agreement. The Third Party Recovering Investors will be filing a motion to file certain of the details of the Third Party suit under seal in order to comply with their obligations under the aforementioned confidentiality agreement. The amounts recovered from the Third Party by each Third Party Recovering Investor are such that, even if they are treated on par with all other investors who have not received any third party recovery, they will still only receive a partial recovery of their total investment loss. Accordingly, if this Objection is sustained by this Court, no Third Party Recovering Investor will achieve a "double recovery."

II. The Receiver's Proposed Treatment of Collateral Recoveries

As a condition to receiving any distribution from the Receiver, McGinn Smith investors are required to disclose whether they received or applied for compensation from any source other than the McGinn Smith Estate. (*See* Distribution Plan, Page 11). In the event an investor received such compensation outside of the McGinn Smith Estate (otherwise referred to as a "collateral recovery"),

[T]he Receiver will reduce payments to such investor *to the extent necessary* to ensure that all allowed investor claims are treated equally with respect to the percentage of their allowed claim

amounts they recover from all sources as of the date of the payments.

Id. (Emphasis added). The Distribution Plan does not specify the method or extent to which the Receiver proposes to reduce distributions to investors who obtained collateral recoveries.

OBJECTION TO PLAN OF DISTRIBUTION

I. The Distribution Plan is Vague and Ambiguous

The Receiver should be required to supplement and revise the Distribution Plan to allow all investors to fully understand how their claims will be treated so that objections, if necessary, can be filed. At the very least, the Receiver should specify the method and extent to which he will reduce distributions to investors that received collateral recoveries (whether from a third party or because of payments received prior to the collapse of the scheme). Under the Distribution Plan, the Receiver vaguely proposes to make such reductions “to the extent necessary to ensure that all allowed investor claims are treated equally” without specifying exactly how he would accomplish this. While it appears that the Receiver proposes a dollar-for-dollar reduction of any investor’s claim, it is unclear that this is indeed what he intends to do. (See Distribution Plan, Page 11).

II. The Distribution Plan Inequitably Prejudices Third Party Recovering Investors

To the extent the Receiver proposes to reduce an investor’s distribution by a dollar-for-dollar amount equal to that investor’s collateral recovery, such a proposal unfairly discriminates against the Third Party Recovering Investors. An S.E.C. receiver’s plan of distribution to Ponzi scheme victims should “treat *all* the fraud victims alike (in proportion to their investments) and order a *pro rata* distribution.” *S.E.C. v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88 (2d Cir. 2002) (emphasis added); *Commodity Futures Trading Com'n v. Topworth Int'l, Ltd.*, 205 F.3d 1107,

1116 (9th Cir. 1999) (finding pro rata distribution best serves equitable purposes of receivership).

Here, the Receiver proposes to make pro rata distributions to investors using the “Net Loss” approach. (*See* Distribution Plan, page 12). Under this “money in, money out” approach, prior payments received by an investor are subtracted from the investor’s total investment to determine the investor’s net loss/claim. The investor will receive a distribution in an amount equal to its pro rata claim (the investor’s claim versus the total claims) against the McGinn Smith Estate. According to the Receiver, “[u]tilizing the pro rata distribution procedure results in *each allowed investor claim receiving a distribution* under the Plan.” *Id.* (emphasis added). However, such a result is unlikely.

Reducing the Third Party Recovering Investors’ distributions from the McGinn Smith Estate by an amount equal to any prior recovery does not treat “all the victims of the fraud alike” and rather disproportionately accounts for the Third Party Recovering Investors’ claims and losses. *Credit Bancorp*, 290 F.3d at 88. Indeed, many Third Party Recovering Investors are likely to receive no distribution from the McGinn Smith Estate in the event their recovery from the Third Party was greater than their proposed distribution under the Distribution Plan.

