**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF NEW YORK**

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| **SECURITIES AND EXCHANGE COMMISSION,** | |
| ***Plaintiff,*** | |
| **-against-** | **10 Civ. ____ ( )** |
| **MCGINN, SMITH & CO., INC.;**<br>**MCGINN, SMITH ADVISORS LLC;**<br>**MCGINN, SMITH CAPITAL HOLDINGS CORP.;**<br>**FIRST ADVISORY INCOME NOTES, LLC;**<br>**FIRST EXCELSIOR INCOME NOTES, LLC;**<br>**FIRST INDEPENDENT INCOME NOTES, LLC;**<br>**THIRD ALBANY INCOME NOTES, LLC;**<br>**TIMOTHY M. MCGINN; AND**<br>**DAVID L. SMITH,** | |
| ***Defendants, and*** | |
| **LYNN A. SMITH,** | |
| ***Relief Defendant.*** | |

**ORDER TO SHOW CAUSE,**
**TEMPORARY RESTRAINING ORDER,**
**AND ORDER FREEZING ASSETS AND GRANTING OTHER RELIEF**

On the Application of Plaintiff Securities and Exchange Commission (the "Commission") for an Order:

(1) directing defendants McGinn, Smith & Co., Inc. ("MS & Co."); McGinn, Smith Advisors LLC ("MS Advisors"); McGinn, Smith Capital Holdings Corp. ("MS Capital"); First Advisory Income Notes, LLC ("FAIN"); First Excelsior Income Notes, LLC ("FEIN"); First Independent Income Notes, LLC ("FIIN"); Third Albany Income Notes, LLC ("TAIN"); Timothy M. McGinn; David L. Smith (collectively, the "Defendants") to show cause why an Order should not be entered, pending a final disposition of this action:

(a) preliminarily enjoining:

(i) MS & Co., MS Capital, FAIN, FEIN, FIIN, TAIN, McGinn and Smith from violating Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77e(a) and 77e(c);

(ii) MS & Co., MS Advisors, MS Capital, McGinn and Smith from violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b) and Exchange Act Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5;

(iii) MS & Co., MS Advisors, McGinn and Smith from violating Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. §§ 80b-6(1) and (2), and Rule 206(4)-8 thereunder, 17 C.F.R. §275.206(4)-8;

(iv) MS & Co. from violating Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78(o)(1), and Smith and McGinn from aiding and abetting this violation; and,

(v) FAIN, FEIN, FIIN and TAIN from violating Section 7(a) of the Investment Company Act of 1940 ("Company Act"), 15 U.S.C. § 80a-7.

(b) freezing the Defendants' and Lynn Smith's (the "Relief Defendant") assets;

(c) directing McGinn and Smith (the "Individual Defendants") to provide verified accountings for themselves and MS & Co., MS Advisors, MS

Capital, FAIN, FEIN, FIIN and TAIN (the "Entity Defendants"), and the Relief Defendant to provide a verified accounting for herself;

(d) appointing a receiver for the Entity Defendants and all other entities McGinn and/or Smith control or have an ownership interest in (collectively the "MS Entities"); and

(e) prohibiting the destruction, alteration or concealment of documents

(2) pending adjudication of the foregoing, an Order:

(a) temporarily restraining the Defendants from violating the aforementioned statutes and rules;

(b) freezing the Defendants' and Relief Defendant's assets;

(c) directing each of the Individual Defendants to immediately provide the verified accounts for themselves and the Entity Defendants, and the Relief Defendant to provide the verified accounts for herself;

(d) appointing a temporary receiver for the MS Entities;

(e) prohibiting the destruction, alteration or concealment of documents by the Defendants; and

(f) providing that the parties may take expedited discovery in preparation for a preliminary injunction hearing on this Order to Show Cause.

This Court has considered: (1) the Complaint filed by the Commission, dated April 20, 2010; (2) the Declaration of Israel Maya, executed on April 20, 2010, and the exhibits thereto; (3) the Declaration of Lara Shalov Mehraban, executed on April 20, 2010, and the exhibits thereto; and (4) the memorandum of law in support of Plaintiff Commission's application, dated April 20, 2010.

Based upon the foregoing documents, the Court finds that a proper showing, as required by Section 20(b) of the Securities Act, Section 21(d) of the Exchange Act, Section 209(d) of the Advisers Act, and Section 42(d) of the Company Act, has been made for the relief granted herein, for the following reasons:

1. It appears from the evidence presented that, unless temporarily restrained, (1) Defendant MS & Co. has violated, and will continue to violate, Sections 5(a) and 5(c) of the Securities Act, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act and Rule 10b-5, Section 206(1), 206(2), and 206(4) of the Advisers Act and Adviser Act Rule 206(4)-8, and Section 15(c)(a)(1) of the Exchange Act; (2) Defendant MS Advisors has violated, and will continue to violate, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act and Rule 10b-5, Section 206(1), 206(2), and 206(4) of the Advisers Act and Adviser Act Rule 206(4)-8; (3) Defendant MS Capital has violated, and will continue to violate, Sections 5(a) and 5(c) of the Securities Act, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act and Rule 10b-5; (4) Defendants FAIN, FEIN, FIIN and TAIN have violated, and will continue to violate, Section 7(a) of the Company Act; and (5) Defendants McGinn and Smith have violated, and will continue to violate Sections 5(a) and 5(c) of the Securities Act, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act and Rule 10b-5, and Section 206(1), 206(2), and 206(4) of the Advisers Act and Adviser Act Rule 206(4)-8, and Defendants McGinn and Smith have aided and abetted, and will continue to aid and abet MS & Co.'s violation of Section 15(c)(a)(1) of the Exchange Act.

2. It appears that the Defendants and Relief Defendant may attempt to dissipate, deplete, or transfer from the jurisdiction of this Court, funds, property and other assets that could

be subject to an order of disgorgement or an order imposing civil penalties. It appears that an order freezing the Defendants' and Relief Defendant's assets, as specified herein, is necessary to preserve the *status quo,* to protect investors and clients of the Defendants from further transfers of funds and misappropriation, to protect this Court's ability to award equitable relief in the form of disgorgement of illegal profits from fraud and civil penalties, and to preserve the Court's ability to approve a fair distribution for victims of the fraud.

3. It appears that an order requiring each of the Individual Defendants and Relief Defendant to provide a verified accounting of their assets, money and property held directly or indirectly by the Defendants and Relief Defendant, or by others for the direct and indirect beneficial interest of the Defendants and Relief Defendant, is necessary to effectuate and ensure compliance with the freeze imposed on the Defendants' and Relief Defendant's assets.

4. It appears that the Defendants may attempt to destroy, alter or conceal documents.

5. It appears that the appointment of a receiver for the MS Entities is necessary to (i) preserve the *status quo*; (ii) ascertain the extent of commingling of funds among the MS Entities; (iii) ascertain the true financial condition of the MS Entities and the disposition of investor funds; (iv) prevent further dissipation of the property and assets of the MS Entities; (v) prevent the encumbrance or disposal of property or assets of the MS Entities and the investors; (vi) preserve the books, records and documents of the MS Entities; (vii) be available to respond to investor inquiries; (viii) protect investors' assets; and (ix) determine whether the MS Entities should undertake bankruptcy filings.

6. Good and sufficient reasons have been shown why procedure other than by notice of motion is necessary.

7. This Court has jurisdiction over the subject matter of this action and over the

Defendants and Relief Defendant, and venue properly lies in this District.

**NOW, THEREFORE,**

**I.**

**IT IS HEREBY ORDERED** that the Defendants show cause, if there be any, to this Court at _____ __.m. on the _____ day of _____ 2010, in Room _____ of the James T. Foley United States Courthouse, 445 Broadway, Albany, NY 12207-2924, why this Court should not enter an Order pursuant to Rule 65 of the Federal Rules of Civil Procedure, Section 20 of the Securities Act, and Section 21 of the Exchange Act, Section 209(d) of the Advisers Act, and Section 42 of the Company Act preliminarily enjoining:

(1) MS & Co., MS Capital, FAIN, FEIN, FIIN, TAIN, McGinn and Smith from violating Sections 5(a) and 5(c) of the Securities Act, 15 U.S.C. §§ 77e(a) and 77e(c);

(2) MS & Co., MS Advisors, MS Capital, McGinn and Smith from violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and Exchange Act Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5;

(3) MS & Co., MS Advisors, McGinn and Smith from violating Sections 206(1), 206(2), and 206(4) of the Advisers Act, 15 U.S.C. §§ 80b-6(1) and (2), and Rule 206(4)-8 thereunder, 17 C.F.R. §275.206(4)-8;

(4) MS & Co., from violating Section 15(c)(1)(A) of the Exchange Act, 15 U.S.C. § 78(o)(1), and Smith and McGinn from aiding and abetting this violation; and,

(5) FAIN, FEIN, FIIN and TAIN from violating Section 7(a) of the Company Act, 15 U.S.C. § 80a-7.

**II.**

**IT IS FURTHER ORDERED** that the Defendants show cause at that time why this Court should not also enter an Order directing that, pending a final disposition of this action, the Defendants, the Relief Defendant, and each of their financial and brokerage institutions, officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, hold and retain within their control, and otherwise prevent, any withdrawal, transfer, pledge, encumbrance, assignment, dissipation, concealment or other disposal of any assets, funds, or other property (including money, real or personal property, securities, commodities, choses in action or other property of any kind whatsoever) of, held by, or under the direct or indirect control of the Defendants and Relief Defendant, including but not limited to, the MS Entities, including but not limited to, those entities listed on Exhibit A, whether held in any of their names or for any of their direct or indirect beneficial interest wherever situated, in whatever form such assets may presently exist and wherever located within the territorial jurisdiction of the United States courts, and directing each of the financial or brokerage institutions, debtors and bailees, or any other person or entity holding such assets, funds or other property of the Defendants and Relief Defendant to hold or retain within its or his control and prohibit the withdrawal, removal, transfer or other disposal of any such assets, funds or other properties including but not limited to, all assets, funds, or other properties held in the accounts listed on Exhibit B, as well as each real estate parcel owned directly or indirectly by the MS Entities, including but not limited to, those entities listed on Exhibit A.

**III.**

**IT IS FURTHER ORDERED** that the Defendants show cause at that time why this

Court should not also enter an Order enjoining and restraining them, and any person or entity acting at their direction or on their behalf, or any other person, from destroying, altering, concealing or otherwise interfering with the access of Plaintiff Commission and the receiver to any and all documents, books and records, that are in the possession, custody or control of the Defendants, and each of their officers, agents, employees, servants, accountants, financial or brokerage institutions, attorneys-in-fact, subsidiaries, affiliates, predecessors, successors and related entities, including but not limited to, the MS Entities, including but not limited to, those entities listed on Exhibit A, that refer, reflect or relate to the allegations in the Complaint, including, without limitation, documents, books, and records referring, reflecting or relating to the Defendants' finances or business operations.

**IV.**

**IT IS FURTHER ORDERED** that the Defendants show cause at that time why this Court should not also enter an Order directing each of the Individual Defendants to serve upon Plaintiff Commission, within three (3) business days, or within such extension of time as the Commission agrees to, a verified written accounting each signed by Defendants McGinn and Smith and also signed by the officer or employees of the Entity Defendants who are most knowledgeable about the assets, liabilities and general financial condition of each of the Defendants, and verified accountings signed by each of the Individual Defendants and the Relief Defendant identifying their own assets, liabilities and general financial condition, if any, under penalty of perjury. Each of the Defendants and Relief Defendant shall serve such sworn updated written accountings by hand delivery, facsimile transmission to (212) 336-1324 or overnight courier service on the Commission's counsel, David Stoelting, Esq., Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

**V.**

**IT IS FURTHER ORDERED** that Individual Defendants and Relief Defendant shall file with the Court and serve on the Commission, within three (3) business days following service of this Order, a list of all accounts at all banks, brokerage firms or financial institutions (including the name of the financial institution and the name and number on the account), tax identification numbers, telephone or facsimile transmission numbers (including numbers of pagers and mobile telephones), electronic mail addresses, World Wide Web sites or Universal Records Locators, Internet bulletin board sites, online interactive conversational spaces or chat rooms, Internet or electronic mail service providers, street addresses, postal box numbers, safety deposit boxes, and storage facilities used or maintained by them or under their direct or indirect control, at any time from January 1, 2005 to the present including but not limited to information concerning the MS Entities, including but not limited to, those entities listed on Exhibit A.

**VI.**

**IT IS FURTHER ORDERED** that the Defendants show cause at that time why this Court should not also enter an Order appointing or continuing the appointment of a receiver for the MS Entities and all entities they control or have an ownership interest in including but not limited to, those entities listed on Exhibit A, to (i) preserve the *status quo*, (ii) ascertain the extent of commingling of funds among the MS Entities; (iii) ascertain the true financial condition of the MS Entities and the disposition of investor funds; (iv) prevent further dissipation of the property and assets of the MS Entities and all entities they control or have an ownership interest in; (v) prevent the encumbrance or disposal of property or assets of the MS Entities and the investors; (vi) preserve the books, records and documents of the MS Entities;) (vii) be available to respond to investor inquiries; (viii) protect the assets of the MS Entities from further

dissipation; and (ix) determine whether the MS Entities should undertake bankruptcy filings.

To effectuate the foregoing, the receiver would be empowered to:

(a) Take and retain immediate possession and control of all of the assets and property, and all books, records and documents of the MS Entities including but not limited to, the entities listed on Exhibit A, and the rights and powers of it with respect thereto including the powers set forth in the management agreements and LLC agreements and/or operating agreements applicable to any LLCs or other property or entities owned or controlled by the Defendants;

(b) Have exclusive control of, and be made the sole authorized signatory for, all accounts at any bank, brokerage firm or financial institution that has possession or control of any assets or funds of the MS Entities including but not limited to, the entities listed on Exhibit A;

(c) Pay from available funds necessary business expenses required to preserve the assets and property of the MS Entities including but not limited to, the entities listed on Exhibit A, including the books, records, and documents of the MS Entities and all entities they control or have an ownership interest in, notwithstanding the asset freeze imposed by paragraph II, above;

(d) Take preliminary steps to locate assets that may have been conveyed to third parties or otherwise concealed;

(e) Take preliminary steps to ascertain the disposition and use of funds obtained by the Defendants resulting from the sale of securities issued by MS Entities including but not limited to, the entities listed on Exhibit A;

(f) Engage and employ persons, including accountants, attorneys and experts, to

assist in the carrying out of the receiver's duties and responsibilities hereunder;

(g) Report to the Court and the parties within 45 days from the date of the entry of this Order, subject to such reasonable extensions as the Court may grant, the following information:

1. All assets, money, funds, securities, and real or personal property then held directly or indirectly by or for the benefit of the MS Entities and all entities they control or have an ownership interest in, including but not limited to, real property, bank accounts, brokerage accounts, investments, business interests, personal property, wherever situated, identifying and describing each asset, its current location and value;

2. A list of secured creditors and other financial institutions with an interest in the receivership assets;

3. To the extent practicable, a list of investors in the MS Entities including but not limited to, the entities listed on Exhibit A;

(h) The receiver's preliminary plan for the administration of the assets of the receivership, including a recommendation regarding whether bankruptcy cases should be filed for all of a portion of the assets subject to the receivership and a recommendation whether litigation against third parties should be commenced on a contingent fee basis to recover assets for the benefit of the receivership.

**VII.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, MS & Co., MS Capital, FAIN, FEIN, FIIN, TAIN, McGinn and Smith and each of them, their agents, servants, employees, and

attorneys-in-fact, and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from, directly or indirectly, singly or in concert, in the offer or sale of any security, by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails to offer or sell securities through the use or medium of a prospectus or otherwise when no registrations statement has been filed or is in effect as to such securities and when no exemption from registration is available in violation of Sections 5(a) and 5(c) of the Securities Act.

**VIII.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, MS & Co., MS Advisors, MS Capital, and each of their financial and brokerage institutions, officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, are temporarily restrained from violating, directly or indirectly, 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, by using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of any security:

(a) to employ any device, scheme, or artifice to defraud;

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

**IX.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, MS & Co., MS Advisors, MS Capital, and each of their financial and brokerage institutions, officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

(a) to employ any device, scheme, or artifice to defraud;

(b) to obtain money or property by means of any untrue statement of a material fact or any omission of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

**X.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, MS & Co., and each of its officers,

agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from violating Section 15(c) of the Exchange Act, 15 U.S.C. § 78(o)(c), and 17 C.F.R. § 240.10b-3, by while acting as a broker or dealer, directly or indirectly, making use of the mails or any instrumentality of interstate commerce, or any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security otherwise than on a national exchange of which it is a member, by means of any manipulative, deceptive or other fraudulent device or contrivance, or to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included within the term "manipulative, deceptive or other fraudulent device or contrivance" as such term is used in Section 15(c)(1) of the Exchange Act.

**XI.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, the Individual Defendants, and each of their financial and brokerage institutions, officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from aiding and abetting any broker's or dealer's violations of Section 15(c) of the Exchange Act, 15 U.S.C. § 78(o)(c), by providing substantial assistance

to an individual or entity, which, while acting as a broker or dealer, directly or indirectly, makes use of the mails or any instrumentality of interstate commerce, or any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security otherwise than on a national exchange of which it is a member, by means of any manipulative, deceptive or other fraudulent device or contrivance, or to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included within the term "manipulative, deceptive or other fraudulent device or contrivance" as such term is used in Section 15(c)(1) of the Exchange Act.

**XII.**

**IT IS FURTHER ORDERED** that pending a hearing and determination of the Commission's Application for Preliminary Injunction, MS & Co., MS Advisors and each of their officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from violating Sections 206(1), 206(2) and 206(4) of the Advisers Act, 15 U.S.C. §§ 80b-6(1) and (2), and Rule 206(4)-8 thereunder, 17 C.F.R. §275.206(4)-8, while acting as an investment advisor, by the use of the mails or any means or instrumentality of interstate commerce, directly or indirectly to employ any device, scheme or artifice to defraud any client or prospective client; to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client; to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

**XIII.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for Preliminary Injunction, FAIN, FEIN, FIIN, and TAIN and each of their officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, who receive actual notice of this Order by personal service, facsimile service, or otherwise, are temporarily restrained from violating Section 7(a) of the Company Act, 15 U.S.C. § 80a-7, while acting as an investment company, shall directly or indirectly, offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce; purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the meals or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; control any investment company which does any of the acts enumerated above; engage in any business in interstate commerce; or control any company which is engaged in any business in interstate commerce.

**XIV.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for a Preliminary Injunction, the Defendants, and each of their

financial and brokerage institutions, officers, agents, servants, employees, attorneys-in-fact, and those persons in active concert or participation with them and all other persons or entities who receive actual notice of such Order by personal service, facsimile service or otherwise, and each of them, hold and retain within their control, and otherwise prevent, any withdrawal, transfer, pledge, encumbrance, assignment, dissipation, concealment or other disposal of any assets, funds, or other property (including money, real or personal property, securities, commodities, choses in action or other property of any kind whatsoever) of, held by, or under the direct or indirect control of the Defendants, including but not limited to, entities owned or controlled by, related to, or associated or affiliated with the MS Entities including but not limited to, those entities listed on Exhibit A, whether held in any of their names or for any of their direct or indirect beneficial interest wherever situated, in whatever form such assets may presently exist and wherever located within the territorial jurisdiction of the United States courts, and directing each of the financial or brokerage institutions, debtors and bailees, or any other person or entity holding such assets, funds or other property of the Defendants to hold or retain within its or his control and prohibit the withdrawal, removal, transfer or other disposal of any such assets, funds or other properties including but not limited to, all assets, funds, or other properties held in the accounts listed in Exhibt B, as well as each real estate parcel owned directly or indirectly by the MS Entities including but not limited to, those entities listed on Exhibit A.

