# Department of Justice

**United States Attorney Richard S. Hartunian**
**Northern District of New York**

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CONTACT: Elizabeth C. Coombe
(518) 431-0247

**Former McGinn, Smith & Co., Inc. Chief Financial Officer Pleads Guilty to Corruptly Interfering with the Administration of the Internal Revenue Laws**

ALBANY, N.Y.— The former chief financial officer for McGinn, Smith & Co., Inc., Brian Shea, 53, of Niskayuna, New York, pled guilty today before United States District Court Judge David N. Hurd to one count of corruptly interfering with the administration of the internal revenue laws announced United States Attorney Richard S. Hartunian, Acting Special Agent-in-Charge Toni Weirauch of the New York Office of the Criminal Investigation Division of the Internal Revenue Service, and Special-Agent-in-Charge Clifford C. Holly of the Albany Division of the Federal Bureau of Investigation. Sentencing is scheduled for November 30, 2012 in Utica, New York. Shea faces up to three years in prison and a $250,000 fine.

As part of the guilty plea, Shea admitted that, as directed by David L. Smith, he had created false accounting entries to conceal that money had been improperly diverted to Timothy M. McGinn from an escrow account holding investor money. McGinn did not report that income on his 2008 and 2009 income tax returns. Shea also admitted that, as directed by Smith and McGinn, he had submitted backdated promissory notes to a regulatory agency regarding money that McGinn and Smith had improperly diverted in connection with offerings of unregistered securities. Finally, Shea admitted that he was aware that investor money had been diverted from one entity to pay investors in other entities without any disclosure to any of the investors. Specifically, Shea admitted the following:

## Background

From 1981 through December 24, 2009, McGinn, Smith & Co. Inc. (the "broker-dealer") was a broker-dealer registered with the Securities and Exchange Commission ("SEC") with its headquarters in Albany, New York. The broker-dealer was also regulated by the Financial Industry Regulatory Authority, Inc. ("FINRA"), a private not-for-profit corporation and a self-regulatory organization that is registered with the SEC as a national securities association pursuant to § 15A of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 73o-3. From 2003 through 2010, the broker-dealer was owned by its founders, Timothy M. McGinn and David L. Smith, and another. Among other things, the broker-dealer was engaged in the business of creating and selling unregistered securities pursuant to Regulation D of the Securities Act of 1933, 17 C.F.R. § 230.501 *et seq.* Sales of these unregistered securities were generally limited to certain types of investors including individuals who met minimum net worth and income requirements. As part of the sales process, the broker-dealer provided investors with documents describing the unregistered securities known as private placement memoranda ("PPMs").

Shea, who graduated from the General Electric Company's financial management program, began working as the chief financial officer and controller for the broker-dealer in 1992. In 2002 he left the broker-dealer to work for Integrated Alarm Services Group ("IASG"). In 2007, IASG was purchased by Protection One, and Shea then accepted a position with McGinn, Smith Alarm Trading, LLC. In April 2009, Shea also returned to the broker-dealer to act as its chief financial officer and controller while continuing to work for McGinn Smith Alarm Trading.

## McGinn Smith Transaction Funding Corporation

McGinn, Smith Transaction Funding Corp. ("MSTF") was a New York corporation controlled by McGinn and Smith through McGinn, Smith Holdings LLC, a New York limited liability company owned by McGinn, Smith, and another. According to the PPM for MSTF, investors could purchase up to $10 million of notes which would pay 8% in interest and mature on July 1, 2012. The PPM further stated that, after deducting a 2% underwriting fee, investor money would be used to (a) provide capital to close financial transactions originated by the broker-dealer; (b) invest in other public and private securities; and (c) purchase $1.5 million of the broker-dealer's 2008 Series Cumulative Preferred Stock.

From May 2, 2008 through November 26, 2008, the broker-dealer raised approximately $6.8 million from investors for McGinn, Smith Transaction Funding Corp., and the investor money was deposited into an escrow account for MSTF at Mercantile Bank (account ending in 3083). Between June 12, 2008 and January 16, 2009, the broker-dealer took $339,058 (5%) from the MSTF escrow account in underwriting fees and "loans" to other McGinn Smith entities.