The Distribution Plan unduly penalizes the Third Party Recovering Investors for undertaking the significant time and expense to pursue recovery from sources *outside* of the McGinn Smith Estate. In this regard, the Third Party Recovering Investors have not reduced the available funds in the McGinn Smith Estate by virtue of their recovery from the Third Party. Permitting the Third Party Recovering Investors to recover the full amount of their receivership distribution without deducting their recovery from the Third Party does not create a risk of “double dipping.” Each Third Party Recovering Investor, at most, received anywhere from 11%

to 15% of their loss pursuant from the Third Party. Under the Distribution Plan, it appears that the Receiver proposes to distribute around 15% to 17% of an investor's total loss. Thus, it is impossible for any Third Party Recovering Investor to "double dip" or otherwise recover more than their investment loss.

Additionally, the Receiver should not punish the Third Party Recovering Investors for pursuing claims that were unavailable to the Receiver under the doctrine of *in pari delicto*. *In re Bernard L. Madoff Inv. Sec. LLC.*, 721 F.3d 54, 63 (2d Cir. 2013). Because the Receiver stands in the shoes of McGinn Smith and its related entities, the Receiver was barred from "suing to recover for a wrong that he himself essentially took part in," which included the claims against the Third Party. *See Wight v. BankAmerica Corp.*, 219 F.3d 79, 87 (2d Cir.2000). Given the limitations imposed upon the Receiver, the Third Party Recovering Investors should not be punished for declining to limit themselves to any recovery available by the Receiver. Similarly, the Third Party Recovering Investors' claims were based upon their unique, individualized circumstances. Thus, the Third Party Recovering Investors' claims against the Third Party could not have been pursued by the McGinn Smith Estate. Any recovery obtained from the Third Party did not prejudice or otherwise affect the rights of other McGinn Smith investors.

While punishing the Third Party Recovering Investors on account of their collateral recovery from the Third Party, the Distribution Plan rewards other McGinn Smith investors who choose to hold off from initiating third party claims until *after* the Receiver makes distributions. Similarly, McGinn Smith investors with currently pending third party claims are rewarded for delaying the progress of their claims. Other McGinn Smith investors may completely forego the pursuit of third party claims given the minimal gain in comparison to the time and expense of

additional litigation. Thus, the Distribution Plan unduly punishes the Third Party Recovering Investors while favorably treating other similarly situated McGinn Smith investors.

III. The Equities Preclude the Receiver from Making Any Reduction to the Third Party Recovering Investors' Receivership Distributions

Given the *de minimis* impact of their collateral recovery, the Third Party Recovering Investors' claims against the McGinn Smith Estate should not be reduced. Under similar circumstances, federal bankruptcy courts have repeatedly held that a "creditor's claim in the bankruptcy case is not affected by third-party payments, except to the extent payment from the debtor would produce a double recovery." *In re Del Biaggio*, 496 B.R. 600, 603 (Bankr. N.D. Cal. 2012) (citing *Ivanhoe Bldg. & Loan v. Orr*, 295 U.S. 243, 55 S.Ct. 685, 79 L.Ed. 1419 (1935); see *In re Journal Register Co.*, 407 B.R. 520, 533 (Bankr.S.D.N.Y.2009):

We start with the proposition that members of an unsecured creditors class may have rights to payment from third parties, such as joint obligors, sureties and guarantors, and these rights may entitle them to a disproportionate recovery compared to other creditors of the same class (up to a full recovery).

The rationale of the policy is to "value *equality of treatment* by the debtor's estate *above equality of overall outcomes* among creditors having different rights against third parties." *In re Del Biaggio*, 496 B.R. at 604 (emphasis added). As such, creditors are entitled to assert the full balance of their claims even where a confirmed bankruptcy plan provides for payment in full of all claims. See *In re Biovance Techs., Inc.*, 2014 WL 2861003, at *4 (Bankr. D. Neb. June 23, 2014) ("The confirmed plan is not a recovery or payment in full. Instead, it is a promise to pay. The foregoing authorities are clear that until such time as [the claimant] has received payment in full, it is entitled to assert the balance due against all responsible parties.").