**XV.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for a Preliminary Injunction, the Defendants, any person or entity acting at their direction or on their behalf, and any other third party including but not limited to any investor, be and hereby are enjoined and restrained from destroying, altering, concealing or

otherwise interfering with the access of Plaintiff Commission and the receiver to any and all documents, books, and records that are in the possession, custody or control of the Defendants and each of their respective officers, agents, employees, servants, accountants, financial or brokerage institutions, or attorneys-in-fact, subsidiaries, affiliates, predecessors, successors and related entities, including but not limited to, the MS Entities, that refer, reflect or relate to the allegations in the Complaint, including, without limitation, documents, books and records referring, reflecting or relating to the Defendants' finances or business operations, or the offer, purchase or sale of securities and the use of proceeds therefrom; and (2) ordered to provide all reasonable cooperation to the receiver in carrying out his duties set forth herein.

**XVI.**

**IT IS FURTHER ORDERED** that, pending a hearing and determination of the Commission's Application for a Preliminary Injunction, each of the Defendants shall file with this Court and serve upon Plaintiff Commission, within three (3) business days, or within such extension of time as the Commission agrees to, a verified written accounting signed by each of the Individual Defendants, and the officers or employees of the MS Entities who are most knowledgeable about the assets, liabilities and general financial condition of the each of the Defendants, if any, under penalty of perjury, of:

(1) All assets, liabilities and property currently held, directly or indirectly, by or for the benefit of each Defendant, including, without limitation, bank accounts, brokerage accounts, investments, business interests, loans, lines of credit, and real and personal property wherever situated, describing each asset and liability, its current location and amount;

(2) All money, property, assets and income received by each such Defendant for his

direct or indirect benefit from the other Defendants, at any time from January 1, 2005 through the date of such accounting, describing the amount, disposition and current location of each of the items listed;

(3) The names and last known addresses of all bailees, debtors, and other persons and entities that currently are holding the assets, funds or property of each Defendant; and

(4) All assets, funds, securities and real or personal property invested by each such Defendant, or any other person controlled by them, and the disposition of such assets, funds, securities, real or personal property.

Each Individual Defendant and the officers or employees of the Entity Defendants who are most knowledgeable about the assets, liabilities and general financial condition of the Defendants, if any, shall verify the Entity Defendant's accounting and serve such sworn statements of asset identifying information by hand delivery, facsimile transmission to (212) 336-1324 or overnight courier service on the Commission's counsel, David Stoelting, Esq., Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281. Each of the Individual Defendants is required to provide the Commission with an accounting for his own personal assets, liabilities and general financial condition, and also provide an accounting for each of the Entity Defendants. The Relief Defendant is required to provide the Commission with an accounting for her own personal assets, liabilities and general financial condition.

**XVII.**

**IT IS FURTHER ORDERED** that _____, pending further order of this Court, be and hereby is appointed to act as receiver for the MS Entities including

but not limited to, those entities listed on Exhibit A, to (1) preserve the *status quo*; (2) ascertain the true financial condition of the MS Entities and the disposition of investor funds; (3) determine the extent of commingling of funds between the MS Entities; (4) prevent further dissipation of the property and assets of the MS Entities; (5) prevent the encumbrance or disposal of property or assets of the MS Entities; (6) preserve the books, records and documents of the MS Entities; (7) be available to respond to investor inquiries; and (8) determine if the MS Entities and all entities they control or have an ownership interest in should undertake a bankruptcy filing. To effectuate the foregoing, the receiver is hereby empowered to:

(a) Take and retain immediate possession and control of all of the assets and property of the MS Entities including but not limited to, those entities listed on Exhibit A, and all books, records and documents of MS Entities, and the rights and powers of it with respect thereto;

(b) Have exclusive control of, and be made the sole authorized signatory for, all accounts at any bank, brokerage firm or financial institution that has possession or control of any assets or funds of MS Entities including but not limited to, those entities listed on Exhibit A;

(c) succeed to all rights to manage all properties owned or controlled, directly or indirectly, by the MS Entities, including but not limited to, those entities listed on Exhibit A, pursuant to the LLC and operating agreement relating to each entity;

(d) Pay from available funds necessary business expenses required to preserve the assets and property of MS Entities and all entities they control or have an ownership interest in, including the books, records, and documents of the Defendants, notwithstanding the asset freeze imposed above;

(e) Take preliminary steps to locate assets that may have been conveyed to third parties or otherwise concealed;

(f) Take preliminary steps to ascertain the disposition and use of funds obtained by the Defendants resulting from the sale of securities issued by the Defendants and the entities they control;

(g) Engage and employ persons, including accountants, attorneys and experts, to assist in the carrying out of the receiver's duties and responsibilities hereunder;

(h) Take all necessary steps to gain control of the Defendants' interests in assets in foreign jurisdictions, including but not limited to taking steps necessary to repatriate foreign assets; and

(i) Take such further action as the Court shall deem equitable, just and appropriate under the circumstances upon proper application of the receiver.

**XVIII.**

**IT IS FURTHER ORDERED** that no person or entity, including any creditor or claimant against any of the Defendants, or any person acting on behalf of such creditor or claimant, shall take any action without further order of this Court to interfere with the taking control, possession, or management of the assets, including but not limited to the filing of any lawsuits, liens or encumbrances or bankruptcy cases to impact the property and assets subject to this order.

**XIX.**

**IT IS FURTHER ORDERED** that the Defendants shall pay the reasonable costs, fees and expenses of the receiver incurred in connection with the performance of his duties described

herein, including but not limited to the reasonable costs, fees and expenses of all persons who may be engaged or employed by the receiver to assist him in carrying out his duties and obligations. All applications for costs, fees and expenses of the receiver and those employed by him shall be made by application to the Court setting forth in reasonable detail the nature of such costs, fees and expenses and shall conform to the Fee Guidelines that will be supplied by the U.S. Securities and Exchange Commission.

**XX.**

**IT IS FURTHER ORDERED** that discovery is expedited as follows: pursuant to Rules 26, 30, 31, 33, 34, 36 and 45 of the Federal Rules of Civil Procedure, and without the requirement of a meeting pursuant to Fed. R. Civ. P. 26(f), the parties and the receiver may:

(1) Take depositions, subject to two (2) calendar days' notice by facsimile or otherwise;

(2) Obtain the production of documents, within three (3) calendar days from service by facsimile or otherwise of a request or subpoena from any persons or entities, including non-party witnesses; and

(3) Service of any discovery requests, notices, or subpoenas may be made by personal service, facsimile, overnight courier, or first-class mail on an individual, entity or the individual's or entity's attorney; and

(4) The receiver may take discovery in this action without further order of the Court.

**XXI.**

**IT IS FURTHER ORDERED** that a copy of this Order and the papers supporting the Commission's Application be served upon the Defendants and Relief Defendant on or before _____, April ____2010, by personal delivery, facsimile, overnight courier, or first-class

mail.

**XXII.**

**IT IS FURTHER ORDERED** that the Defendants and Relief Defendant shall deliver any opposing papers in response to the Order to Show Cause above no later than _____, April____2010, at 4:00 p.m. Service shall be made by delivering the papers, using the most expeditious means available, by that date and time, to the New York Regional Office of the Commission at 3 World Financial Center, Room 4300, New York, New York 10281, Attn: David Stoelting Esq., or such other place as counsel for the Commission may direct in writing. The Commission shall have until _____, April___, 2010, at 5:00 p.m., to serve, by the most expeditious means available, any reply papers upon the Defendants and Relief Defendants, or upon their counsel, if counsel shall have made an appearance in this action.

**XXIII.**

**IT IS FURTHER ORDERED** that this Order shall be, and is, binding upon the Defendants and Relief Defendants and each of their respective officers, agents, servants, employees, attorneys-in-fact, subsidiaries, affiliates and those persons in active concert or participation with them who receive actual notice of this Order by personal service, facsimile service, or otherwise.

_____

UNITED STATES DISTRICT JUDGE

Issued at : _____: _____ __.m.
April __, 2010
Albany, New York

# EXHIBIT A

**Exhibit A**
**List of Known Entities Controlled By McGinn and/or Smith**

107th Associates LLC Trust 07
107th Associates LLC
74 State Street Capital LP
Acquisition Trust 03
Capital Center Credit Corporation
CMS Financial Services
Cruise Charter Ventures LLC dba YOLO Cruises
Cruise Charter Ventures Trust 08
First Advisory Income Notes LLC
First Commercial Capital Corp.
First Excelsior Income Notes LLC
First Independent Income Notes LLC
FirstLine Junior Trust 07
FirstLine Senior Trust 07
FirstLine Trust 07
Fortress Trust 08
Integrated Excellence Junior Trust
Integrated Excellence Junior Trust 08
Integrated Excellence Senior Trust
Integrated Excellence Senior Trust 08
IP Investors
James J. Carroll Charitable Fund
JGC Trust 00
KC Acquisition Corp.
KMB Cable Holdings LLC
Luxury Cruise Center, Inc.
Luxury Cruise Holdings, LLC
Luxury Cruise Receivables, LLC
M & S Partners
McGinn, Smith & Co.
McGinn, Smith Acceptance Corp.
McGinn, Smith Advisors
McGinn, Smith Alarm Trading
McGinn, Smith Asset Management Corp.
McGinn, Smith Capital Holdings
McGinn, Smith Capital Management LLC
McGinn, Smith Financial Services Corp.
McGinn, Smith FirstLine Funding LLC
McGinn, Smith Funding LLC
McGinn, Smith Group LLC
McGinn, Smith Holdings LLC
McGinn, Smith Independent Services Corp.
McGinn, Smith Licensing Co.

McGinn, Smith Transaction Funding Corp.
Mr. Cranberry LLC
MS Partners
MSFC Security Holdings LLC
NEI Capital LLC
Pacific Trust 02
Pine Street Capital Management LLC
Pine Street Capital Partners LP
Point Capital LLC
Prime Vision Communications LLC
Prime Vision Communication Management Keys Cove LLC
Prime Vision Communications of Cutler Cay LLC
Prime Vision Funding of Cutler Cove LLC
Prime Vision Funding of Key Cove LLC
RTC Trust 02
SAI Trust 00
SAI Trust 03
Security Participation Trust I
Security Participation Trust II
Security Participation Trust III
Security Participation Trust IV
Seton Hall Associates
TDM Cable Funding LLC
TDM Cable Trust 06
TDM Luxury Cruise Trust 07
TDM Verifier Trust 07
TDM Verifier Trust 07R
TDM Verifier Trust 08
TDM Verifier Trust 08R
TDM Verifier Trust 09
TDM Verifier Trust 11
TDMM Benchmark Trust 09
TDMM Cable Funding LLC
TDMM Cable Jr Trust 09
TDMM Cable Sr Trust 09
Third Albany Income Notes LLC
Travel Liquidators, LLC
White Glove Cruises LLC
White Glove LLC

# EXHIBIT B

# Exhibit B
## Known Bank Accounts

| Institution | Account Number | Name of Account Holder | Account Name 2 |
|---|---|---|---|
| Mercantile Bank | [redacted]1998 | 107th Assoc. LLC Trust 07 | |
| Mercantile Bank | [redacted]1987 | 107th Associates LLC | |
| M&T Bank | [redacted]6850 | 107th Associates LLC | |
| M&T Bank | [redacted]3478 | 74 State Street Capital LP | Operating |
| M&T Bank | [redacted]7062 | 74 State Street Capital LP | |
| M&T Bank | [redacted]5288 | Acquisition Trust 03 | Operating Account |
| Whitney National Bank | [redacted]9335 | Benchmark Communication LLC | |
| M&T Bank | [redacted]0805 | Capital Center Credit Corp | Operating |
| M&T Bank | [redacted]2250 | Capital Center Credit Corp | Careclub Depository, 99 Pine St |
| JPMorganChase | [redacted]6587 | Capital Center Credit Corp | Special Account Michael Lewy Attn: David Rees |
| NFS/Fidelity | [redacted]8178 | Capital Center Credit Corp | C/O MCGINN SMITH & CO INC ATTN DAVID P REES |
| JPMorganChase | [redacted]4817 | Capital Center Credit Corp c/o McGinn Smith & Co | |
| Monterey Bank | [redacted]6854 | Charter Cruise Ventures | dba YOLO Cruises |
| M&T Bank | [redacted]3133 | CMS Financial | |
| M&T Bank | [redacted]6985 | CMS Financial Services Corp. | |
| M&T Bank | [redacted]2064 | CMS Financial Services Corp. | |
| Monterey Bank | [redacted]6846 | Cruise Charter Ventures | dba YOLO Cruises |
| Mercantile Bank | [redacted]3972 | Cruise Charter Ventures LLC | |
| Mercantile Bank | [redacted]1307 | Cruise Charter Ventures LLC | |
| Mercantile Bank | [redacted]2808 | Cruise Charter Ventures Trust 08 | |
| M&T Bank | [redacted]3528 | First Advisory Income Notes | Operating |
| M&T Bank | [redacted]7489 | First Advisory Income Notes | Escrow |
| M&T Bank | [redacted]9147 | First Excelsior Income Notes LLC | Alarm Accum Account |
| M&T Bank | [redacted]9139 | First Excelsior Income Notes LLC | Operating |
| Charter One Bank | [redacted]863-8 | First Excelsior Income Notes LLC | Escrow |
| JPMorganChase | [redacted]6928 | First Excelsior Income Notes LLC | |
| NFS/Fidelity | [redacted]9280 | First Excelsior Income Notes LLC | |
| M&T Bank | [redacted]6013 | First Independent Income Notes | Operating |
| M&T Bank | [redacted]9279 | First Independent Income Notes | Monitoring Contract Accum |
| Charter One Bank | [redacted]003-6 | First Independent Income Notes | Timothy McGinn |
| JPMorganChase | [redacted]6893 | First Independent Income Notes | |
| JPMorganChase | [redacted]0087 | First Independent Income Notes | |
| NFS/Fidelity | [redacted]8934 | First Independent Income Notes | |
| Mercantile Bank | [redacted]1921 | FirstLine Senior Trust 07 DTD 5/19/07 | McGinn Smith Capital Holdings Corp. TTEE |
| M&T Bank | [redacted]5028 | FirstLine Sr Trust 07 | |
| M&T Bank | [redacted]5366 | FirstLine Sr Trust 07 Series B | |
| Mercantile Bank | [redacted]0733 | FirstLine Sr Trust 07 Series B | McGinn Smith & Co Inc Trustee |
| M&T Bank | [redacted]5010 | FirstLine Trust 07 | |
| Mercantile Bank | [redacted]1910 | FirstLine Trust 07 DTD 5/19/07 | McGinn Smith Capital Holdings Corp. TTEE |
| Mercantile Bank | [redacted]0722 | FirstLine Trust 07 Series B | McGinn Smith & Co Inc Trustee, UAD 10/16/07 |
| M&T Bank | [redacted]5358 | FirstLine Trust 07 Series B | |
| M&T Bank | [redacted]6413 | Fortress Trust 08 | c/o McGinn Smith Capital Holdings Corp. |
| Mercantile Bank | [redacted]9187 | Fortress Trust 08 UTD 9/10/08 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6165 | Integrated Excellence Jr Trust | |
| Mercantile Bank | [redacted]3994 | Integrated Excellence Jr Trust 08 DTD 5/28/08 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6173 | Integrated Excellence Sr Trust | |

**Exhibit B**

**Known Bank Accounts**

| Institution | Account Number | Name of Account Holder | Account Name 2 |
|---|---|---|---|
| Mercantile Bank | [redacted]3983 | Integrated Excellence Sr Trust 08 DTD 5/27/08 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6868 | IP Investors LLC | |
| M&T Bank | [redacted]3783 | James J. Carroll Charitable Fund | |
| M&T Bank | [redacted]6815 | JGC Trust 00 | Operating c/o McGinn Smith |
| Mercantile Bank | [redacted]1674 | Luxury Cruise Center Inc | |
| Mercantile Bank | [redacted]0446 | Luxury Cruise Center Inc | |
| Mercantile Bank | [redacted]0435 | Luxury Cruise Charter Inc. Payables | |
| M&T Bank | [redacted]3996 | M&S Partners | |
| JPMorganChase | [redacted]3443 | McGinn Smith & Co | |
| JPMorganChase | [redacted]5670 | McGinn Smith & Co | |
| NFS/Fidelity | [redacted]0167 | MCGINN SMITH & CO DELIGIANNIS MASTER ACCOUNT | |
| NFS/Fidelity | [redacted]0035 | MCGINN SMITH & CO AVERAGE PRICE ACCOUNT | |
| JPMorganChase | [redacted]4300 | McGinn Smith & Co Capital A/C | |
| JPMorganChase | [redacted]4302 | McGinn Smith & Co Corporate Bond A/C Attn: David Rees | |
| JPMorganChase | [redacted]4306 | McGinn Smith & Co Deposit Account Attn: David Rees | |
| JPMorganChase | [redacted]4305 | McGinn Smith & Co Error Account Attn: David Rees | |
| JPMorganChase | [redacted]4301 | McGinn Smith & Co Firm Trading A/C Attn: David Rees | |
| JPMorganChase | [redacted]4303 | McGinn Smith & Co Govt Bond A/C Attn: David Rees | |
| NFS/Fidelity | [redacted]1007 | MCGINN SMITH & CO INC | |
| NFS/Fidelity | [redacted]0051 | MCGINN SMITH & CO INC ALBANY BTAM $ DIFFERENCE | |
| NFS/Fidelity | [redacted]0043 | MCGINN SMITH & CO INC ALBANY BTAM MASTER ACCOUNT | |
| NFS/Fidelity | [redacted]1007 | MCGINN SMITH & CO INC DAVID L SMITH | |
| NFS/Fidelity | [redacted]0175 | MCGINN SMITH & CO INC DELIGIANNIS $ DIFFERENCE | |
| NFS/Fidelity | [redacted]0086 | MCGINN SMITH & CO INC NYC BTAM UNALLOCATED | |
| NFS/Fidelity | [redacted]0728 | MCGINN SMITH & CO INC REVENUE ACCOUNT | |
| NFS/Fidelity | [redacted]0060 | MCGINN SMITH & CO INC ALBANY BTAM UNALLOCATED | |
| NFS/Fidelity | [redacted]0205 | MCGINN SMITH & CO INC BOYLAN $ DIFFERENCE | |
| NFS/Fidelity | [redacted]0191 | MCGINN SMITH & CO INC BOYLAN MASTER ACCOUNT | |
| NFS/Fidelity | [redacted]0183 | MCGINN SMITH & CO INC DELIGIANNIS UNALLOCATED | |
| NFS/Fidelity | [redacted]0116 | MCGINN SMITH & CO INC ERROR ACCOUNT | |
| NFS/Fidelity | [redacted]0230 | MCGINN SMITH & CO INC RABINOVICH $ DIFFERENCE | |
| NFS/Fidelity | [redacted]0221 | MCGINN SMITH & CO INC RABINOVICH MASTER ACCOUNT | |
| NFS/Fidelity | [redacted]0248 | MCGINN SMITH & CO INC RABINOVICH UNALLOCATED | |