Between August 22, 2008 and July 8, 2009, McGinn improperly diverted $230,000 of investor funds held in the MSTF escrow account by directing that the money be wired to his personal bank accounts at M&T Bank (ending in 9504 and 2675) (the "Diverted MSTF Money"):

| Date | Amount | McGinn Account Number |
|---|---|---|
| 08/22/2008 | $50,000 | 9504 |
| 09/08/2008 | $50,000 | 9504 |
| 10/22/2008 | $20,000 | 9504 |
| 10/27/2008 | $50,000 | 9504 |
| 11/07/2008 | $30,000 | 9504 |
| 07/08/2009 | $30,000 | 2675 |

These transactions were all booked as loans from MSTF to McGinn with entries that the money was "due from" McGinn to MSTF. On February 27, 2009, McGinn wired $100,000 from his personal bank account into MSTF's checking account ending in number 6207. After all of these transactions, McGinn still had $130,000 of MSTF investor money.

In April 2009, when SHEA returned to the broker-dealer, he began to review and update the bank and accounting records associated with MSTF, and he noticed that, other than the accounting entries, there were no promissory notes, imputed interest, payment schedules, or even principal or interest payments supporting the classification of the Diverted MSTF Money as "loans."

During the summer and fall of 2009, FINRA was examining the broker-dealer. In response to requests from FINRA, Smith directed SHEA to gather information and documents. In September 2009, FINRA noticed inconsistent accounting entries regarding "loans" from TDM Cable Funding LLC (an entity owned by McGinn, Smith, and another) to McGinn, Smith, and the other owner. After noticing the inconsistencies, on September 30, 2009, FINRA, among other actions, requested "all documentation related to loans made payable to" Smith, McGinn, and others from a list of entities including, among others, MSTF and TDM Cable Funding, LLC. Smith informed SHEA of this request, and SHEA was aware that no such documentation existed.

At some point during the FINRA examination, Smith told SHEA he was concerned that McGinn had taken the Diverted MSTF Money because that was not permitted by the PPM. Smith asked SHEA what other transactions occurred at the same time that McGinn had taken the Diverted MSTF Money, and SHEA identified $360,000 that Smith had taken from NEI Capital, LLC (another entity owned by McGinn Smith Holdings LLC which was owned by Smith, McGinn, and another). Smith told SHEA that the Diverted MSTF Money that McGinn had taken from the MSTF escrow account should appear to have come from NEI, and he directed SHEA to create false accounting entries by booking the transactions related to the Diverted MSTF Money as money that McGinn had received from NEI Capital, LLC, not MSTF.

As directed by Smith, on November 2, 2009, SHEA made false accounting entries on the books for MSTF and NEI Capital, LLC to make it appear, falsely, that the Diverted MSTF Money had come from NEI Capital LLC, not the MSTF escrow account. Specifically, SHEA made an entry in the MSTF books stating that the "loans" due from McGinn were actually due to NEI. A false accounting entry was also made to the NEI books stating that MSTF owed NEI $130,000. At the time SHEA made the false accounting entries, he was aware that the false entries would conceal and disguise (i) that McGinn had improperly taken the Diverted MSTF Money and (ii) the true amount of income that McGinn had received in 2008 and 2009.

Also on November 2, 2009, as directed by McGinn and Smith, backdated promissory notes were created by others regarding money that McGinn and Smith had improperly diverted in connection with offerings of other unregistered securities. On November 16, 2009, as directed by Smith, SHEA sent the newly prepared backdated promissory notes to FINRA with a cover letter that he had prepared stating, "Attached you will find the documentation as requested in item #5 in your September 30, 2009 correspondence." SHEA did not disclose that the promissory notes had just been created.

On October 15, 2009, McGinn filed his joint 2008 U.S. Individual Income Tax Return, and that return did not include any of the payments that he had received from MSTF's escrow account. On March 7, 2011, McGinn filed his joint 2009 U.S. Individual Income Tax Return and that return did not include any of the payments that he had received from MSTF's escrow account.

SHEA also knew that between June and August 2009 approximately $216,000 was diverted from MSTF to pay investors in Firstline Trust 07, Firstline Senior Trust 07, Firstline Trust 07 Series B, and Firstline Senior Trust 07 Series B (the "Firstline Trusts"). Investors in the Firstline Trusts had purchased unregistered securities in return for monthly payments on their investments to be paid from the revenue stream produced by loans made by McGinn Smith Funding LLC ("Funding") to Firstline Security, Inc., a Utah corporation which provided security alarm services. When SHEA learned that the money had been diverted from MSTF, he was aware that Firstline Security, Inc. had filed for bankruptcy approximately 18 months earlier, on January 25, 2008, and that the company had not made any payments on the loan since then. Neither Firstline, nor MSTF investors were aware of the diversions.

The investigation was conducted by the Criminal Investigation Division of the Internal Revenue Service and the Federal Bureau of Investigation. The case is being prosecuted by Assistant United States Attorneys Elizabeth C. Coombe and Richard D. Belliss of the United States Attorney's Office for the Northern District of New York.