Consistent with this rationale, Courts in S.E.C. receivership proceedings have approved plans of distribution that called for *zero reduction* to an investor's distribution, despite collateral

recoveries by certain groups of investors. *See Credit Bancorp*, 290 F. Supp. 2d at 418. In *Credit Bancorp*, the receiver proposed a plan of distribution that provided supplemental receivership distributions to certain groups of qualified claimants. Several customers objected to the plan of distribution on the basis that the claimants receiving supplemental distributions already received collateral recoveries from their insurance policies or third-party proceedings. Citing the receiver's argument in support of the plan, the court overruled the customers' objections. *Id.* at 424. Specifically, the receiver:

. . . did not want to eliminate the incentive for any customer to obtain compensation from sources other than the Receivership. To deduct from a customer's distribution under the Plan any amounts received from collateral sources would have eliminated any incentive for customers to seek compensation from such sources. Benefits for all customers taken as a whole are maximized if customers are encouraged to seek compensation from other sources.

Here, equitable treatment of all McGinn Smith investors precludes the Receiver from making any reductions to the Third Party Recovering Investors' distributions. Granting the Receiver unfettered discretion to reduce distributions "to the extent necessary" is contrary to the principle that "equality is equity" in receivership matters. *Cunningham v. Brown*, 265 U.S. 1, 13, 44 S.Ct. 424, 68 L.Ed. 873 (1924).

IV. Alternatively, Reductions to Receivership Distributions (If Any) Should Be Proportional to an Investor's Loss

At most, any reduction on account of the Third Party Recovering Investors' recovery from the Third Party should be made from each investor's total investment. In other words, collateral recoveries should be deducted from the initial investment (in other words, as "money out") and not in a dollar-for-dollar amount from an investor's distribution from the McGinn Smith Estate. This approach better serves the equitable principles guiding receiverships by: (a)

proportionally accounting for collateral recoveries and (b) allowing *all* qualified McGinn Smith investors to share in the McGinn Smith Estate funds. See *United States v. Real Property*, 89 F.3d 551, 553 (9th Cir. 1996) (“[T]he equities demand that *all* . . . defrauded customer[s] share equally in the fund of pooled assets in accordance with the SEC plan.”) (emphasis added). Additionally, any deduction on account of the Third Party Recovering Investors’ collateral recovery should be net of all attorneys’ fees and expenses incurred in obtaining such recovery. See e.g., *S.E.C. v. Parish*, 2010 WL 5394736, at *10 (D.S.C. Feb. 10, 2010).

Proportional reductions, as described above, have been favored over dollar-for-dollar reductions by courts and receivers in prior Ponzi scheme receivership actions. *Parish*, 2010 WL 5394736 at *10. In *Parish*, the receiver’s initial plan of distribution sought to reduce distributions from the receivership in a dollar-for-dollar amount equal to an investor’s collateral recovery. Following the objection of certain investors, the receiver agreed it was “more equitable to treat third-party recoveries as reductions from investors’ [principal investment],” rather making dollar-for-dollar reductions. *Id.*

The *Parish* court adopted the receiver’s findings and recognized that this “approach appropriately takes into account the reduction to the investor’s loss achieved by the third-party recovery without unduly penalizing the investor for the recovery.” *Id.* The court further ordered that any reductions made on account of third-party recoveries were to be net of attorneys’ fees and expenses in obtaining such recovery. *Id.* at *11.

Clearly, the equities favor a proportional reduction of the Third Party Recovering Investors’ distributions—if at all. The Receiver does not otherwise justify the basis for reducing receivership distributions on a dollar-for-dollar basis, which will result in many Third Party Recovering Investors receiving no recovery from the McGinn Smith Estate.