**Exhibit B**

**Known Bank Accounts**

| Institution | Account Number | Name of Account Holder | Account Name 2 |
|---|---|---|---|
| NFS/Fidelity | [redacted]0140 | MCGINN SMITH & CO INC SANCHIRICO $ DIFFERENCE | |
| NFS/Fidelity | [redacted]0132 | MCGINN SMITH & CO INC SANCHIRICO MASTER ACCOUNTS | |
| NFS/Fidelity | [redacted]0159 | MCGINN SMITH & CO INC SANCHIRICO UNALLOCATED | |
| NFS/Fidelity | [redacted]0108 | MCGINN SMITH & CO INC SYNDICATE ACCOUNT | |
| JPMorganChase | [redacted]4304 | McGinn Smith & Co Municipal Bond Account Attn: David Rees | |
| JPMorganChase | [redacted]9815 | McGinn Smith & Co Reserve A/C Residual Bal | |
| NFS/Fidelity | [redacted]0019 | MCGINN SMITH & CO RISKLESS PRINCIPAL | |
| JPMorganChase | [redacted]4307 | McGinn Smith & Co Syndicate A/C | |
| M&T Bank | [redacted]1081 | McGinn Smith & Company | Dividend |
| M&T Bank | [redacted]4734 | McGinn Smith & Company | |
| M&T Bank | [redacted]3569 | McGinn Smith Advisors LLC | |
| M&T Bank | [redacted]5044 | McGinn Smith Alarm Trading LLC | |
| M&T Bank | [redacted]4351 | McGinn Smith Capital Holdings | MSCH Paying Agent for Vidsoft Inc. |
| M&T Bank | [redacted]3551 | McGinn Smith Capital Holdings | Payment Agent for Vigilant Privacy Corp. |
| M&T Bank | [redacted]8803 | McGinn Smith Capital Holdings | |
| JPMorganChase | [redacted]3573 | McGinn Smith Capital Holdings | |
| NFS/Fidelity | [redacted]5734 | MCGINN SMITH CAPITAL HOLDINGS | |
| M&T Bank | [redacted]5783 | McGinn Smith Capital Holdings Corp | Hannan Reserve Account |
| Mercantile Bank | [redacted]1635 | McGinn Smith Funding LLC | |
| Monterey Bank | [redacted]6838 | McGinn Smith Funding LLC | |
| M&T Bank | [redacted]8925 | McGinn Smith Holdings LLC | |
| NFS/Fidelity | [redacted]2944 | MCGINN SMITH INCENTIVE PL CUST IRA OF TIMOTHY MCGINN | |
| JPMorganChase | [redacted]3246 | McGinn Smith Incentive Savings Plan | |
| Mercantile Bank | [redacted]9022 | McGinn Smith Independent Services Corp | |
| M&T Bank | [redacted]6975 | McGinn Smith Independent Services Corp | |
| M&T Bank | [redacted]5051 | McGinn Smith Licensing Company LLC | |
| Mercantile Bank | [redacted]3083 | McGinn Smith Transaction Funding Corp | |
| M&T Bank | [redacted]6207 | McGinn Smith Transaction Funding Corp | |
| Mercantile Bank | [redacted]8857 | McGinn Smith Transaction Funding Corp | 2nd Offering Account |
| M&T Bank | [redacted]5036 | McGinn Smith Acceptance Corp | |
| JPMorganChase | [redacted]0294 | McGinn, Tim (Union Bank of California Cust Adams Keegan Retirement Svgs Plan, FBO Tim McGinn A/C # [redacted]5003) | |
| NFS/Fidelity | [redacted]2745 | McGinn, Timothy M. | |
| M&T Bank | [redacted]2675 | McGinn, Timothy M. | |
| M&T Bank | [redacted]9504 | McGinn, Timothy M. | |
| Mercantile Bank | [redacted]2171 | MR Cranberry LLC | c/o Timothy McGinn |
| NFS/Fidelity | [redacted]4272 | MR Cranberry LLC | |
| M&T Bank | [redacted]6421 | MSFC Security Holdings LLC | |
| Mercantile Bank | [redacted]9220 | NEI Capital LLC | |
| M&T Bank | [redacted]5833 | Pacific Trust 02 | Operating |
| M&T Bank | [redacted]9626 | Pine Street Capital Management LLC | |
| M&T Bank | [redacted]5478 | Pine Street Capital Partners | |
| M&T Bank | [redacted]9535 | Pine Street Capital Partners LP | Operating |
| Mercantile Bank | [redacted]9687 | Prime Vision Communication Mgmt Keys Cove LLC | c/o McGinn Smith & Co |
| Bank of Florida | [redacted]5976 | Prime Vision Communications LLC | |

**Exhibit B**

**Known Bank Accounts**

| Institution | Account Number | Name of Account Holder | Account Name 2 |
|---|---|---|---|
| Mercantile Bank | [redacted]9698 | Prime Vision Communications of Cutler Cay LLC | c/o McGinn Smith & Co |
| Mercantile Bank | [redacted]9518 | Prime Vision Funding of Cutler Cove LLC | c/o McGinn Smith & Co |
| Mercantile Bank | [redacted]9529 | Prime Vision Funding of Key Cove LLC | c/o McGinn Smith & Co |
| M&T Bank | [redacted]5767 | RTC Trust 02 | Accum |
| M&T Bank | [redacted]5775 | RTC Trust 02 | Operating |
| JPMorganChase | [redacted]6792 | RTC Trust II | |
| M&T Bank | [redacted]3635 | SAI Trust 00 | |
| Charter One Bank | [redacted]323-3 | SAI Trust 00 | |
| M&T Bank | [redacted]8966 | SAI Trust 03 | Jr |
| M&T Bank | [redacted]4620 | SAI Trust 03 | Sr |
| M&T Bank | [redacted]7729 | Security Participation Trust I | |
| M&T Bank | [redacted]9410 | Security Participation Trust II | Accum |
| M&T Bank | [redacted]9288 | Security Participation Trust II | Operating |
| M&T Bank | [redacted]8123 | Security Participation Trust III | Operating |
| M&T Bank | [redacted]8115 | Security Participation Trust III | Accum |
| M&T Bank | [redacted]5460 | Security Participation Trust IV | |
| Charter One Bank | [redacted]023-6 | Security Participation Trust Oper | |
| M&T Bank | [redacted]4492 | Seton Hall Associates | McGinn & Smith |
| NFS/Fidelity | [redacted]2208 | Smith, David L. | |
| M&T Bank | [redacted]9965 | Smith, David L. | |
| NFS/Fidelity | [redacted]0916 | Smith, Lynn A. | |
| NFS/Fidelity | [redacted]0912 | Smith, Lynn A. | |
| Bank of America | | Smith, Lynn A. | |
| Mercantile Bank | [redacted]9507 | TDM Cable Funding LLC | c/o McGinn Smith & Co |
| Mercantile Bank | [redacted]9573 | TDM Cable Funding LLC / TDM Cable Trust 06 | c/o McGinn Smith & Co |
| M&T Bank | [redacted]4765 | TDM Cable Funding LLC TDM Verifier Trust 07 Operating | TDM Verifier Trust 07 Operating |
| M&T Bank | [redacted]4500 | TDM Cable Funding LLC Trust 06 Account | Trust 06 Account |
| M&T Bank | [redacted]5234 | TDM Luxury Cruise Trust 07 | |
| Mercantile Bank | [redacted]2086 | TDM Luxury Cruise Trust 07 DTD 7/16/07 | McGinn Smith Capital Holdings Corp - TTEE |
| Mercantile Bank | [redacted]1437 | TDM Verifier Trust 07 | Escrow |
| Mercantile Bank | [redacted]4216 | TDM Verifier Trust 07R | |
| M&T Bank | [redacted]5738 | TDM Verifier Trust 08 | |
| Mercantile Bank | [redacted]1030 | TDM Verifier Trust 08 DTD 12/11/07 | McGinn Smith Capital Holdings Corp - TTEE |
| Mercantile Bank | [redacted]9132 | TDM Verifier Trust 08R DTD 12/11/07 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6736 | TDM Verifier Trust 09 | |
| Mercantile Bank | [redacted]4007 | TDM Verifier Trust 09 DTD 12/15/08 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]7064 | TDM Verifier Trust 11 | |
| M&T Bank | [redacted]0409 | TDM Verifier Trust 11 | |
| M&T Bank | [redacted]7056 | TDMM Benchmark Trust 09 | |
| Mercantile Bank | [redacted]9077 | TDMM Cable Funding LLC | |
| Mercantile Bank | [redacted]4139 | TDMM Cable Jr Tr 09 DTD 1/16/09 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6728 | TDMM Cable Jr Trust 09 | |
| Mercantile Bank | [redacted]4150 | TDMM Cable Sr Tr 09 DTD 1/16/09 | McGinn Smith Capital Holdings Corp - TTEE |
| M&T Bank | [redacted]6710 | TDMM Cable Sr Trust 09 | |
| M&T Bank | [redacted]5462 | Third Albany Income Notes | Escrow |
| NFS/Fidelity | [redacted]9884 | Third Albany Income Notes | |
| M&T Bank | [redacted]9550 | Third Albany Income Notes | Operating |
| M&T Bank | [redacted]3593 | Third Albany Income Notes | Alarm Accum |
| JPMorganChase | [redacted]6988 | Third Albany Income Notes | |

**Exhibit B**

**Known Bank Accounts**

| Institution | Account Number | Name of Account Holder | Account Name 2 |
|---|---|---|---|
| NFS/Fidelity | [redacted]9671 | [redacted] TTEE David L Smith & Lynn A Smith, Irrev Tr U/A [redacted]04 | |

**GEORGE S. CANELLOS**
**REGIONAL DIRECTOR**
**David Stoelting**
**Kevin McGrath**
**Michael Paley**
**Lara Shalov Mehraban**
**Linda Arnold**
**Attorneys for Plaintiff**
**SECURITIES AND EXCHANGE COMMISSION**
**New York Regional Office**
**3 World Financial Center, Room 400**
**New York, NY 10281-1022**
**(212) 336-0174 (Stoelting)**

**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| **SECURITIES AND EXCHANGE COMMISSION,** | |
| ***Plaintiff,*** | |
| ***v.*** | **10 Civ. _____ (___)** |
| **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,** | |
| ***Defendants, and*** | |
| **LYNN A. SMITH,** | |
| ***Relief Defendant.*** | |

**PLAINTIFF'S MEMORANDUM OF LAW IN SUPPORT OF APPLICATION FOR EMERGENCY RELIEF**

## TABLE OF CONTENTS

Plaintiff Securities and Exchange Commission respectfully submits this memorandum of law in support of its emergency application to stop an ongoing fraud being perpetuated by defendants Timothy McGinn ("McGinn"), David Smith ("Smith"), McGinn Smith & Co. ("MS & Co."), McGinn Smith Advisors LLC ("MS Advisors"), McGinn Smith Capital Holdings ("McGinn Smith Capital"), First Advisory Income Notes, LLC ("FAIN"), First Excelsior Income Notes, LLC ("FEIN"), First Independent Income Notes, LLC ("FIIN"), and Third Albany Income Notes, LLC ("TAIN") (collectively the "Defendants"), and to recover proceeds of the fraud received by relief defendant Lynn. A. Smith.

## PRELIMINARY STATEMENT

Since 2003, McGinn and Smith, through the various entities they control, have raised more than $120 million by selling securities in the form of notes and certificates to hundreds of investors in more than 20 unregistered debt offerings. A new offering has taken place as recently as December 2009, and McGinn and Smith appear to be continuing to solicit investors for new and existing offerings. Investors are currently owed more than $85 million in principal, but there are few liquid assets available.

As a result, the Commission seeks emergency relief to protect investors and preserve the status quo, including an asset freeze over all assets controlled by the Defendants and the Relief Defendant. In addition, the Court should appoint a Receiver to take immediate possession of the assets of the Defendants and the Relief Defendant, locate additional assets, and take other actions to preserve the status quo. The Commission also seeks verified accountings, expedited discovery, and an injunction against further violations.

## STATEMENT OF FACTS

The evidence supporting this emergency application is set forth in the Appendix of Exhibits in Support of Emergency Application (Volumes 1-4), the Decl. of Israel Maya executed

on April 19, 2010 ("Maya Decl."), the Decl. of Lara Shalov Mehraban executed on April 19, 2010 ("Mehraban Decl."), and the Decl. of Roseann Danielo executed on April 19, 2010.

This evidence is summarized below.

**The Four Fund Offerings**

Between September 2003 and October 2005, MS & Co. acted as the placement agent for four unregistered debt offerings by the Funds, raising a total of $106 million. Mehraban Decl. at ¶ 2. Smith reviewed and approved the private placement memoranda ("PPMs") by which the investments were marketed and sold to investors, and made the majority of investment decisions for the Funds. Mehraban Decl. at ¶ 5. The Funds each had approximately 150 to 300 investors. Maya Decl. at ¶ 20. Even though MS & Co. did not register the Funds as investment companies, each Fund invested more than 40% of its assets in securities, including unsecured loans by the Funds to affiliates as well as various equities. Mehraban Decl. at ¶ 12.

The Four Funds from the beginning earned minimal investment income, generating only $13 million in income and expenses of $37 million, for a combined loss, since inception, of approximately $24 million. Defendants also made numerous fraudulent misrepresentations and omissions in connection with the Fund offerings, including false statements about: (1) the diversity of investments within each Fund and among the Funds; (2) the level of due diligence performed by product and industry professionals; (3) underwriting by top-tier investment banking firms; and (4) the notes being offered only to accredited investors. The PPMs did not disclose that the Funds' primary purpose was to satisfy the liquidity needs of other non-performing MS Entities. Mehraban Decl. at ¶ 7. Moreover, several investors told the Commission staff that MS & Co. did not provide them with a PPM prior to their investment.

Mehraban Decl. at ¶ 11. In addition, MS & Co. apparently downplayed the level of risk in its other communications to investors. Mehraban Decl. at ¶ 8.

Even after acknowledging the dire condition of the Funds in 2008 letters, Smith and McGinn and MS Advisors continued to siphon off as "fees" much of the remaining moneys in the Funds. MS & Co. also continued to sell and roll investors' notes in these Funds, including junior notes, as recently as April 28, 2009. Internal MS & Co. documents show $3.6 million in new and rollover investments in the Funds during 2008 and 2009, including by customers of Smith. Maya Decl. at ¶ 34.

**The Trust Offerings**

Since November 2006, MS & Co. has created numerous trusts that have raised at least $23 million. Some of the trusts have conducted two offerings. MS Capital has been the trustee for each trust, and MS & Co. has been the placement agent for each offering. Whereas Smith made most investment decisions for the Funds, McGinn was generally responsible for managing the investments of the Trusts.

The Trusts issued one or two classes of securities with promised interest rates ranging from 7.75% to 13% *per annum*, and stated that interest would be paid at the maturity date, which varied from about 18 months to over 5 years from the date of the offering. Mehraban Decl. at ¶ 17. The Trust PPMs stated that each Trust was created for a highly specific purpose, *i.e.*, to purchase specific contracts and/or receivables related to long-term contracts for burglar alarm services or "triple play" (broadband, cable and phone) services, or the sale of luxury cruise cabins.

In general, the structure of the Trusts was to use the funds raised by the offering (minus substantial fees) to make a loan to another MS Entity, which would then use the funds (minus

substantial additional fees) to purchase these specific contracts or receivables. (Mehraban Decl. at ¶ 18. This allowed McGinn and Smith to obscure the use of the offering proceeds, which they often misappropriated for their own benefit or used to loan funds to other MS Entities. The misappropriation of Trust monies included, among other things: (1) overpayments to themselves for sham services, (2) payments to members of their families, and (3) payments to meet payroll expenses for MS & Co. Mehraban Decl. at ¶ ¶ 21 to 26.

The fees structure was not adequately explained in the PPMs. For example, one PPM disclosed on the cover page that MS & Co. would receive a maximum of 8% of the offering proceeds. The PPM later disclosed, however, that MS & Co. would indirectly receive -- through other MS Entities for dubious or non-existent services -- an additional 26% of the offering proceeds, for a total of 34%, or $1,050,000 of the total $3,000,000 raised by the offering. Mehraban Decl. at ¶ 29.

The Trusts PPMs also contained material misrepresentations and omissions concerning the use of monies raised For example, McGinn and Smith knew, or should have known, that the promised interest payments were not achievable given the exorbitant fees paid to MS & Co. and the misappropriation of offering proceeds. The PPMs did not disclose that the monies raised by the Trusts would be used to make interest payments to investors in other MS Entities; certain material conflicts of interest; and that monies raised would be used to charter a ship and pay other expenses, including procuring strippers to entertain passengers for a sexually-themed cruise and that investor money would be used to buy insurance for them Mehraban Decl. at ¶ 45. In at least one example (Firstline), MS & Co. continued to raise funds for an offering even after the entity that was the intended beneficiary of the funds raised filed for bankruptcy. Maya Decl. at ¶ 51.

**The Financial Condition of the MS Entities Has Continued To Deteriorate**

Although Smith and McGinn have concealed their disastrous financial condition from investors, internal emails and documents reveal the MS Entities' dire liquidity crisis. See Mehraban Decl. ¶¶ 54 to 85. The evidence marshaled by the Commission details McGinn and Smith's efforts to use any cash available to satisfy the MS Entities' most pressing funding needs -- often the demands of a large or complaining investor or to meet the firm's payroll -- and to disguise the use of the funds by channeling money through an intermediate MS Entities. Finally, the Relief Defendant, Lynn Smith, has received the proceeds of Fund and Trust offerings for no apparent consideration. Daniello Decl. ¶ 25.

## ARGUMENT

### I. DEFENDANTS SHOULD BE TEMPORARILY RESTRAINED AND PRELIMINARILY ENJOINED FROM FURTHER VIOLATIONS OF THE FEDERAL SECURITIES LAWS

Section 20(b) of the Securities Act, 15 U.S.C. § 77t(b), and Section 21(d) of the Exchange Act, 15 U.S.C. § 78u(d), entitle the Commission to temporary and injunctive relief against future securities law violations upon a "substantial showing of likelihood of success as to both a current violation and the risk of repetition." *SEC v. Cavanagh*, 155 F.3d 129, 132 (2d Cir. 1998). Because the Commission is "not . . . an ordinary litigant, but . . . a statutory guardian charged with safeguarding the public interest in enforcing the securities laws," its burden to secure temporary or preliminary relief is less than that of a private party. *SEC v. Mgmt. Dynamics, Inc.*, 515 F.2d 801, 807 (2d Cir. 1975). It need not show irreparable injury, a balance of equities in its favor, or the unavailability of remedies at law. *Id.* at 808; *SEC v. Bonastia*, 614 F.2d 908, 912 (3d Cir. 1980); *SEC v. Graystone Nash, Inc.*, 820 F. Supp. 863, 875 n.13 (D.N.J. 1993), *rev'd on other grounds*, 25 F.3d 187 (3d Cir. 1994). Instead, the Commission need only make a "proper showing" of violative activity to obtain a temporary restraining order or

preliminary injunction against statutory violations. *See SEC v. Cavanagh*, 155 F.3d 129, 132 (2d Cir. 1998); *Mgmt. Dynamics*, 515 F.2d at 807; *Bonastia*, 614 F.2d at 912 ("reasonable likelihood" of repetition must be shown).

The Commission meets this standard without difficulty under these circumstances. MS & Co., MS Capital, the Funds, McGinn and Smith violated the registration provisions of the Securities Act; MS & Co., MS Advisors, MS Capital, McGinn and Smith violated the antifraud provisions of the Securities Act and Exchange Act; MS & Co., MS Advisors, McGinn and Smith violated the antifraud provisions of the Advisers Act; MS & Co. violated the broker-dealer antifraud provisions of the Exchange Act, and McGinn and Smith aided and abetted these violations; and the Funds violated the registration provisions of the Investment Company Act. Many of the acts underlying the violations are ongoing and, if a temporary restraining order is not entered, the Defendants' ongoing scheme will continue to harm existing investors and may ensnare new victims.

### A. The Commission Has Made a Substantial Showing that The Defendants Have Violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any security to (1) employ any device, scheme, or artifice to defraud; or (2) to obtain money or property by means of an untrue statement of a material fact or omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit the same conduct in connection with the purchase or sale of securities.

To establish a violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5, the Commission must show: (1) a materially false or misleading statement or omission, (2) in connection with the purchase or sale (for purposes of the Exchange Act), or in the offer or sale (for the purposes of Securities Act), of securities, and (3) scienter.[1] *See, e.g., SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *Basic, Inc. v. Levinson*, 485 U.S. 224, 235 n.13 (1988).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic,* 485 U.S. at 231. "Scienter" is a "mental state embracing the intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder, et al.,* 425 U.S. 185, 193, n. 12 (1976). In the Second Circuit, scienter is established by knowing or reckless conduct. *E.g., Novak v. Kasaks*, 216 F.3d 300 (2d Cir. 2000).

MS & Co., MS Advisors, MS Capital, Smith and McGinn engaged in a practice and course of business that operated as a fraud and deceit upon investors. Specifically, since at least 2005, the Defendants have marketed notes in the Funds and certificates in the Trusts with promises of attractive interest rates while knowing that the proceeds would be used in a manner that could not support the promoted rates of return and that would waste principal. Among other things, investors' money was used without their knowledge to pay "interest" to other investors; make loans to McGinn and Smith individually; pay excessive and unauthorized fees MS Entities; make loans to MS & Co. affiliates; and to make other unauthorized payments contrary to investors' interests.

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[1] The Commission must establish scienter to prove violations of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5. *See Aaron v. SEC,* 446 U.S. 680 (1980). A showing of negligence is sufficient to establish a violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act. *Aaron v. SEC*, 446 U.S. at 695.

The scheme required that MS & Co. continue to create new Trusts charging increasingly greater up-front fees, and to make false promises of returns, in order to continue making interest obligations for existing investors, meet MS & Co.'s payroll, pay other business and personal expenses for Smith and McGinn, and otherwise keep the scheme from unraveling.

The Fund PPMs contained material misrepresentations and omissions by, among other things: (1) misleading investors about the diversity of investments in the Funds; (2) falsely stating that the notes were being offered only to accredited investors; (3) failing to disclose that the primary purpose of the Funds was to satisfy the liquidity needs of other MS & Co. affiliates; and (4) failing to disclose that MS & Co. and MS Advisors would consistently put the needs of the MS Entities ahead of the Fund investors' interests.

The Trust PPMs contained material omissions, including, among other things, failing to disclose: that the monies would be commingled with the proceeds of other offerings; various conflicts of interest arising from the use of investment proceeds to fund affiliated entities; that MS Capital would divert monies from new investors to make the interest payments and return of principal to earlier Trust investors, to make payroll and cover expenses for MS & Co.; and that investors were unlikely to get their principal back unless MS & Co was successful in raising new funds based on similar false promises. A number of the Trust PPMs also contained misrepresentations that "all parties endeavor to operate at arm's length." But. given the exorbitant fees earned and the amount of loans to insolvent affiliates of MS & Co., the Defendants were not operating at arm's length.

These misstatements and omissions were material, and concerned the very nature of the investment. The fact that a business is a Ponzi scheme -- where profits cannot meet current obligations to investors, where new investors are funding payments to old investors, and where

investors will lose their money if the source of new funds dries up -- is material information. *See SEC v. Better Life Club of America*, 995 F. Supp. 167, 176-77 (D.D.C. 1998) (entire solicitation for pyramid scheme "was itself a broad misrepresentation on the grandest scale"); *SEC v. Research Automation Corp.*, 585 F.2d 31, 35-36 (2d Cir. 1978) (misleading statements and omissions concerning the use of money raised from investors are material as matter of law).

MS & Co., MS Capital, MS Advisors, Smith and McGinn each made material misrepresentations or omissions, and engaged in acts of deception, in furtherance of the scheme. The false statements in the Fund PPMs, issued by MS & Co, can be attributed to Smith. Each PPM stated that all inquiries relating to the notes should be directed to Smith. Smith was president of MS & Co. He also controlled MS Advisors, the sole and managing member of each of the Funds. Smith also admitted in his FINRA testimony that he reviewed the Fund PPMs and provided comments.

McGinn and Smith (as well as MS & Co., MS Capital and MS Advisors, which were all controlled by McGinn and Smith) acted with the requisite scienter because, among other things, they personally directed the Funds' and Trusts' use of proceeds, and therefore must have known that the offering proceeds were not being used for the purposes told to investors.[2]

### B. The Commission Has Made a Substantial Showing that MS & Co., MS Capital, the Funds, McGinn and Smith Violated Sections 5(a) and 5(c) of the Securities Act.

Sections 5(a) and 5(c) of the Securities Act make it unlawful for any person, directly or indirectly, to use the mails or other means of interstate commerce to sell or to offer to sell a security for which a registration statement is not on file or in effect, absent an available

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[2] The knowledge of individuals who exercise substantial control over a corporation's operation is properly imputed to the corporation. *In re Sunbeam Sec. Litig.*, 89 F. Supp. 2d 1326, 1340 (S.D. Fla. 1999).

exemption. Scienter is not an element of a Section 5 violation. *See SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 859-60, *aff'd*, 159 F.3d 1348 (2d Cir. 1998). To establish a *prima facie* case of a Section 5 violation, the Commission must show that: (1) a person, directly or indirectly, sold or offered to sell securities; (2) no registration statement was filed or in effect; and (3) interstate means were used in connection with the offer or sale. *See, e.g., SEC v. Continental Tobacco Co. of South Carolina, Inc.*, 463 F.2d 137, 155-56 (5th Cir. 1972).

Here, MS& Co., MS Capital, the Funds, McGinn and Smith violated Sections 5(a) and 5(c) because they: (1) offered and sold notes issued by the Funds and certificates issued by the Trusts, which are "securities"; (2) for which no registration statements had been filed; and (3) they used interstate means by, among other things, using the mails to send offering materials to investors throughout the United States.

As an initial matter, the notes issued by the Funds and the certificates issued by the Trusts were securities under *SEC v. Reves*, 494 U.S. 56, 64-67 (1990), where the Supreme Court held that notes are presumed to be securities under the Securities Act and Exchange Act, but that such presumption could be rebutted where the notes fall into certain judicially created categories that are plainly not securities or the notes bear a "family resemblance" to the notes in those categories. The Court outlined four factors to consider in making this determination: (1) the motivations that would prompt a reasonable seller and buyer to enter into a transaction; (2) the plan of distribution of the instrument; (3) the reasonable expectations of the investing public; and (4) whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. *Id.*

Here, as to the first *Reves* factor, the investors were primarily interested in the profit, in the form of interest, expected from these transactions and the defendants' stated purpose in

selling the notes was to finance the acquisition of various income producing investments and assets. As to the second factor, the notes were offered and sold to a broad segment of the public. As to the third *Reves* factor, the PPMs were marketed to "potential investors," refer to note holders as "investors," refer to the notes as "securities" and stated that the proceeds of the notes will be used to purchase "investments." Based on these representations, a reasonable member of the investing public would consider these notes to be securities. Finally, as to the fourth factor, there is no regulatory scheme aside from the securities laws that would significantly reduce the risk of the investments offered by the Defendants. Un addition, the certificates issued by the Trusts meet the definition of securities under the three-part *Howey* test, See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (investment contract is a security when there is (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits derived from the efforts of others).

In addition, no registration statements were filed in connection with the notes or certificates. Finally, there were investors in multiple states. Accordingly, the Commission has established a *prima facie* case and the burden shifts to the defendants to show that the transactions were exempt from registration. *See SEC v. Cavanaugh*, 1 F. Supp. 2d 337, 361 (S.D.N.Y. 1998).

No exemption from Section 5 registration applies here. In their PPMs, the Funds claim exemption from registration under Section 4(2) of the Securities Act and Rule 506 of Regulation D, the private offering exemption. The Funds fail to meet either exemption. The applicability of the exemption under Section 4(2) turns on whether the particular class of person affected needs the protection of the Securities Act. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953). The Funds fail to meet this exemption because there were numerous unaccredited,

unsophisticated investors in each Fund who did not have access to type of information normally provided in a registration statement, including audited financial information, that would allow them to make an informed investment decision.

The Funds also fail to meet the exemption in Section 506, which requires that the Funds issue securities only to accredited investors and up to 35 unaccredited investors as long as the unaccredited investors have "such knowledge and experience in financial and business matters that [they] are capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description." 17 C.F.R. § 230.506(b)(2)(ii).

The following four factors are considered in determining whether issuers are subject to integration: (1) common control over the issuers; (2) a disregard of entity form; (3) the issuers are engaged in the same type of business; and (4) commingling of assets among the issuers. *See Equity Programs Investment Corp.*, 1978 SEC No-Act. Lexis 2236 (Nov. 28, 1978); *see also Rathbone, King & Seeley, Inc.*, 1987 SEC No-Act. Lexis 1982 (Apr. 20, 1987). All of the factors are met: MS & Co. controlled the Funds; the Funds invested in many of the same assets and MS & Co. transferred money between the Funds to, among other things, make investors' interest payments; they all had the same investment purposes; and funds were commingled.

The offerings likewise are subject to integration under Rule 502(a), which lists five factors to consider in determining whether offerings should be integrated: (1) whether the sales are part of a single plan of financing; (2) whether the sales involve issuance of the same class of securities; (3) whether the sales have been made at or about the same time; (4) whether the same type of consideration is being received; and (5) whether the sales are made for the same general purpose. *See* SEC Release No. 33-4552 (November 6, 1992); *Cavanagh*, 1 F. Supp. 2d at 364.

The Funds' offerings meet all five factors. *See Johnson v. Bumba*, 764 F. Supp. 1263 (N.D. Ill. 1991) (finding integration of general and limited partnerships); *SEC v. Melchior*, 1993 WL 89141, at * 10 (D. Utah Jan 14, 1993) (finding integration of twenty separate oil and gas limited partnerships).

According to the Funds' records, the Funds had well over 35 unaccredited investors. Mehraban Decl. at ¶ 10. The Funds also failed to meet the exemption in Rule 506 even assuming that the offerings are not integrated because there is no evidence that, prior to the sales, the unaccredited investors were provided with, at a minimum, a Fund's audited balance sheet, as required by Rule 502(b)(2)(i)(b). Accordingly, the Funds do not meet the exemption in Rule 506. The Funds also exceeded the offering limits of Rules 504 and 505 because three of the Funds' offerings were for $20 million and the fourth was for $30 million. Finally, they do not qualify for the Section 3(a)(11) intrastate exemption because investors resided in more than one state.

Section 5 imposes liability on persons who directly or indirectly offer or sell securities in unregistered, nonexempt transactions. Here, McGinn and Smith are liable indirectly as control persons of the issuer and Smith is directly liable for personally participating in the Fund sales. MS & Co. is liable as the placement agent, and the Funds are liable as the issuers.

The Trust offerings should be integrated under the tests outlined above. MS Capital created trusts with three purposes: to purchase "triple play" contracts, alarm contracts and luxury cruise cabin rentals, and the Trusts should be integrated along these lines. As integrated, these offerings exceeded the $1 million and $5 million exemptions in Rule 504 and 505. In addition, the Trusts failed to meet the exemption in Rule 506 because there is no evidence that, prior to the sales, the unaccredited investors were provided with, at a minimum, the Trust's audited balance

sheet, as required by Rule 506(b)(2)(i)(b). The Trusts may also fail to comply with Rule 506 because it appears that some investors in the Trusts are unaccredited and/or unsophisticated. Finally, the Trusts do not appear to qualify for the Section 3(a)(11) exemption because investors resided in multiple states.

MS & Co., MS Capital, McGinn and Smith are liable for violations of Section 5 in connection with the Trust offerings. MS & Co. is directly liable under Section 5 as the placement agent for the Trusts. MS Capital is also directly liable as the trustee for the Trusts because it created and operated the Trusts, and McGinn and Smith are controlling members of the trustee. *See SEC v. Murphy*, 626 F.2d 633, 642 (9th Cir. 1980) (noting that courts have found that entities that organized partnerships and determined their success or failure were issuers for purposes of Section 5). McGinn and Smith are indirectly liable as control persons of the placement agent and the trustee, and McGinn is directly liable for participating in the sales of the certificates in the Trusts.

### C. The Commission Has Made a Substantial Showing that MS & Co., MS Advisors, McGinn and Smith Violated The Antifraud Provisions of the Advisers Act.

Section 206 of the Advisers Act prohibits fraud by investment advisors. MS Advisors was the investment adviser to the Funds until April 2009. MS & Co. registered as an investment adviser in April 2009 and then replaced MS Advisors as the adviser to the Funds. McGinn and Smith are also "investment advisers," as defined by Adviser Act Section 202(a)(11), and each owned and controlled MS Advisors and MS & Co. Thus, they can be charged with direct violations of the Advisers Act. *See In the Matter of John J. Kenny and Nicholson/Kenny Capital Management, Inc.*, Advisers Act Release No. 2128 (May 14, 2003), at n. 54 and accompanying text (finding that chairman, CEO and co-owner of adviser was an adviser) (*citing*, as examples, *SEC v. Berger*, 244 F. Supp.2d 180, (S.D.N.Y. 2001) (finding associated person liable under §§

206(1) and 206(2) based on control of investment adviser), *aff'd on other grounds*, 2003 U.S. App. LEXIS 3562 (2d Cir. Feb. 27, 2003); *SEC v. Gotchy*, 981 F.2d 1251 (4th Cir. 1992) (unpublished table decision) (finding president and half-owner of investment adviser liable under §§ 206(1) and 206(2)).

Sections 206(1) and 206(2) of the Advisers Act prohibit fraudulent conduct by investment advisers. The Supreme Court has interpreted Sections 206(1) and 206(2) to impose a fiduciary duty on investment advisers, requiring an affirmative obligation of utmost good faith, and full and fair disclosure of all material facts to an investment adviser's clients, as well as an affirmative obligation to employ reasonable care to avoid misleading its clients. *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963). This fiduciary duty requires investment advisers to act for the benefit of their clients, and precludes investment advisers from using their clients' assets to benefit themselves. Scienter is necessary to violate Section 206(1) of the Advisers Act, but scienter is not required to prove violations of Section 206(2) of the Advisers Act. *See Steadman v* SEC, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). For purposes of Sections 206(1) and 206(2), the advisor's client is the fund and not the investors in the fund. *See Goldstein v. SEC*, 451 F.3d 873, 881 (D.C. Cir. 2006).

Here, in violation of Sections 206(1) and 206(2), MS & Co., MS Advisors, McGinn and Smith failed to act for the benefit of the Funds by, among other things, investing in assets they knew were non-performing; engaging in affiliated transactions; and making personal loans to McGinn, Smith and Rogers. *See, e.g., SEC v. Trabulse*, 526 F. Supp. 2d 1008, (N.D. Cal. 2007) (finding manager of fund violated Sections 206(1) and 206(2) of the Advisers Act when he used fund monies for his personal expenses).

Section 206(4) of the Advisers Act prohibits investment advisors from engaging in any "act, practice or course of business which is fraudulent, deceptive, or manipulative" in interstate commerce. 15 U.S.C. §80b-6(4). Rule 206(4)-8 promulgated thereunder defines as a fraudulent practice an investment adviser's making false statements of material fact to any investor or prospective investor in a pooled investment vehicle, or failing to state material facts necessary to make statements made to such investors not misleading. 17 C.F.R. § 275.206(4)-8 (effective Sept. 10, 2007). Scienter is not required to find a violation of this Rule. *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles* (SEC Rel. No. IA-2628, Aug. 9, 2007).

Section 206(4) and Rule 206(4)-8 are applicable because the Funds are "pooled investment vehicles."[3] As a result of the materially misleading statements to Fund investors made after September 10, 2007, MS & Co., MS Advisors, McGinn and Smith violated Section 206(4) and Rule 206(4)-8.

**D. The Commission Has Made a Substantial Showing that MS & Co. Violated 15(c) of the Exchange Act and and McGinn and Smith Aided and Abetted The Violation.**

Section 15(c)(1)(A) of the Exchange Act prohibits any broker or dealer from using the mails or other means of interstate commerce "to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . . by means of any manipulative, deceptive, or other fraudulent device or contrivance." Exchange Act Rule 15c1-2 defines the term "manipulative, deceptive, or other fraudulent device or contrivance" to include: (a) "an act, practice or course of business which operates or would operate as a fraud or deceit upon any person" and (b) "any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which

[3] A pooled investment vehicle is defined under Rule 206(4)-8 to include, among other vehicles, any investment company defined in Section 3(a) of the Investment Company Act, and as discussed below, the Funds are investment companies under Section 3(a).

they are made, not misleading, which statement is made with knowledge or reasonable grounds to believe that it is untrue or misleading." Accordingly, Section 15(c) is similar to Sections 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *See, e.g., SEC v. George,* 426 F.3d 786 (6th Cir. 2005) ("The elements of a § 15(c)(1) violation are the same as those for a violation of [§ 10(b) of the Exchange Act and § 17(a) of the Securities Act]."); *SEC v. Dowdell*, 2002 WL 424595, at *6 (W.D. Va. March 14, 2002) ("The same scienter requirement attributed to Section 17(a)(1) and Section 10(b) violations applies to 15(c)(1) violations.").

MS & Co. was at all relevant times a registered broker-dealer. By virtue of its fraud in connection with sale of notes and certificates through the Fund and the Trust offerings, discussed above, MS & Co. violated Section15(c). The elements of aiding and abetting liability are: (1) existence of a primary violation; (2) knowledge on the part of the actor that his acts were part of an illegal or improper scheme; and (3) substantial assistance. *See* Section 20(e) of the Exchange Act; *see also IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980). By virtue of their roles as principals of MS & Co. in causing the sale of notes and certificates through the Fund and the Trust offerings, McGinn and Smith aided and abetted the violations of Section 15(c).

### E. The Commission Has Made a Substantial Showing that The Funds Have Violated and Are Continuing to Violate Section 7(a) of the Investment Company Act.