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Intervenor. :

**DECLARATION OF BONNIE R. GOLUB, ESQUIRE IN SUPPORT OF OBJECTION
TO RECEIVER'S MOTION FOR AN ORDER (I) APPROVING PLAN
OF DISTRIBUTION AND (II) AUTHORIZING INTERIM DISTRIBUTIONS**

I, Bonnie R. Golub, Esquire, of Weir & Partners LLP, hereby declare under penalty of perjury:

1. I am partner with the law firm of Weir & Partners LLP, a Pennsylvania limited liability partnership. I am admitted to practice in the State Courts of New York, Pennsylvania,

and New Jersey, as well as United States Courts for the Northern District of New York, the Southern District of New York, the Eastern District of Pennsylvania, the Middle District of Pennsylvania, the District of New Jersey, and the Third Circuit Court of Appeals.

2. I submit this Declaration in support of the Objection to the Receiver's Motion for an Order (I) Approving Plan of Distribution and (II) Authorizing Interim Distributions (Doc. # 847), filed herewith (the "Objection to Distribution Plan").

3. I have reviewed the Receiver's Motion for an Order (I) Approving Plan of Distribution and (II) Authorizing Interim Distributions (the "Motion") and Proposed Plan of Distribution (the "Distribution Plan") and am familiar with the facts set forth therein.

4. Weir & Partners LLP represents 44 investors who invested in various investments sold through McGinn Smith & Company and its affiliated brokers ("McGinn Smith") and who obtained a partial recovery from a third party (the "Third Party"). These investors are referred to in this Objection as the "Third Party Limited Recovery Investors".

5. Each of Third Party Recovering Investors are specifically identified in Exhibit "A" to the Memorandum of Law attached hereto.

6. The Third Party Limited Recovery Investors obtained a partial recovery of their losses pursuant to a settlement agreement that is subject to a confidentiality agreement.

7. The Third Party Limited Recovery Investors will be filing a separate motion to file certain of the details of the Third Party suit under seal in order to comply with their obligations under the aforementioned confidentiality agreement.

8. Under the terms of the Distribution Plan, the Receiver proposes to reduce the distribution owing to any McGinn Smith investor who obtained a collateral recovery (a third-party recovery) “to the extent necessary.”

9. Based on the information provided by the Receiver in the Distribution Plan, it appears that the McGinn Smith investors are otherwise entitled to receive approximately 15% to 17% of their total loss or claim.

10. The Third Party Recovering Investors object to the Distribution Plan on the basis that they are unduly penalized for obtaining recovery from sources outside of the McGinn Smith Estate.

11. The amounts recovered from the Third Party by each Third Party Recovering Investor are such that, even if they are treated on par with all other investors who have not received any third party recovery, they will still only receive a partial recovery of their total investment loss.

12. In further support of the Third Party Recovering Investors’ claims, I submit herewith, the Third Party Investors’ Objection to the Distribution Plan and Memorandum of Law.

WEIR & PARTNERS LLP
a Pennsylvania Limited Liability Partnership

By: /s/ Bonnie R. Golub
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Dated: February 16, 2016

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THIRD ALBANY INCOME NOTES, LLC, :
TIMOTHY M. MCGINN, AND DAVID L. SMITH, :
GEOFFREY R. SMITH, Individually and as Trustee :
of the David L. and Lynn A. Smith Irrevocable Trust :
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-and- :

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

Intervenor. :

CERTIFICATE OF SERVICE

I, Bonnie R. Golub, being at all times over 18 years of age, hereby certify that on this 16th day of February, 2016, a true and correct copy of the Objection to Receiver’s Motion for an Order (I) Approving Plan of Distribution of Estate Assets and (II) Authorizing Interim Distributions (“Objection”) and Memorandum of Law and Declaration of Bonnie R. Golub (“Supporting Documents”) were caused to be served by e-mail upon all parties who receive electronic notice in this case pursuant to the Court’s ECF filing system, as follows:

- **William J. Brown** wbrown@phillipslytle.com, khatch@phillipslytle.com
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- **Kevin Laurilliard, Esquire** laurilliard@mltw.com

And, I hereby certify that on this 16th day of February, 2016, I mailed, via First Class Mail using the United States Postal Service, a copy of the Objection and the Supporting Documents to the individuals listed below.

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Dated: February 16, 2016

/s/ Bonnie R. Golub
Bonnie R. Golub, Esquire