The Funds are operating as unregistered investment companies in violation of Section 7(a) of the Investment Company Act, which prohibits unregistered investment companies from, among other things, offering or selling securities. Section 3(a)(1)(A) of the Investment Company Act defines an investment company to include: "any issuer which is or holds itself as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities." According to the virtually identical PPMs for the four Fund

offerings, each entity was "formed to identify and acquire various public and/or private investments." As a result, the Funds were holding themselves out as being engaged primarily in the business of investing in securities, and thus they are investment companies.

The Funds also qualify as investment companies under Section 3(a)(1)(C) of the Act, which defines an investment company to include: "any issuer which is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis."

The Commission has applied a five-factor test to determine whether an issuer is primarily engaged in the business of investing, reinvesting, owning, holding or trading in securities. *Tonopah*, 26 S.E.C. 426, 1947 LEXIS 321 (July 22, 1947). The five factors are: "(1) the company's historical development; (2) its public representations of policy; (3) the activities of its officers and directors; and most important, (4) the nature of its present assets; and (5) the sources of its present income." *Id.*, at *3; *see Certain Prima Facie Investment Companies*, Inv. Co. Act Release No. 10937, 1979 SEC LEXIS 340, at * 9 (Nov. 13, 1979) (proposing release).

Under Section 2(a)(36) of the Investment Company Act, the definition of "security" includes, among other things, "any note, stock, treasury stock, security future, bond, debenture, [or] evidence of indebtedness . . ." As an initial matter, the notes held by the Funds satisfy the four *Reves* factors (discussed above in Section I. B). As to the first *Reves* factor, the Second Circuit has held that the test is whether the motivation for the transaction primarily is an investment motivation on the one hand, which suggests that the note is a security, or on the other hand a commercial/consumer purpose, which suggests a non-security. *Pollack v. Laidlaw*

*Holdings, Inc.*, 27 F.3d 808, 812 (2d Cir. 1994). Here, as in *Pollack*, the Funds had an investment purpose in acquiring the loans. With respect to the second factor, courts have found that a note distributed to only one investor can be a security. *See Leeman v. Burns*, 175 F. Supp. 2d 551, 559 n. 14 (S.D.N.Y. 2001) (citing cases). The third factor examines the reasonable expectations of the investing public. Here, the investors in the Funds expected the Funds to make investments, which suggests that the notes are securities. Finally, there is no regulatory framework applicable to these investments that renders regulation under the securities laws unnecessary.

Moreover, the Commission, which is entitled to deference in interpreting the securities laws, has stated in No-Action Letters that the definition of "security" under the Investment Company Act is broader than the definitions in the Securities Act and Exchange Act. *E.g.*, *Harrell Int'l Inc.*, SEC No Act., 1989 LEXIS 698 (May 24 1998) (commercial note is a security for purposes of 1940 Act even if it is not a security for purposes of the 1933 and 1934 Acts); *Bank of America Canada*, SEC No Act., 1983 LEXIS 2653 (July 25, 1983) ("[A] determination that a note evidencing a commercial transaction is not a security under the 1933 Act and 1934 Act is, in our view, not applicable in determining whether a person engaged in the business of investing in such notes is investing in 'securities' in the context of a determination of whether the person is an investment company under the 1940 Act."). The Commission also has concluded in Action Letters that promissory notes in the hands of the lending institution are securities under the Act. *See, e.g., Bank of America Canada, supra*; *Harrell Int'l, supra*; *see also The Commonwealth Fund*, SEC No Act. (July 15, 1971) (notes evidencing working capital loans in the hands of the lender are securities for purposes of the 1940 Act).

More than 40% of each Fund's assets were securities. As for the other factors, the Funds were "primarily engaged" in the business of investing in securities, and the Funds have not claimed any exemption under the Investment Company Act, and no exemption could apply. The Funds cannot claim exemption under Section 3(c)(1) because they each have more than 100 investors. The Funds also cannot claim exemption under Section 3(c)(7) because many investors are not "qualified purchasers" (defined in Section 2(a)(51) as a person having more than $5,000,000 in investments). Finally, the Funds cannot claim exemption under Rule 3a-7 because they were not investment-grade rated.

Although the Commission need not show that the failure of the Funds to register resulted in harm to investors, by disregarding the registration requirements of the Investment Company Act, the Funds denied investors the considerable safeguards the Investment Company Act imposes on registered funds. For example: (a) Section 17 of the Act would prohibit the type of affiliated transactions that comprise approximately half of the Funds' assets; (b) Section 10(f) of the Act would have prohibited MS Advisors from purchasing securities underwritten by its affiliate MS & Co.; and (c) Section 18 of the Act would have required the Funds to have at least thee dollars of assets for every dollar of debt it issued.

**F. The Defendants Are Likely to Continue Their Illegal Conduct**

The Defendants have engaged in a series of fraudulent transactions with hundreds of investors over the course of at least the past five years. They have continued to offer new fraudulent Trusts as recently as December 2009. McGinn's and Smith's control over the McGinn Smith Entities gives them direct access to investors and other sources of money, demonstrating a substantial likelihood of future violations. A temporary restraining order is therefore warranted to preserve the *status quo* pending a preliminary injunction hearing. *See*

*e.g., Bonastia*, 614 F.2d at 912 (citing *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 807 (2d Cir. 1975)); *SEC v. Shared Medical Sys. Corp.*, Civ. A. No. 91-6546, 1992 WL 208029 at *7 (E.D. Pa. Aug. 17, 1992).

## II. THE COURT SHOULD GRANT ADDITIONAL RELIEF TO FACILITATE THE PRESERVATION OF INVESTOR ASSETS AND PROSECUTION OF THE CASE

### A. The Court Should Order the Appointment of a Receiver

The Court should appoint a temporary receiver for MS & Co., MS Capital, MS Advisors, the Funds, and all of the dozens of other entities McGinn and Smith own or exercise control over, (the "McGinn Smith Entities"). Courts will appoint a receiver where necessary (1) to preserve the *status quo* while various transactions are being unraveled so as to determine an accurate picture of the fraudulent conduct, *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1105; (2) to protect those already injured from "further despoliation of their property or rights," *Esbitt v. Dutch-American Mercantile Corp.*, 335 F.2d 131, 143 (2d Cir. 1964); (3) to prevent the dissipation of assets pending further action by the court, *SEC v. American Board of Trade, Inc.*, 830 F.2d 431, 436 (2d Cir. 1987); (4) to install a responsible officer of the court who could bring companies into compliance with the law, *id.* at 437; or (5) to place hopelessly insolvent entities in bankruptcy to effect their liquidation, *id.* at 436. In addition, the Investment Company Act expressly authorizes the appointment of a trustee or Receiver in these circumstances. Section 42 of the Investment Company Act.

The Defendants' conduct indicates that they cannot be trusted to safeguard the remaining assets and act in the best interests of investors. A receiver will ensure that the funds will be protected and appropriate decisions can be made about the viability of the McGinn Smith Entities. A receiver also will be able to ensure that an accounting is performed in order to understand the true condition of the McGinn Smith Entities.

The Commission staff has found candidates for the position of receiver, who have each submitted detailed proposals setting forth billing rates for themselves and professionals they are likely to hire, as well as summary information detailing their relevant experience and qualifications. Upon the Court's request, the Commission staff is prepared to submit to the Court the relevant information for each candidate.

**B. The Court Should Enter An Asset Freeze**

In its Complaint, the Commission seeks injunctive relief, disgorgement, prejudgment interest thereon and civil penalties. The ancillary remedy of an immediate freeze of the assets of the Defendants and Relief Defendant and all affiliated McGinn Smith Entities is appropriate here to ensure that sufficient funds will be available to satisfy any final judgments the Court might enter against the Defendants and Relief Defendant, and to protect those assets against dissipation. Exchange Act Section 21(d)(5); *see SEC v. Unifund, SAL*, 910 F.2d 1028, 1041-42 (2d Cir. 1990) (asset freeze was warranted in amount sufficient to satisfy potential judgment for penalties in insider trading case); *SEC v. Infinity Group Co.*, 212 F.3d 180, 197 (3d Cir. 2000) (purpose of asset freeze is to preserve status quo by preventing dissipation and diversion of assets). When there are concerns that defendants might dissipate assets, a court need only find some basis for inferring a violation of federal securities laws in order to impose a freeze order. *SEC v. Unifund, SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990); *see* 15 U.S.C. § 78u(d)(5) [Exchange Act, § 21(d)(5)] (court may grant any equitable relief appropriate or necessary for benefit of investors). Here, the Commission has shown significant cause for concern about the safety of investor assets. An asset freeze is necessary to prevent: (a) further misappropriation or dissipation of assets; and (b) the Defendants' making select repayments of interest and/or

principal to some investors to the detriment of other investors, including the satisfaction of recent arbitration awards.

### C. The Court Should Order An Accounting

Courts may impose the equitable remedy of a sworn accounting to provide an accurate measure of unjust enrichment and defendants' current financial resources. *See, e.g., SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1105 (2d Cir. 1972); *SEC v. Lybrand*, No. 00 Civ. 1387(SHS), 2000 WL 913894, at *12 (S.D.N.Y. July 6, 2000); *SEC v. Margolin*, No. 92 Civ. 6307(PKL), 1992 WL 279735, at *7 (S.D.N.Y. Sept. 30, 1992). In this case, bank records obtained so far indicate complex chains of questionable transfers of money among the McGinn Smith Entities. An accounting is critical for determining the disposition of funds of the McGinn Smith Entities, the amount of the Defendants' and Relief Defendant's unjust enrichment, and the assets available for disgorgement.

### D. The Court Should Order Expedited Discovery and Prohibit the Destruction of Documents

The Court should order expedited discovery under Federal Rules 30(a), 33(a) and 34(b) to allow the Commission to supplement its motion for a preliminary injunction. The Commission has not yet obtained documents directly from the Defendants, and expedited discovery is needed to enable the Commission to present a more complete evidentiary record to the Court and will sharpen and focus the issues that must be decided by the Court at a hearing on the preliminary injunction motion. Expedited discovery will also assist the Commission in locating additional assets and effectuating any order entered by the Court freezing the Defendants' and Relief Defendant's assets. Likewise, the Court should enter an order prohibiting the Defendants and Relief Defendant, or any of their agents, from destroying and

altering documents to preserve as much of the evidence as possible given the Defendants' continuing misconduct.

## CONCLUSION

For the foregoing reasons, and those set forth in the accompanying Declarations and exhibits, the Commission respectfully requests that its application be granted.

Dated: New York, NY
April 20, 2010

Respectfully submitted,

**s/ David Stoelting**
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*Of Counsel:*
Andrew Calamari
Kevin McGrath
Michael Paley
Lara Shalov Mehraban
Linda Arnold

**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF NEW YORK**

| | | |
|---|---|---|
| **SECURITIES AND EXCHANGE COMMISSION,** | : | |
| ***Plaintiff,*** | : | |
| **-against-** | : | **10 Civ. ____ ( )** |
| **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,** | : | |
| ***Defendants, and*** | : | |
| **LYNN A. SMITH,** | : | |
| ***Relief Defendant.*** | : | |

**DECLARATION OF ISRAEL MAYA**

I, Israel Maya, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am a Staff Accountant in the Broker-Dealer Inspection Program at the New York Regional Office of the Securities and Exchange Commission, and have been employed by the Commission since August 2003. My duties include conducting examinations of registered broker-dealers as well as to assist the Commission's Division of Enforcement. This declaration is in support of the Commission's Emergency Application for a Temporary Restraining Order, Preliminary Injunction, Expedited Hearing and Other Relief.

2. I received a B.S. in Accounting from Brooklyn College in 1978. Prior to coming to work at the Commission in 2003, I had 25 years of experience in the accounting, financial

services and brokerage industries, and I worked as an examiner at several regulatory agencies and as a controller and chief financial officer.

3. This declaration is based on my personal knowledge, information and belief. Among the sources of my information and the bases of my belief are documents obtained and reviewed by the Commission staff, including records obtained by subpoena from several banks that maintain accounts for certain defendants and entities affiliated with the defendants, including monthly account statements, transfer records, opening documents. I have also reviewed records and other documents obtained from the Financial Industry Regulatory Authority ("FINRA"), which conducted an investigation of the McGinn and Smith and entities they control. In addition, I reviewed transcripts of testimony of McGinn, Smith and others taken by FINRA.

4. The records from FINRA include 35 Quicken files for various entities. Quicken is an accounting software where income and expenses are posted to generate financial reports, such as balance sheets, income statements, and source and uses of funds. It has the capabilities to convert data in Excel and Adobe Reader format or PDF. Financial reports may be generated for various time periods. It appears that many of the entities controlled by McGinn and Smith used Quicken software. The Quicken files I reviewed were obtained by FINRA during FINRA's investigation of McGinn Smith, and were provided to the staff of the Commission. To facilitate my analysis, I converted these Quicken files into Excel spreadsheets.

5. This declaration is submitted for the purpose of supporting the Commission's motion for expedited relief. I have not set forth each and every fact that I know about the events and occurrences referred herein. To the extent that there are assertions herein concerning dates and numbers, they are approximate based upon information and evidence gathered to date.

**DEFENDANTS**

6. **Timothy M. McGinn ("McGinn")**, age 62, is a resident of Schenectady, New York. McGinn is licensed as a registered representative and hold the following securities licenses: Series 4; Series 24; Series 51(Municipal Fund Securities Principal); Series 53 (Municipal Securities Principal); Series 63 (Uniform Securities Agent State Law). App. Ex. 27 (copy of FINRA's Central Registration Depository ("CRD") for McGinn).

7. **David L. Smith ("Smith"),** age 65, is a resident of Saratoga Springs, New York. Smith is licensed as a registered representative and holds the following securities licenses: Series 4 (Registered Options Principal); Series 7 (General Securities Representative); Series 24 (General Securities Principal, and Financial) and Series 27 (Operational Principal). App. Ex. 26 (CRD).

8. **McGinn, Smith & Co., Inc. ("MS & Co.")**, a New York corporation with its principal place of business in Albany, NY, has been a registered broker-dealer since 1980. App. Ex. 28 (CRD). MS & Co. is owned by Smith (50%), McGinn (30%) and Livingston (20%), and has been the placement agent for many securities offerings, including the FIIN, FAIN, FEIN and TAIN offerings. On April 20, 2009, MS & Co. registered as an investment advisor with the Commission, making it a dual registrant for the period between April 20, 2009 and December 24, 2009, when the broker dealer ceased operations and filed a partial Form BDW (Broker Dealer Withdrawal) with the Commission.

9. **McGinn, Smith Advisors LLC ("MS Advisors")** is a New York corporation with its principal place of business in Albany, New York. MS Advisors is owned by Smith (50%), McGinn (30%) and Livingston (20%). MS Advisors, the investment adviser to the FIIN, FAIN,

FEIN and TAIN offerings, was registered as an investment advisor with the Commission from January 3, 2006 to April 24, 2009. App. Ex. 29.

10. **McGinn, Smith Capital Holdings Corp. ("MS Capital")** is a New York corporation with its principal place of business in Albany, NY. MS Capital is owned by MS Holdings (52%), Smith (24%) and McGinn (24%). MS Capital is the trustee for all three tranches of the FIIN, FAIN, FEIN and TAIN offerings.

11. **First Advisory Income Notes, LLC ("FAIN")**, a New York limited liability company owned by MS Advisors, is located at 99 Pine Street, Albany, NY. App. Ex. 4.

12. **First Excelsior Income Notes, LLC ("FEIN")**, a New York limited liability company owned by MS Advisors, is located at 99 Pine Street, Albany, NY. App. Ex. 2.

13. **First Investment Income Notes ("FIIN")**, a New York limited liability company owned by MS Advisors, is located at 99 Pine Street, Albany, NY. App. Ex. 1.

14. **Third Albany Income Notes, LLC ("TAIN")**, a New York limited liability company owned by MS Advisors, is located at 99 Pine Street, Albany, NY. App. Ex. 3.

**RELIEF DEFENDANT**

15. Lynn A. Smith is the wife of David Smith.

**THE FOUR FUNDS NOTE OFFERINGS**

16. The FIIN PPM, dated September 15, 2003, states that the offering was for $20 million and that three types of notes were offered: 5% secured senior notes due in 2004; 7.5% senior secured subordinated notes due in 2008; and 10.25% secured junior notes due in 2008. App. Ex, 1.

17. The FEIN PPM, dated January 16, 2004, states that the offering was for $20 million and offered three types of notes: 5% secured senior notes due in 2005; 7.5% secured senior subordinated notes due in 2007; and 10.25% secured junior notes due in 2009. App. Ex. 2.

18. The TAIN PPM, dated November 1, 2004, states that the offering was for $30 million and offered three types of notes: 5.75% secured senior notes due in 2005; 7.75% secured senior subordinated notes due in 2007; and 10.25% secured junior notes due in 2009. App. Ex. 3.

19. The FAIN PPM, dated October 1, 2005, states that the offering was for $20 million and offered three types of notes: 6% secured senior notes due in 2006; 7.75% secured senior subordinated notes due in 2008; and 10.25% secured junior notes due in 2010. App. Ex. 4.

20. As of October 9, 2009, according to the staff's analysis, FIIN had 183 investors, FAIN had 207 investors, FEIN had 242 investors and TAIN had 279 investors. *See also* Exhibit 30 (email to Smith dated February 12, 2008, listing numbers of "families" and "investments" in each of the Four Funds).

21. Using the Quicken records for FIIN, FAIN, FEIN and TAIN, I prepared a summary of assets, liabilities and ownership equities for all Four Funds. App. Ex. 31. This summary chart shows that the Four Funds raised a total of $106,941,500 from investors since 2003. App. Ex. 31. The Funds have returned a total of $23,137,500 to investors in redemptions, sales, cancels and payouts. App. Ex. 31.

22. The Funds' principal obligation to investors as of September 30, 2009 is $83,804,000. As of September 30, 2009, the Funds had a total of $475,974.57 in cash in its bank accounts. App. Ex. 31.

23. I have analyzed the assets and liabilities of the Four Funds. The Funds liabilities have exceeded its assets from the initial FIIN offering in 2003. From December 2003 through September 2009, moreover, the gap between the Funds' equity and the amount due to investors has grown considerably. I prepared a chart showing the widening gap between the Four Funds between 2003 and 2009. App. Ex. 32.

24. Using the Quicken records, I generated a consolidated income statement for the Four Funds. The income statement shows that from December 31, 2003 through September 30, 2009, the Four Funds had a total income of $12,963,768.49. App. Ex. 33. During this period, the Four Funds spent a total of $37,031,137.20. *Id.* Accordingly, the Four Funds had a total loss from operations of $24,067,368.71. *Id.*

25. I also generated balance sheets for each of the Four Funds. See App. Exhs. 34 (FIIN); 35 (FEIN); 36 (TAIN); and 37 (FAIN). In addition, I generated a consolidated balance sheet for the Four Funds. App. Ex. 38.

26. The balance sheets set forth the percentage of investments with entities affiliated with McGinn, Smith or entities they control. App. Ex. 38. The percentage of investments increased over time. As of year end 2003, it appears that 21% of investments were with affiliates. The percentage appears to have increased to 35% (2004), 39% (2005), 45% (2006), 47% (2007) and 47% (2008). As of September 30, 2009, the percentage of investments with affiliates increased to 48.8%. App. Ex. 38.

27. The investments by the Four Funds that were not with affiliates were for the most part with nonpublic entities. Based on the Funds' records, only $3.6 million appears to have been invested in liquid, publicly traded investments; however, my review of these publicly traded investments revealed that the actual market value was just $1.5 million as of September

30, 2009. Due to the absence of a quoted market and the illiquidity of the remaining investments, I was not able to determine a valuation for the remaining assets.

28. The Quicken records value that the assets held by the Four Funds were carried at a book value of $69,785,312.63 as of September 30, 2009. However, the actual value of the portfolio was far less, because the portfolio consisted almost entirely of investments in nonpublic companies, about half of which were affiliated with McGinn, Smith, or entities they controlled. The significant overvaluation is acknowledged in an e-mail sent to David Smith on December 2, 2007 by MS & Co.'s chief financial officer, David Rees. App. Ex. 67, at 10-15. The Rees e-mail contrasts the "book value" of the portfolio with the "net realizable" value. Rees concludes that the book value at the time ($69,384,870) is $32 million greater than what he stated was the net realizable value ($37,160,299). *Id.*

29. Many of the remaining assets have incorrect valuations. For instance, on a consolidated basis as of September 30, 2009, FIIN, FAIN, FEIN and TAIN list asset values of $6.2 million in Palisades Entertainment; $2 million in an investment titled GSC Capital Corp.; and $1.2 million is attributed to an investment in CCI Group, Inc. The Quicken records, however, show no cash flow from Palisades since December 27, 2006, no cash flow attributable to the GSC Capital Corp. since May 27, 2007 and no cash flow from CCI Group since November 30, 2008. My research also disclosed that Asset Holding Corp. (formerly known as GSC Capital Corp.) filed for bankruptcy on June 30, 2009 and CCI Group declared bankruptcy on September 27, 2007.

30. My analysis of the September 30, 2009 Quicken balance sheets for FIIN, FAIN, FEIN and TAIN show that $26 million of the outstanding $46 million in loans (or 56%), were to entities affiliated with McGinn and Smith or entities they control. The same analysis also

showed that 88% of outstanding loans appear to be non-performing since they have not paid principal or interest for at least six months and in some instances since inception. App. Ex. 40 (loan analysis of Four Funds).

31. My analysis discloses a pattern of monetary transfers of funds, coded as "investments" on the firm's Quicken records, between FIIN, FAIN, FEIN and TAIN and the other affiliated entities. Many of these "investments" appear to be interest free loans, which appear to have been made simply to provide cash to an affiliated entity for the purpose of satisfying a specific need, such as a pending investor redemption and pending investor interest payments. Smith and McGinn often signed the transaction documents on behalf of both parties, as in a promissory note for $300,000 dated February 9, 2008 between FAIN and 107th Associates. App. Ex. 55. The notes were signed by McGinn, on behalf of behalf of 107th Associates, LLC, as Managing Member of 107th Associates, LLC. McGinn owns 30% of 107th Associates, LLC. The $300,000 was used by 107th Associates to finance CMS Financial, a company of which Smith is the Chairman of the Board and McGinn is the Vice Chairman of the Board. As of December 31, 2007, FAIN had invested $3.1 million in Coventry Resources Corp. (a/k/a CMS Financial).

32. I also conducted an analysis of sources and uses of funds for the period ended September 30, 2009. The source and use of funds statements (App. Ex. 41) generated from Quicken records shows the sources of money received by the Funds and how the money was used. As of September 30, 2009, FIIN, FAIN, FEIN and TAIN had $222.4 million deposited into their bank accounts. This amount includes funds received from investors ($107 million), funds returned from investments ($40.8), loans received from affiliated entities ($15 million), and income ($12.9 million).

33. As of the same date, FIIN, FAIN, FEIN and TAIN had $221.9 million in disbursements. The "Uses of Funds" include how the monies were used, such as money used to redeem investors' notes ($23 million), pay interest expenses ($26 million), funds used for investments and loans to affiliated entities ($54.8 million), and make other investments ($59.8 million). The net of all the sources and uses of monies is the cash balance of $475,974.57 remaining in the Fund's bank accounts, as of September 30, 2009. See App. Exhs. 33, 41 (showing sources and used of funds for the Four Funds combined).

34. Despite the deteriorating condition of the Four Funds, and despite sending out several letters in 2008 notifying investors of events of default (App. Exs. 58-62), Smith and McGinn and their sales force continued to sell interests in FIIN, FAIN, FEIN and TAIN to new investors at par value. During 2008 and 2009, the Four Funds raised, or rolled over, an additional $3.6 million from investors. App. Ex. 39.

**VERIFIER 08 OFFERING**

35. In addition to the Four Funds, McGinn and Smith since 2003 engaged in two dozen investment banking transactions. App. Ex. 42.

36. In about December 2007, McGinn Smith initiated an offering for Verifier08, which offered up to $3.85 million in 18-month notes and 36-month notes, with returns of 8.5% and 10%, respectively. App. Ex. 10.

37. The Verifier 08 PPM stated that "the net proceeds from the Offering will be lent by the Trust Fund to MS Funding for the purpose of purchasing $3,000,000 face value of Guaranteed Payment Units issued by the Verifier Capital LLC." App. Ex. 10, at 4-6.

38. McGinn Smith also represented to Verifier08 investors in the Verifier08 "Declaration of Trust" that any unused funds above the $3 million used to purchase guaranteed

payment units ("GPUs") would only be invested in the most conservative manner. Specifically, the Declaration of Trust states that, to the extent any funds are not employed for the purposes of the loan to MS Funding, the funds may be used for "temporary investments" in "(1) certificates of deposit, [ ] (2) short term AAA rated debt obligations regularly traded on a recognized exchange in the United States, or [ ] (3) obligations issued by the United States Treasury or other obligations backed by the 'full face [sic] and credit' of the United States." App. Ex. 10 (Exhibit "A").

39. However, funds were used to make loans to other entities controlled by McGinn and Smith. For example, the trustee transferred $100,000 from Verifier 08 to Luxury Cruise Center Inc., a Florida corporation affiliated with Cruise Charter Ventures LLC, an entity owned by M & S Partners which organizes and markets "lifestyle" cruises for couples and single women. App. Ex. 19. McGinn is the managing member of Cruise Charter Ventures, which also does business as YOLO (You Only Live Once) Cruises. App. Ex. 44.

40. Verifier 08 does not appear to have received any return on its $3 million investment in GPUs. Verifier08's only source of funds, other than Verifier08 investors, has been loans from other entities controlled by Smith and McGinn. In fact, the vast majority of the interest payments (totaling $591,000) made to Verifier08 investors was funded by loans from other entities controlled by McGinn and Smith. App. Ex. 45.

41. Some of the payments made to Verifier08 investors as "interest" were actually a return of investor capital. For example, on February 15, 2008, Verifier08 transferred $100,000 (of the money raised from investors) from its escrow account to another affiliated Entity, TDM Verifier Trust 07. On March 27, 2008, TDM Verifier Trust 07 returned these funds to Verifier 08's operating account (without any payment of interest). At the time of this deposit the

Verifier08 operating account had a zero balance, and no other funds were deposited into that account until April 15, 2008. Nonetheless, the Quicken records reflect that, between April 1, 2008 and April 11, 2008, approximately $51,000 was used to make initial interest payments to the Verifier08 noteholders. Thus, unbeknownst to these noteholders, their interest payments were funded not by any return on an underlying investment, but by the return of a portion of the funds they had invested. App. Ex. 46.

42. Verifier 08 used new investor funds to redeem prior investors. I reviewed TDM Verifier Trust 08's escrow account bank statement at Mercantile Bank for July 2009 and saw that six certain investors deposited a total of $225,000 ($50,000, $15,000, $10,000, $100,000, $40,000 and $10,000) into the account. I confirmed that the liability, "Due to Investors", increased on the Quicken records and that these deposits reflected new investor funds.

43. On July 28, 2009, $184,500 was transferred from TDM Verifier Trust 08's Mercantile Bank to M&T Bank in Albany. On July 29, 2009, $130,000 was transferred to National Financial Services ("NFS"), the financial institution that clears transactions for MS & Co. and their clients. The next business day, on July 30, 2009, an additional $2,762.50 was transferred from M&T Bank to NFS. I reviewed NFS's securities receipts journals for July 30, 2009 and observed that NFS received TDM Verifier Trust 08 notes (Cusip-Number 872998MCO) for four different investors, for $130,000 ($10,000, $40,000, $45,000, and $35,000).

44. I also reviewed the brokerage statements prepared by NFS for these four individuals. Each individual was a client of MS & Co. and each redeemed their previously purchased TDM Verifier08 notes on July 30, 2009. I verified that the redemption amount agreed to the amounts indicated on TDM Verifier Trust 08 Quicken records. The redemptions totaled

$130,000 in principal plus $2,762.50 in interest. App. Ex. 47. My review of the TDM Verifier Trust 08 cash balance during the relevant period showed that without the $225,000 in deposits from the six new investors, there would not have been sufficient funds to redeem the earlier four investors.

**TDM CABLE FUNDING LLC**

45. The staff also identified a series of transactions which enriched Smith, McGinn and Rogers. TDM Cable Funding LLC borrowed funds from and used the borrowed funds to make payments to other McGinn Affiliated Entities and to make favorable loans to McGinn, Smith and Rogers.

46. On September 29, 2006, FIIN loaned TDM Cable Funding LLC ("TDM Cable") $2,625,000. TDM Cable is an affiliate controlled by McGinn, Smith, and Rogers. According to information provided by MS & Co. to FINRA, TDM Cable Funding was formed "to purchase certain assets associated with private operated cable systems (POCs) providing cable TV, internet access, telephones, and security alarm systems to homeowners associations generally in gated communities." App. Ex. 48. Prior to the loan, TDM Cable's bank account had a zero balance. Immediately after receiving the $2,625,000 from FIIN, according to the Quicken records, TDM Cable paid a $275,000 underwriting fee to MS & Co., loaned more than $352,000 to McGinn, loaned $350,000 to Smith and loaned another $350,000 to Rogers. According to the terms of these three loans, McGinn, Smith and Rogers had to pay only 3% interest and no interest or principal was due until October 2012. App. Ex. 49.

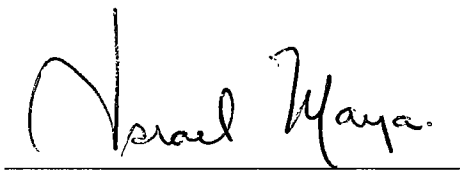
47. Following these initial loans, Smith, McGinn and Rogers continued to take loans from TDM Cable Funding. In total, Smith received $694,000, McGinn received $830,000 and Rogers received $563,000. App. Exs. 49-50. Despite the terms of the loans, my review of the

Quicken records revealed no interest has accrued on these loans nor has TDM Cable Funding received any repayments since the loans were issued.

48. Although the FIIN note was repaid by TDM Cable Funding, the loans to the individuals have not been repaid to TDM Cable Funding. *See* App. Ex. 40 (summarizing loans to McGinn and Smith). In addition, according to his testimony provided to FINRA, Smith stated that he received $600,000 from TDM Cable as a loan for payment as an officer. App. Ex. 23 at 1045.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on April 19, 2010
New York, New York



Israel Maya

**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| **SECURITIES AND EXCHANGE COMMISSION,** | |
| ***Plaintiff,*** | |
| ***v.*** | **10 Civ. _____ (___)** |
| **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,** | |
| ***Defendants, and*** | |
| **LYNN A. SMITH,** | |
| ***Relief Defendant.*** | |

**DECLARATION OF LARA SHALOV MEHRABAN**

I, Lara Shalov Mehraban, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am an attorney in the Enforcement Division of the New York Regional Office of the Securities and Exchange Commission ("Commission"). I have been employed with the Commission since September 2007. I make this declaration in support of the Commission's application for expedited relief against defendants McGinn Smith & Co., Inc. ("MS & Co."), McGinn Smith Advisors LLC ("MS Advisors"), McGinn Smith Capital Holdings LLC ("MS Capital"), First Advisory Income Notes, LLC ("FAIN"), First Excelsior Income Notes ("FEIN"), First

Independent Income Notes ("FIIIN"), Third Albany Income Notes ("TAIN"), Timothy M. McGinn and David L. Smith, and relief defendant Lynn A. Smith, including imposing a receivership on the assets of the defendants and all of the other entities controlled by McGinn and/or Smith (collectively the "McGinn Smith Entities").

**FIIN, FEIN, TAIN AND FAIN (THE "FUNDS")**

2. Between September 2003 and October 2005, MS & Co. acted as the placement agent for four unregistered debt offerings by the Funds, raising a total of approximately $106 million from approximately 150 to 300 investors. (App. Exs. 1 to 4 (Fund Private Placement Memoranda); Maya Decl. at ¶ 20.) MS Advisors held 100% of the membership interest in the Funds and was their sole managing member. MS Advisor also served as the investment advisor to the Funds.

3. The terms of the offerings by the Funds, as disclosed in their private placement memoranda ("PPMs"), are summarized below:

| OFFERING | DATE OF PPM | AGGREGATE PRINCIPAL AMOUNT | TYPES OF NOTES SOLD |
|---|---|---|---|
| FIIN | Sept. 15, 2003 (App. Ex. 1) | $20 million | 5% Secured Senior Notes due 2004<br>7.5% Secured Senior Subordinated Notes due 2008<br>10.25% Secured Junior Notes due 2008 |
| FEIN | Jan. 16, 2004 (App. Ex. 2) | $20 million | 5% Secured Senior Notes due 2005<br>7.5% Secured Senior Subordinated Notes due 2007<br>10.25% Secured Junior Notes due 2009 |
| TAIN | Nov. 1, 2004 (App. Ex. 3) | $30 million | 5.75% Secured Senior Notes due 2005<br>7.75% Secured Senior Subordinated Notes due 2007<br>10.25% Secured Junior Notes due 2009 |

| | | | |
|---|---|---|---|
| FAIN | Oct. 1, 2005<br>(App. Ex. 4) | $20 million | 6% Secured Senior Notes due 2005<br>7.75% Secured Senior Subordinated Notes due 2007<br>10.25% Secured Junior Notes due 2010 |

4. According to the PPMs, each note holder was entitled to quarterly interest payments. The Secured Senior Subordinated and Secured Junior Note holders' rights to payments were subordinated to the rights of the Senior Secured Note holders.

5. The PPMs contain essentially identical disclosures, terms and conditions. They were prepared at Smith's direction and were reviewed and commented on by him. (App. Ex. 20, at 205.) The PPMs for the Funds describe the type of investments that would be acquired:

> various public and/or private investments, which may include, without limitation, debt securities, collateralized debt obligations, bonds, equity securities, trust preferreds, collateralized stock, convertible stock, bridge loans, leases, mortgages, equipment leases, securitized cash flow instruments, and any other investments that may add value to our portfolio (individually an "Investment" and collectively, the "Investments").
>
> (App. Exs. 1 to 4, at 1.)

6. The PPMs do not authorize investments in entities affiliated with McGinn and Smith, and they do not disclose that investor funds will be used to invest in entities affiliated with McGinn and Smith. Instead, in the section entitled "Affiliated Transactions," the PPMs specifically state that the Funds may acquire "Investments" from affiliates that have already purchased such "Investments":

> We may acquire Investments from our managing member or an affiliate of our managing member that has purchased the Investments. If the Investment is purchased from our managing member or any affiliate, we will not pay above the price paid by our managing member or such affiliate for the Investment, other than to reimburse our managing member or such affiliate for its costs and any discounts that it may have received by virtue of a special arrangement or relationship. In other words, if we

> purchase an Investment from our managing member or any of its affiliates, we will pay the same price for the Investment that we would have paid if we had purchased the Investment directly. . . .
>
> (App. Exs. 1 to 4, at 17.)

7. Although the PPMs include broad, generic disclosures about, among other things, the potential illiquidity of the notes, considerable fees, conflicts of interests and the risk of loss of the investment, the PPMs do not disclose that about half of the investments made by the Funds could (and eventually would) be in McGinn Smith Entities. (App. Exs. 34 to 38.)

8. The PPMs also represent that the Funds would invest in a wide range of investments. (App. Exs. 1 to 4, at 17.) This notion was reinforced in letters soliciting investors, such as a July 6, 2004 letter from a MS & Co. broker to a prospective investor, in which he wrote:

> The [FEIN] Notes represent a basket of asset backed securities with substantial cash flow, a history of performance and limited liquidity in the marketplace. The portfolio includes securities from both the public and private sector. Asset classes consist of bonds, notes, preferred stock, leases, mortgages, limited partnerships, and securitized cash flow instruments. Our most active market of ideas comes from small private placements ($25 - $50 million) offered by investment banks primarily to institutional investors. We take comfort in these ideas due to the fact that these offerings are usually proceeded [sic] with substantial due diligence, scrutinized by product and industry professionals, and underwritten by top-tier investment banking firms with an ongoing capability to assist with additional capital if necessary. . . . I feel this investment is a great way for you to earn an attractive yield while minimizing risk.
>
> App. Ex. 56.

9. Contrary to these representations, there does not appear to have been significant "due diligence," "scrutin[y] by product and industry professionals," or underwriting by "top-tier investment banking firms" for any of the investments made

by the Funds at any time. Moreover, the supposed "basket" of securities consisted in large part of promissory notes from MS & Co. affiliates that did not have "a history of performance," at least not good performance as implied by the phrase in the context in which it was used.

10. The PPMs also state that the notes were being offered only to "accredited investors." By MS & Co.'s own records, however, the Funds each had many unaccredited investors. According to MS & Co.'s records, as of March 20, 2006, FAIN had 30 unaccredited investors; FEIN had 46 unaccredited investors; FIIN had 31 unaccredited investors; and TAIN had 75 unaccredited investors. (App. Ex. 67, at 368.)

11. Moreover, several investors that I interviewed with another SEC staff attorney stated that MS & Co. did not provide them with a PPM prior to their investment. One investor told us that Smith steered him away from investing in blue chip stocks such as General Electric, as too risky, and told him that the MS & Co. private placements were safer.

12. The Funds are not registered as investment companies. Another SEC staff attorney performed an analysis of the Funds' assets to determine whether they were securities. She prepared a spreadsheet analyzing each of the Fund's investments. She looked at the documents underlying each investment. Based on this review, she determined that the Funds owned various types of securities in the form of notes, stock, and indebtedness. She concluded that, as of September 30, 2009, FIIN had 85% of its assets invested in securities, 88% of FAIN's assets were invested in securities, 67% of FEIN's assets were invested in securities, and 75% of TAIN's assets were invested in securities, based on the definition of "security" in the Investment Company Act. (Her

analysis is included in the Appendix at Exhibits 34 to 37.) I reviewed my colleague's analysis and the documents on which it was based.

13. Accordingly, as discussed in Section I.E of the accompanying Memorandum of Law, the Funds are investment companies, and should have registered as such.

## THE TRUST OFFERINGS

14. Since November 2006, MS & Co. has created at least 18 trusts that have raised at least $23 million. (App. Ex. 65.) Some trusts have conducted two offerings. MS Capital, or another McGinn Smith Entity, has been the trustee for each of these Trusts and MS & Co. has been the placement agent for each offering. The SEC staff has obtained PPMs for 13 of these offerings which are included in the Appendix at Exhibits 5 to 11 and 13 to 18.

15. Unlike the Fund offerings, which included very broad investment parameters, the Trust PPMs explained that each Trust was created for a highly specific purpose, *i.e.*, to purchase specific contracts and/or receivables related to long-term contracts for burglar alarm services or "triple play" (broadband, cable and phone) services, or the sale of luxury cruise cabins. (App. Exs. 5 to 11 and 13 to 18.)

16. Between 2006 and 2009, MS & Co. acted as placement agent for: four Firstline Jr. and Sr. Trust 07 offerings, TDM Cable Trust 06, TDM Luxury Cruise Trust 07, TDM Verifier Trust 07, TDM Verifier Trust 08, Cruise Charter Venture Trust 08, Fortress Trust 08, Integrated Excellence Jr. and Sr. Trusts 08, TDM Cable Trust 08, TDM Verifier Trust 09, TDMM Benchmark Trust 09, TDMM Cable Jr. and Sr. Trusts 09, TDM Verifier Trust 07R, and TDM Verifier Trust 08R.

17. Each of the Trusts issued one or more tranches of notes to investors. The notes promised interest rates ranging from 7.75% to 13% per annum, and stated that principal would be paid at the maturity date, which varied from about 18 months to about five years from the date of the offering.

18. According to the Trust PPMs, each Trust would use the funds raised in the offering (minus placement agent fees) to make a loan to another intermediary McGinn Smith Entity which would then use those funds (minus substantial additional fees) to purchase from a third entity contracts and/or receivables related to either alarm contracts, "triple play" (broadband, cable and phone service), or luxury cruise cabins. (E.g., App. Ex. 5, at 4.) McGinn, Smith and/or Matthew Rogers (a senior managing director at MS & Co. and frequent business partner of McGinn and Smith) sometimes also had an ownership interest in the third entity from which the assets were purchased. The Trusts were generally left no asset other than a loan to another McGinn Smith Entity and a purported "security" interest in the assets to be purchased by that entity. (*Id.*)

19. The Declarations of Trust obtained by the SEC staff typically defined "Permitted Investments" to mean a promissory note ("the Note") evidencing a loan from the Trust to the intermediary McGinn Smith Entity. In addition, to the extent not employed for that loan, the Declaration permitted temporary investments limited to (1) certificates of deposit; (2) regularly traded short-term AAA rated debt obligations; or (3) U.S. Treasury obligations. (E.g., App. Ex. 7, at Ex. A.)

20. MS & Co. extracted enormous up-front fees from the Trusts, some of which appear to be for dubious or non-existent services:

*TDMM Cable 09*

21. For example, in the January 2009 TDMM Cable 09 Trust offering, MS & Co. raised $2,875,000, purportedly for the purchase of triple-play service contract receivables. (App. Exs. 14 and 15.) The TDMM Cable 09 PPMs state that, after the payment of $183,500 in underwriting fees by the Trust, the Trust would loan the net proceeds to TDM Cable Funding, which would then pay MS & Co. an additional $400,000 for "acquisition negotiations, legal and due diligence activities"-- making MS & Co.'s total fee $583,500, or 20.3% of the gross proceeds of the offering. (App. Ex. 14, at 1, 5; Ex. 15, at 1, 6.)

22. In addition to the hefty 20.3% fee provided by the PPM, MS & Co. actually took as "fees" even more funds raised in the offering for a total of at least $1.64 million of the offering proceeds (which is nearly three times the amount of the disclosed fee). Instead of using the funds raised in the TDMM Cable 09 Trust offering for the purposes stated in the PPM, McGinn and Smith used the money raised from investors primarily to cover MS & Co.'s firm's payroll during the first four months of 2009.

23. On January 30, 2009, for example, McGinn personally instructed his bankers to transfer $475,000 from the Trust to TDM Cable Funding, and then to transfer $413,000 from the TDM Cable Funding to MS & Co., where it was immediately used to cover the firm's payroll. (App. Ex. 67, at 55.)

24. In February 2009, McGinn again instructed his bankers on two occasions to transfer large sums of money from a TDMM Cable 09 account to TDM Cable Funding and then to MS & Co. (App. Ex. 67, at 88, 112.) On the first occasion, the funds were

immediately used to pay MS & Co.'s mid-February payroll (App. Ex. 67, at 78.); and on the second occasion to make the end of February payroll.

25. The following months, McGinn again transferred substantial amounts from the TDMM Cable 09 Trust accounts to MS & Co. to cover the March 31 and April 30 payrolls. (App. Ex., 67 at 198, 222 and 224.)

26. Not all money misappropriated by MS & Co. from the TDMM Cable 09 accounts went to MS & Co. for payroll. McGinn also instructed his bankers to transfer a total of at least $99,000 to McGinn's personal account; more than $21,000 to McGinn's son Matthew (apparently a lawyer who worked for MS & Co.); more than $105,000 to a MS & Co. affiliate called Mr. Cranberry; $18,750 to politician John Faso's law firm; at least $70,000 to MSTF; $26,500 to Verifier 07, another Trust; $10,000 to Firstline Trust; $25,000 to Rogers; $24,000 to Smith; and more than $335,000 to Smith's wife, Lynn Smith. (App. Ex. 67, at 228, 232, 237, 249 and 267.)

*TDMM Benchmark Trust 09*

27. In the Benchmark 09 Trust, for example, the PPM disclosed that MS & Co. would receive a "selling commission" of 5.5%, an additional 1.5% "nonaccountable marketing allowance," and a 1% "wholesale" fee from the trust. The cover page of the PPM thus proclaimed that the fees paid by the Trust would be 8% of total sales. (App. Ex. 18.)

28. Although this representation implies that the total fees paid by investors to MS & Co. would not exceed 8%, the PPM later disclosed that MS & Co. would indirectly receive an additional 26% of the offering proceeds in fees before any investor funds were even invested. As the PPM states, the Trust would loan 92% of the offering fees (after

MS & Co.'s initial fees were taken out) to MS & Co. affiliate TDMM Cable Funding. TDMM Cable Funding would then spend approximately "$625,000 on "acquisition costs" (broken down in the PPM as $75,000 for "legal," $150,000 for "due diligence," and $400,000 for "investment banking"). (*Id.*, at 8.)

29. Thus according to the PPM only about $1,950,000 of the $3 million raised would be used for investment. The other $1,050,000 went directly to inflated fees for these dubious or non-existent services. The PPM further contained language stating that such fees may not be returned to the Trust even if the contemplated investment did not occur. (*Id.*, at 6.)

30. The Benchmark 09 Trust PPM further states that the certificates issued to investors would earn 10.5% interest per year, paid monthly, with the certificates due after five years. (App. Ex. 18, at 1.)

31. These exorbitant fees, and the high rate of return promised to investors, required the Benchmark 09 Trust to earn a fairly spectacular rate of return on its investments in order to honor its obligations to investors. McGinn, Smith, MS & Co., and MS Capital knew or should have known that the Trust would not be able to earn a sufficient return on its investments to pay interest to investors and return their principal.

**Additional Misstatements in Trust PPMs**

*TDM Cable Trust 06*

32. The PPM for TDM Cable Trust 06 is dated November 13, 2006. It states that the offering is for a maximum of $3,550,000 in certificates, in 24-month and 48-month certificates, at 7.75% and 9.25% respectively. (App. Ex. 5)

33. The PPM states that TDM Cable Trust 06 "will advance funds to TDM Cable Funding, LLC," and that TDM Cable Funding will use the "net proceeds from the Offering . . . to purchase the Preferred Return cash flow stream arising out of": (1) the sale of cable TV, broadband internet, and fiber optic telephone services to homeowners in Cutler Cay and Keys Grove, Florida; and (2) "certain preferred payments received in connection with the purchase of the ADT Note." (App. Ex. 5 at 4.)

34. The PPM does not disclose that the entities selling assets to TDM Cable 06 were also controlled by MS & Co. In addition, bank accounts of TDM Cable Trust 06 show several transfers of funds that appear contrary to the terms of the PPM, including transfers to FIIN, FEIN, TAIN, and other McGinn Smith Entities. (*See* Daniello Decl. at ¶¶ 5 to 9.)

*TDM Verifier Trust 07*

35. The PPM for the TDM Verifier Trust 07 is dated February 23, 2007. It states that the maximum offering amount is for $3,475,000 in twelve- and twenty-four month certificates, receiving 8.25% and 9% interest, respectively. (App. Ex. 6.)

36. The PPM states that the Trust will advance funds to TDM Cable Funding LLC, which after fees, will be used to purchase "guaranteed payment units," from Verifier Capital LLC. *(Id.* at 4.)

37. Bank accounts of TDM Verifier Trust 07 show several transfers of funds that appear contrary to the terms of the PPM, including transfers to FAIN and other McGinn Smith Entities. (*See* Daniello Decl. at ¶¶ 10 to 12.)

*Firstline Sr. Trust 07*

38. The PPM for Firstline Senior Trust 07 is dated May 19, 2007. The PPM states that the maximum offering amount is for $1,850,000 in forty-month certificates, receiving 9.25% interest. (App. Ex. 7.)

39. The PPM states that the Trust will "apply the entire net proceeds of the Offering to the purchase of the Senior Tranche of Financing" secured by a portfolio of home alarm contracts owned by Firstline Security, Inc. (*Id.* at 4.)

40. A bank account of Firstline Sr. Trust shows several transfers of funds that appear contrary to the terms of the PPM, including transfers to FAIN and another McGinn Smith Entity. (*See* Daniello Decl. at ¶ 13.)

*TDM Luxury Cruise Trust 07*

41. The PPM for TDM Luxury Cruise 07 is dated July 16, 2007. The PPM states that the maximum offering amount will be $3,630,000 of certificates due on September 1, 2011, paying 10% per year. (App. Ex. 8.)

42. The PPM further states that, after the payment of fees, the Trust will advance funds to TDM Cable Funding LLC, which in turn has purchased $1,450,000 in a preferred interest in Luxury Cruises and has committed to made an additional capital contribution in Luxury Cruises of $1,555,000. (*Id.* at 4.)

43. The bank records for TDM Luxury Cruise Trust 07 show several transfers of funds that appear contrary to the terms of the PPM, including transfers to various McGinn Smith Entities. (*See* Daniello Decl. at ¶¶ 15-16.)

*Cruise Charter Ventures Trust 08*

44. The PPM for Cruise Charter Ventures Trust 08, dated February 14, 2008, states that the maximum offering amount is $3,250,000 in 13% certificates due March 1, 2010. The PPM states that "[t]he net proceeds from the Offering will be lent to [Cruise Charter Ventures LLC, or "CCV"] for the charter of the M/V Sapphire Princess and the sale, marketing and administrative expenses associated with selling 2,678 berths for the cruise." (App. Ex. 11, at 4.)

45. The PPM did not disclose that Cruise Charter Ventures operated under the name YOLO (You Only Live Once) Cruises. The PPM did not disclose that YOLO Cruises is a sexually-oriented affinity group, that MS & Co. would procure strippers to entertain passengers, and that investor money would be used to, among other things, buy insurance for the strippers. (App. Ex. 67, at 82-84, 221.) The Cruise Charter Ventures LLC PPM, dated September 25, 2009, contains a somewhat more complete disclosure. (*See* App. Ex. 19, at 5.)

46. McGinn was the managing member of YOLO. He and other MS & Co. employees were heavily involved in the day-to-day operations of YOLO, and were well aware of the activities on the cruise. (App. Ex. 67, at 218.)

47. This venture apparently was unsuccessful. By June 30, 2009, CCV had lost $1.5 million. (App. Ex. 25, at 60. )

**ADDITIONAL OFFERINGS**

48. During the same period that the Trusts were created, MS & Co. also acted as placement agent for at least nine other offerings, including a 2008 offering for newly created affiliate McGinn Smith Transaction Funding that raised $6.87 million, and two

2008 offerings for Christian Values Network, that raised a total of $3.51 million. PPMs for two of these offerings are included in the Appendix at Exhibits 12 and 19.

**MCGINN AND SMITH HAVE TAKEN LARGE PERSONAL "LOANS" FROM VARIOUS MCGINN SMITH ENTITIES AND FALSIFIED LOAN DOCUMENTS**

49. McGinn, Smith and Rogers frequently received substantial personal "loans" from McGinn Smith Entities. For example, between October 2006 and October 2009, TDM Cable Funding "loaned" McGinn $830,341, Smith $694,000 and Rogers $563,000. (App. Ex. 53.) Smith testified that none of these loans have been repaid and no interest has been paid on the loans. (*See, e.g.,* App. Ex. 20, at 378, 381, 387.) Based on their testimony to FINRA, McGinn and Smith apparently believed that they were entitled to the money as compensation, and had no intention of paying the loans back. (App. Ex. 20, at 383-85 and App. Ex. 25, at 83 and 95-97.)

50. In particular, Smith admitted that he received a $350,000 loan from TDM Cable Funding on October 2, 2006, and that McGinn and Rogers each received loans of approximately the same amount on or around the same date. (App. Ex. 20, at 384.) Smith testified that the loans were "accommodations" for the officers of the company for services performed. Smith admitted that other than his role as an equity owner of TDM Cable Funding, however, he did not personally perform any services to justify the loan he received. (*Id.*)

51. McGinn admitted in his testimony before FINRA that he and Smith each took a $200,000 loan from the Firstline Trust. (App. Ex. 25, at 68.) Firstline Securities filed for bankruptcy a few months after the four Firstline offerings raised about $7

million. According to McGinn, as of April 2009, Firstline Securities still owes the Firstline Trust $5.9 million, but McGinn and Smith have not re-paid their loans. (*Id.*)

52. McGinn admitted during his FINRA testimony that several promissory notes were created and backdated in response to FINRA's request for documentation of the loans during its exam of MS & Co. (App. Ex. 24, at 171-180.)

53. MS & Co. also admitted to FINRA that, in 2008 and 2009, McGinn had authorized a number of additional personal loans, which were not evidenced by loan documentation. MS & Co.'s list of these loans is attached to the Appendix at Exhibit 54.

## MS & CO.'S FINANCIAL CONDITION DETERIORATED AND THE SCHEME BEGAN TO UNRAVEL

54. The Funds have lost money in each year of their existence and, at least since late 2007, have been insolvent. (App. Ex. at 33.)

55. It appears that shortly after inception, the Funds were not able to return principal to investors when notes became due. On December 21, 2006, an MS & Co. employee sent an email to Smith telling him that a TAIN investor wanted to redeem $100,000 in TAIN notes due December 15, 2006 and purchase $100,000 in one of the Trusts (TDM 9.25%). Smith replied to her that the broker "needs to replace the $100,000 before doing the trade." He continued: "I am running on fumes with all of these redemptions and cannot afford any more. Please inform Andy [Guzzetti, MS & Co.'s head salesman]." (App. Ex. 67, at 9.) At the time of this email, the notes that Smith referred to as being "redeemed" were already a week past maturity. Other emails show investors being redeemed only when new investors are found to replace them. (E.g., App. Ex. 67, at 16, 92, 205 and 287.)

56. In January 2008, Smith sent a letter on behalf of MS Advisors to the Secured Junior Note holders in the Funds, stating that Funds had run into financial difficulty, and falsely placing blame for the Funds' difficulty on "the subprime crisis." The letter continued that the impact on the Funds of the subprime crisis was "primarily on liquidity" and that it is "unlikely" that the Funds would be able to retire the Secured Junior Notes at maturity. The letter stated that interest on the Secured Junior Notes was being reduced to 5% "until such a time as some of our investments return to a timely cash flow or we can refinance our debt or raise additional capital." The letter concluded that MS Advisors was "making a significant contribution to increasing the cash flow for all of the Funds by suspending the commissions due to [MS & Co. and MS Capital]." (App. Ex. 58.)

57. In April 2008, MS Advisors wrote to these investors again informing them that all of the problems cited in the January letter have "become more acute." The letter noted that, due to the fact that two of the Funds' investments had eliminated their dividends or ceased distributions, the Funds were "forced" to eliminate the interest payments to the holders of the Secured Junior Notes for this quarter. The letter noted that MS Advisors had been advised by counsel that "distributions at this time quite probably reflect a return of capital and not interest, and therefore distributions at this time might be considered an invasion of principal due to the Senior and Senior Subordinated Noteholders. This is a result of not knowing how and where to price our investments in these very illiquid markets." (Examples of these letters are attached to the Appendix as Exhibits 59 and 60.)

58. In October 2008, Smith sent a letter on behalf of MS Advisors to all classes of note holders in the Funds informing them that because of the "current condition of the financial credit markets" and "financial crisis," MS Advisors had determined that the Funds were unable to retire the note due November 15, 2008 and would require a restructuring plan for all three classes of note holders. The plan extended the maturity dates and reduced interest payments for all the note tranches. The letter reiterated MS Advisor's pledge to discontinue taking fees from the Funds, stating:

> We understand that many of you have personal liquidity issue due to retirement or other financial needs and this plan may put a hardship on you. [MS Advisors and MS & Co.] will be making its own sacrifice. Management fees, commission, and administrative fees aggregate to approximately $2,750,000 for all of our Funds that are part of the reorganization. In an effort to improve liquidity we have agreed to forfeit all such feature fees while this reorganization plan is in effect.
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> (App. Ex. 61.)

59. Audited financial statements for MS & Co. for 2008 show that the firm had a loss of more than $1.8 million during that year. The audit includes a "going concern" clause. (App. Ex. 66.)

60. As reflected in the emails described below, as 2009 progressed, there was a growing desperation at McGinn Smith to make payroll, to assuage complaining investors, and to generally keep the house of cards from falling.

61. On January 5, 2009, Brian Cooper (a senior accountant at MS & Co.) sent McGinn an email entitled "good news," that contained a list of "funding needs" and the "funds available" to meet those needs. There was about $8,000 more in funds available than funds needed. (App. Ex. 67, at 28) The accounts containing funds often

did not belong to the entities needing funding. These funding availability/needs emails appear to have occurred at least weekly in 2009. (Some additional examples are included in the Appendix at Exhibit 67, at 53, 218, 219, 236, 240, and 270.)

62. On January 20, 2009, McGinn emailed MS & Co.'s head of sales, Andrew Guzzetti, "We will need to collect a minimum of 2 million by Jan 30." (App. Ex. 67, at 49.)

63. On February 10, 2009, in an email to McGinn, David Rees (MS & Co.'s CFO) wrote, "any possibility of receiving some of the remaining fees by Friday? Payroll is on the 13th. I would have paid it Monday the 16th, but that is a bank holiday." McGinn responded, "Sales are pretty slow. I may be able to do $100,000, but that's all." (App. Ex. 67, at 78.)

64. On February 16, 2009, William Lex, a registered representative at MS & Co., emailed McGinn asking "Will the 2/15/09 TDM 07 redemptions be made to client accounts on 2/17/09." McGinn responded, "Depends on how much is collected on roll offering." (App. Ex. 67, at 89-90.) Lex replied: "Wrong answer." McGinn then responded: "Bill, what do you expect me to do?" And Lex replied: "Lend money to the TDM 07 until the new sales come in. If it were my deal, that is what I would do. Please don't think I'm being a smart ass. I am just desperate to keep some credibility with my clients so they will keep investing in McGinn, Smith & Co., Inc. products." (*Id.*)

65. On February 24, 2009, Smith emailed Livingston (a principal at MS & Co., who owned 20% of the holding company), with a copy to McGinn, "I am forwarding the Friday's payroll, which is approximately $182,000. Dave [R]ees

informs me that we have $75,000 of payables that can't be put off. We have approximately $30,000 to meet the above. I really don't know how we are going to survive." (App. Ex. 67, at 97.)

66. A few hours later, Smith emailed Livingston telling him that he would have to instruct Rees to delete paychecks for McGinn, Livingston and himself, among others, and to pay no bills except health insurance. He then noted: "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. 67, at 98.) (As described above, MS & Co. used the proceeds of the TDMM Cable 09 Trust offering to make this payroll.)

67. On February 25, 2009, Livingston 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. 67, at 99.) In a series of lengthy emails on March 2 & 3, 2009 email he elaborated, stating among other things, "Decisions have been made over the last year that I have had zero say in that I would rather not put in an email but put me at risk." (Emphasis added.) (App. Ex. 67, at 136-140.)

68. On February 27, 2009, Smith emailed Livingston discussing the difficulties facing McGinn Smith. He noted that he would be "working on solutions over the weekend, including plans for a cold calling group." He also noted that McGinn sent $125,000 to McGinn Smith to cover payroll and shore up capital "but as we all know that is a temporary solution." (App. Ex. 67, at 114.)

69. On March 5, Rees emailed McGinn that another $100,000 would be coming in from a new sale of TDM Verifier Trust 07 and asking McGinn for his "priority list" for who should be redeemed. (App. Ex. 67, at 148.)

70. On March 11, 2009 Smith emailed Livingston, "I am working from home today on how I am going to raise $175m by Friday for MSC." (App. Ex. 67, at 171.)

71. On March 16 and 17, 2009, in an email discussion between Lex and Smith, with copies to McGinn and Guzzetti, regarding redemption on behalf of seven of his client of a total of $125,000 in TDM Verifier 07 notes:

> Lex wrote: "I believe if we don't get my clients redeemed immediately if not sooner, we could be facing regulatory complaints. I think making the redemptions happen is cheaper than dealing with complaints. Please advise that my clients will be redeemed today so I can communicate that fact to my clients."
>
> Smith responded the next day: "It would be helpful if you could sell the $125,000 worth of redemptions. We have not moved any of this product for weeks, which is causing the bottleneck. Do you have anything pending?"
>
> Lex responded a few minutes later: "When 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 and I've tried to reassure them that that is not the case. This current situation is not helping me to build confidence with clients who have hundreds of thousands of dollars in McGinn, Smith Investments. I NEED TO HEAR BEFORE NOON TODAY THAT THESE CLIENTS ARE GOING TO BE REDEEMED THIS WEEK"
>
> (App. Ex. 67, at 176-77) (underline emphasis added; capital emphasis in original).)

72. On March 16, Guzzetti sent an email saying that three of his clients "are making noise about their TDM Verifier Redemptions." McGinn responded that he had sent one of the clients a partial payment the prior week. (App. Ex. 67, at 174.)

73. On March 27, 2009, Rees emailed McGinn, "any commission $ available for McGinn, Smith? I believe we are owed about $50K." McGinn responded, "Don't know yet. Depends on collections and where we stand on April 1 distributions. Does not look promising." (App. Ex. 67, at 189)

74. On March 27, 2009, McGinn emailed Cooper in response to Cooper's list of funding obligations and availability: "Will I get the rest of the analysis today? I need to know how much I can get from Verifier and TDM Luxury Cruise." (App. Ex. 67, at 194.)

75. On April 7, 2009, in an email to McGinn, Smith and Guzzetti, Lex wrote, "I just got off the phone with [Investor] who has been calling for almost two months to get his TDM redemption. He is one of many people who refer to our deals as a Ponzi Scheme." (App. Ex. 67, at 204 (emphasis added).)

76. On April 8, 2009, Lex wrote an email to Smith with copies to McGinn and Guzzetti that one of his clients should be redeemed out of TDM 07: "I purchased a $10,000 note in my 401(K) on April 1, 2009 so that this elderly couple could be promptly redeemed." Smith responded to Lex on the same day, "I am having [your clients] taken care of tomorrow. We have $75,000 ticketed, but uncollected. I just did $100,000 that should be processed by next Wednesday. $30,000 of the ticketed has to go to Frank Chiappone as he sold the new notes. $25,000 has to be allocated to another client who is making lots of noise. That leaves $120,000 available to take care of your

remaining [clients who are owed] $105,000, assuming noone else has a critical situation." (App. Ex. 67, at 205.)

77. On May 24, 2009, Shea wrote McGinn and Smith that they would just be able to cover payroll "but it is very tight." He continued: "We will need a cash infusion next week to cover certain expenses including last month's health care. We need to address the rent situation as well." (App. Ex. 67, at 229.)

78. On June 5, 2009, Smith personally loaned McGinn Smith $366,000. (App. Ex. 67, at 266.)

79. In another email, dated July 15, 2009, Lex emailed Guzzetti, with copies to McGinn and Smith, asking: "When will you be redeeming the $25,000 TDM Verifier note for [certain investors]? [One of these investors] renewed his $75,000 note and I don't want to be embarrassed and have him lose confidence in the McGinn Smith deals. He is a candidate for more investments unless he loses confidence. He invested in his alarm deal and renewed this investment despite having $300,000 tied up in FIIN, TAIN and FAIN ($100,000 in each). LETS NOT BLOW IT. WE NEED TO MAINTAIN INVESTOR CONFIDENCE IN MCGINN SMITH DEALS!!!!!!!!!!!" (App. Ex. 67, at 263 (emphasis in original).)

80. On August 11, 2009, Cooper emailed Smith to ask him to approve a $25,000 redemption out of TDM Verifier 08r. He proposed that the funds would come out of TDM Verifier 07r's account (which had a balance of $66,106) and noted that a broker had a $50,000 commitment "scheduled to come in Mid Augusts that can be used to return the $25,000 to the 07r account." (App. Ex. 67, at 271.)

81. On November 2, 2009, Smith emailed McGinn: "The following people will not be paid today" for a total of just over $43,000. Included in the list are McGinn, Smith and Mathew Rogers, among others. (App. Ex. 67, at 320.)

82. On December 14, 2009, Cooper emailed McGinn and Smith with charts of bank balances and overdue interest payments. One chart showed interest payments that were due on November 1, and December 1, 2009 to investors in six entities totaling $320,000. The bank accounts for those entities held only about $27,000. (App. Ex. 67, at 3636-64.)

**THE SCHEME APPEARS TO BE ONGOING**

83. Notwithstanding these financial woes, MS & Co. continued to solicit investors for the Funds and the existing Trusts, as well as new Trusts and other entities throughout 2009.

84. It appears that MS & Co. used the original PPMs for these sales. The final known investor in the Funds, who purchased FEIN notes on April 28, 2009, received an email containing the 2004 PPM for FEIN. The 2004 FEIN PPM did not include any disclosures about the current financial condition of FEIN, including the fact that the Junior noteholders would not be paid interest that quarter.

85. As another example, in September 2009, a MS & Co. broker emailed McGinn and asked whether there were any material changes in the TDMM Cable 11% notes that had been originally offered in the beginning of 2009. McGinn replied, "No." (App. Ex. 67, at 291.)

86. MS & Co. appears to have been continuing to raise funds for the McGinn Smith Entities as late as December 2009. In a December 10, 2009 email, for

example, McGinn notes that he sold $125,000 of the Benchmark 09 Trust. (App. Ex. 67, at 354.)

87. Given the cash flow problems of the Funds and the Trust, as well as the other McGinn Smith Entities, it is likely that any new investor funds are also being used to continue the defendants' fraudulent scheme.

I declare under penalty of perjury that the foregoing is true and correct.

Executed: New York, New York
April 19, 2010

Lara Shalov Mehraban

**UNITED STATES DISTRICT COURT**
**NORTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| **SECURITIES AND EXCHANGE COMMISSION,** | |
| ***Plaintiff,*** | |
| **-against-** | **10 Civ. ____ ( )** |
| **MCGINN, SMITH & CO., INC.;**<br>**MCGINN, SMITH ADVISORS LLC;**<br>**MCGINN, SMITH CAPITAL HOLDINGS CORP.;**<br>**FIRST ADVISORY INCOME NOTES, LLC;**<br>**FIRST EXCELSIOR INCOME NOTES, LLC;**<br>**FIRST INDEPENDENT INCOME NOTES, LLC;**<br>**THIRD ALBANY INCOME NOTES, LLC;**<br>**TIMOTHY M. MCGINN; and**<br>**DAVID L. SMITH,** | |
| ***Defendants, and*** | |
| **LYNN A. SMITH,** | |
| ***Relief Defendant.*** | |

**DECLARATION OF ROSEANN DANIELLO**

I, Roseann Daniello, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am a Staff Accountant in the Enforcement Division of the New York Regional Office of the Securities and Exchange Commission and have been employed by the Commission since May 1992. My duties include analyzing brokerage records, bank records, business records, and research regarding related individuals, all in relation to Commission investigations to enforce the federal securities laws. This declaration is in support of the Commission's Emergency Application for a Temporary Restraining Order, Preliminary Injunction, Expedited Hearing and Other Relief.

2. I received a B.B.A. in Finance from Iona College in 1991. I began my career with the Commission as a Securities Compliance Examiner in May 1992 and have worked on numerous investigations and litigations.

3. I have reviewed bank records obtained pursuant to subpoena from several banks, including M&T Bank and Mercantile Bank. The records were voluminous and included such documents as account opening forms, monthly account statements and debit and credit memoranda.

4. Listed below are selected transfers that were identified based on monthly account statements. However, I was unable to determine the nature of many transfers because we did not receive complete backup information from the banks.

***TDM Cable Trust LLC 06***

5. The Mercantile bank account of TDM Cable Trust 06 shows ten transfers from the TDM Cable Trust 06 account at Mercantile Bank to a FIIN account:

- $1,030,000 on November 29, 2006;
- $795,000 on December 8, 2006;
- $150,000 on December 11, 2006;
- $35,000 on December 12, 2006;
- $100,000 on December 14, 2006;
- $100,000 on January 5, 2007;
- $70,000 on January 26, 2007;
- $70,000 on January 30, 2007;
- $50,000 on February 2, 2007; and
- $50,000 on February 5, 2007.

6. The bank records also show that TDM Cable Trust LLC 06 made the following transfers to an entity named MR Cranberry LLC:

- $49,000 on February 13, 2007; and
- $372,000 on March 23, 2007.

7. There was also a transfer of $10,000 from TDM Cable Trust LLC 06 to TDM Verifier Trust 09 on January 8, 2009.

8. The M&T bank records of TDM Cable Trust 06 show the following transfers to a FEIN account:

- $14,500 on 3/19/08;
- $5,000 on 4/29/08; and
- $20,000 on 12/1/08.

9. The M&T bank records of TDM Cable Trust 06 show the following deposits:

- $50,000 from FIIN on 2/7/07;
- $22,200 from MR Cranberry LLC on 3/1/07;
- $25,000 from TAIN on 3/3/08;
- $25,000 from FEIN on 3/10/08;

***TDM Verifier Trust 07***

10. Mercantile Bank records show several transfers by TDM Verifier Trust 07:

- $872,000 to MR Cranberry LLC on June 4, 2007;
- $145,000 to FAIN on June 15, 2007; and
- $100,000 to TDM Verifier Trust 08 on February 14, 2008.

11. M&T Bank records show several transfers by TDM Verifier Trust 07:

- $100,000 to TDM Verifier Trust 08 on 3/25/08;

- $19,600 to TDM Verifier Trust 08 on 11/25/08; and
- $75,000 to TDM Verifier Trust 08 on 4/1/09.

12. M&T Bank records show the following deposits into TDM Verifier Trust 07's account:

- $44,000 from McGinn Smith Transaction Funding on 5/15/08;
- $76,500 from TDM Cable Financing LLC on 8/18/08;
- $76,500 from TDM Verifier Trust 08 on 11/20/08;
- $77,000 from McGinn Smith Transaction Funding on 2/17/09;
- $49,000 from TAIN on 2/18/09;
- $99,500 from TAIN on 2/19/09;
- $50,000 from TDM Verifier Trust 08 on 4/2/09; and
- $72,000 from McGinn Smith Transaction Funding on 5/15/09.

***Firstline Sr. Trust 07***

13. Mercantile Bank records show several transfers by Firstline Sr. Trust 07:

- $594,000 to MR Cranberry LLC on 6/8/07;
- $682,000 to FAIN on 6/15/07;
- $124,000 to FAIN on 6/15/07;
- $250,000 to MR Cranberry LLC on 6/22/07;
- $760,000 to MR Cranberry LLC on 6/27/07;
- $924,000 to MR Cranberry LLC on 8/1/07; and
- $110,300 to MR Cranberry LLC on 8/7/07.

14. M&T Bank records also show a $17,114.17 deposit from TDM Cable Financing LLC into Firstline Sr. Trust 07's account on 9/4/07.

***TDM Luxury Cruise Trust 07***

15. M&T Bank records show the following transfers from TDM Luxury Cruise Trust 07:

- $84,000 to McGinn Smith Funding LLC on 4/4/08;
- $89,000 to McGinn Smith Transaction Funding on 7/1/08;
- $83,000 to TDM Verifier Trust 08 on 10/1/08;
- $25,000 to Firstline Sr. Trust 07 on 12/1/08;
- $839.57 to TDM Cable Funding LLC Trust 06 on 12/5/08;
- $5,500 to TDMM Cable Sr. Trust 09 on 3/2/09;
- $4,000 to Integrated Excellence Sr. Trust on 3/2/09;
- $105,000 to Firstline Sr. Trust 07 on 3/31/09;
- $10,000 to McGinn Smith Transaction Funding on 5/1/09;
- $32,500 to TDM Verifier Trust 09 on 7/6/09;
- $25,000 to TDM Verifier Trust 08 on 7/6/09;
- $12,500 to Firstline Sr. Trust 07 on 7/6/09;
- $27,000 to Firstline Sr. Trust 07 on 8/4/09;
- $27,000 to TDMM Cable Sr. Trust 09 on 8/4/09;
- $6,000 to MS Funding on 2/1/10; and
- $1,565 to TDMM Cable Sr. Trust 09 on 3/4/10.

16. M&T Bank records show the following deposits into TDM Luxury Cruise Trust 07's account :

- $90,000 from McGinn Smith Funding LLC on 3/5/08;
- $45,000 from Integrated Excellence Jr. Trust on 8/29/08;
- $68,000 from TDM Verifier Trust 07R on 6/4/09;
- $27,000 from Firstline Sr. Trust 07 on 8/4/09; and
- $77,000 from FIIN on 9/9/09.

***Firstline Sr. Trust 07 Series B***

17. Mercantile Bank records show the following transfers from Firstline Sr. Trust 07 Series B to McGinn Smith Funding:

- $504,000 on 11/27/07;
- $350,000 on 12/17/07;
- $114,000 on 12/28/07; and
- $215,000 on 2/1/08.

***TDM Verifier Trust 08***

18. Mercantile Bank records show the following transfers from TDM Verifier Trust 08:

- $100,000 to Luxury Cruise Charter Inc. Payables on 1/29/08; and
- $100,000 to TDM Verifier Trust 07 on 2/15/08.

19. Mercantile Bank records show the following deposits into TDM Verifier Trust 08's account:

- $100,000 from TDM Verifier Trust 07 on 2/14/08;
- $25,000 from FEIN on 3/21/08; and
- $340.01 from TDM Verifier Trust 07 on 4/1/08.

***Fortress Trust 08***

20. M&T Bank records show the following transfers from Fortress Trust 08:

- $45,000 to FIIN on 11/5/08; and
- $1,400 to TDMM Cable Sr. Trust 09 on 10/1/09.

21. There was also a $45,000 deposit from FIIN into Fortress Trust 08's account on 11/3/08.

***TDMM Cable Jr. Trust 09***

22. Mercantile Bank records show the following transfers from TDMM Cable Jr. Trust 09 to McGinn Smith Transaction Funding:

- $15,000 on April 22, 2009;
- $11,000 on April 24, 2009;
- $60,000 on April 30, 2009;
- $53,000 on May 1, 2009;
- $27,000 on May 5, 2009;
- $26,500 on May 15, 2009; and
- $78,500 on July 2, 1009.

23. Bank records also show a transfer of $34,000 from TDMM Cable Jr. Trust 09 to MR Cranberry LLC on April 30, 2009.

24. There was also a transfer of $30,000 from TDMM Cable Jr. Trust 09 to Timothy McGinn on April 30, 2009.

25. On July 30, 2009, records show a transfer of $175,000 from TDMM Cable Jr. Trust 09 to an account at National Financial Services in the name of Lynn Smith.

***TDMM Cable Sr. Trust 09***

26. M&T Bank records show the following transfers from TDMM Cable Sr. Trust 09:

- $4,800 to Integrated Excellence Sr. Trust on 5/5/09;
- $4,300 to TDMM Cable Jr. Trust 09 on 5/5/09;
- $1,750 to TDMM Cable Jr. Trust 09 on 7/1/09;
- $5,000 to Integrated Excellence Sr. Trust on 7/2/09;
- $1,800 to TDMM Cable Jr. Trust 09 on 8/12/09;
- $2,520.83 to TDMM Cable Jr. Trust 09 on 9/15/09;
- $2,520.84 to TDMM Cable Jr. Trust 09 on 10/15/09;
- $1,400 to Fortress Trust 08 on 10/26/09; and
- $2,514.47 to TDMM Cable Jr. Trust 09 on 11/19/09.

27. M&T Bank records show the following deposits into TDMM Cable Sr. Trust 09's account:

- $5,500 from TDM Luxury Cruise 07 on 3/2/09;
- $12,146 from TDMM Cable Jr. Trust 09 on 7/2/09;
- $27,000 from TDM Luxury Cruise 07 on 8/4/09;
- $74,000 from FIIN on 9/9/09; and
- $1,400 from Fortress Trust 08 on 10/1/09.

***TDM Verifier Trust 07R***

28. Mercantile Bank records show the following transfers from TDM Verifier Trust 07R:

- $68,000 to TDM Luxury Cruise Trust on 6/4/09;
- $67,000 to TDM Verifier Trust 08 on 7/6/09;
- $67,000 to Firstline Sr. Trust on 8/4/09;
- $25,000 to TDM Verifier Trust 08 on 8/11/09;
- $52,000 to TDM Verifier Trust 08 on 10/5/09; and
- $15,000 to TDM Verifier Trust 09 on 10/6/09.

29. M&T Bank records show the following deposit into TDM Verifier Trust 07R's account:

- $67,437.50 from TDM Cable Funding LLC on 6/4/09.

***Integrated Excellence Sr. Trust 08***

30. Mercantile Bank records show the following transfers from Integrated Excellence Sr. Trust 08:

- $755.68 to Fortress Trust 08 on 7/30/09; and
- $166.66 to Integrated Excellence Jr. Trust on 10/1/09.

***MR Cranberry LLC***

31. Mercantile Bank records show a $532,871 transfer from MR Cranberry LLC to FAIN on 8/10/07.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on April 19, 2010
New York, New York

Roseann Daniello