

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION :

*Plaintiff,*

vs.

Case No. 1:10-CV-457  
(GLS/CFH)

McGINN, SMITH & CO., INC., :  
McGINN, SMITH ADVISORS, LLC :  
McGINN, SMITH CAPITAL HOLDINGS CORP., :  
FIRST ADVISORY INCOME NOTES, LLC, :  
FIRST EXCELSIOR INCOME NOTES, LLC, :  
FIRST INDEPENDENT INCOME NOTES, LLC, :  
THIRD ALBANY INCOME NOTES, LLC, :  
TIMOTHY M. McGINN, AND :  
DAVID L. SMITH, GEOFFREY R. SMITH, :  
Individually and as Trustee of the David L. and :  
Lynn A. Smith Irrevocable Trust U/A 8/04/04, :  
LAUREN T. SMITH, and NANCY McGINN, :

*Defendants,*

LYNN A. SMITH and  
NANCY McGINN,

*Relief Defendants. and*

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

*Intervenor.*

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**THIRD WRITTEN STATUS REPORT OF THE RECEIVER**

This Report describes relevant events respecting the status of the Receivership Estates at this time and also incorporates by reference updates which have been posted regularly on the Receiver’s website since the commencement of this action ([www.mcginnsmithreceiver.com](http://www.mcginnsmithreceiver.com)).<sup>1</sup> This Report also supplements the First Report of the Receiver (Docket No. 49) and the Second Written Report of the Receiver (Docket No. 425). The Receiver’s Motion for an Order (I)

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<sup>1</sup> The Receiver’s website contains more detailed descriptions of each of these events and others which were reported to investors contemporaneously with their occurrence.

Approving Plan of Distribution of Estate Assets (“Plan”) and (II) Authorizing Interim Distributions was approved by Court Order on October 31, 2016 (Docket No. 904). The Court directed the Receiver to file this status report in six months of the date of its January 20, 2017 Text Order.

### **Summary of Events**

While this action was commenced by the SEC on April 20, 2010, both civil and criminal proceedings against the defendants and relief defendants continued through April 18, 2016 when the Second Circuit Court of Appeals, following a series of prior appeals by the defendants, affirmed the SEC’s judgments against David Smith, Timothy McGinn, Lynn Smith, the Smith Trust, Geoffrey Smith and Lauren Smith. The criminal convictions on February 6, 2013 of David Smith and Timothy McGinn resulted in their incarceration in federal prisons while serving their respective 10 and 15-year sentences.

During the period from 2010 to 2013, the Receiver continued to operate multiple businesses (other than the securities business) which had been under the control of McGinn Smith, and eventually sold each of those businesses for positive cash after stabilizing their operations. During the Receivership, all of the businesses operated profitably, which profits (after expenses) were recovered for eventual payment to defrauded investors. Those businesses included Alarm Traders (alarm service business), Cruise Charter Ventures (high-end luxury cruise vacations), Benchmark (triple play business in the Gulf Southeast providing cable, telephone and internet service to apartment and condominium complexes), YOLO (adult-themed cruise charters, which the Receiver did not operate but liquidated shortly after the commencement of the action), and Seton Hall (medical office building in Troy, New York).

Other McGinn Smith assets were collected and liquidated over time with the proceeds deposited into the Receiver's accounts.

During 2012, the Receiver also initiated a court-approved claims allowance process for investors and creditors through a confidential database for which investors were provided a confidential password to review their allowed claims and for those holding disputed claims to file paper claims with the Receiver by an established bar date. The vast majority of claims were granted "allowed" status. The Receiver classified claims as "disputed" primarily when the investor had received preferential treatment or had engaged in conduct or had a relationship making it inequitable or unlawful to distribute monies to those disputed investors. At the Court's direction, the same process was also established for equity claims, but equity claims are not receiving a distribution under the Plan since it is unlikely that investors will be repaid in full.

In 2012, the Receiver sold the Smiths' Vero Beach property following litigation pursued by the Smith's challenging the Receiver's authority to do so, and in 2014 the Receiver also successfully sold the Smiths' Sacandaga Lake property following extensive litigation between the Smith Trust and the SEC concerning the Receiver's authority to sell the same. Each sale resulted in material proceeds for investors. The McGinn residence was also sold during this time, and the Verifier investment was also successfully liquidated for \$4 million in 2013 by the Receiver.

During the Receivership period and following the sale of the alarm business, the Receiver vacated the office premises at 99 Pine Street and moved all records to a storage location. The Receiver continues to employ a controller on a part-time basis for continued reconciliation of the financial records, the preparation of tax returns and assistance with administration of the claims

process, which involves both verifying data, review and approval of claims, and the issuance of checks.

At this time, the Receiver has two record storage locations, and a process for the destruction of those records will begin later in 2017.

### **Liquid Assets of the Estate**

As of July 14, 2017, estate assets total \$21,350,384. This compares favorably to the initial account balance of \$485,491.63 at the time of the commencement of the Receivership in 2010, as described in more detail in the First Report of the Receiver (Docket No. 49).

### **Plan of Distribution**

On December 31, 2015, the Receiver filed the Plan for Court approval anticipating the eventual conclusion of the defendants' litigation with the SEC, which litigation eventually concluded successfully for the SEC on appeal in April 2016. The Court approved the Plan and overruled objections on October 31, 2016. Once the Order approving the Plan became final on December 1, 2016, the Receiver activated the process to make Plan distributions to investors with allowed claims.

On December 23, 2016, the Receiver posted an announcement on the Receiver's website that each investor would receive in early 2017 an explanatory investor letter from the Receiver, an Investor Questionnaire, and IRS Form W-9 for completion. The investor letter (one for each claimed investment) provided the investor with a claim number, the Investor Questionnaire and W-9 Form along with a self-addressed return envelope. The investor letter also contained instructions on how to complete each Investor Questionnaire, information once again about the Receiver's website where investors could obtain current information about the Plan distribution

process, an explanation that distributions would be made in groups on a rolling basis to holders of allowed claims as properly completed Investor Questionnaires and W-9 forms were returned, and that claims which were marked with a “D” for disputed or “P” as paper claim would be subject to a claims objection process to either deal with a dispute or the expungement of what were duplicate paper claims.<sup>2</sup> A form copy of the investor letter and Investor Questionnaire are attached as **Exhibit A**.

In preparation for the mailing of several thousand Investor Questionnaires, the Receiver created an expanded claims database based partially upon the Receiver’s original confidential (password protected) 2012 claims database posted to the Receiver’s website which investors had used to determine whether their claims had been properly calculated and allowed by the Receiver. Also, during this time, the Receiver’s staff coded claims as accepted, disputed or duplicate paper claims so as to properly code and provide each investor with a claim number.

On January 25, 2017, a sample investor letter and Investor Questionnaire was posted to the Receiver’s website so that investors could begin to assemble the information necessary to complete their individual mailings. During this time, those website postings caused many investors to submit change of address or death notices, which the Receiver’s staff used to request needed information (such as original Death Certificates and Letters Testamentary) and to update the Receiver’s database. Once the database was updated, several thousand investor letters, Investor Questionnaires and W-9 forms were mailed to investors. A target date of February 28, 2017 was established for return of the completed information, but that date was not a legal bar date.

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<sup>2</sup> The Court-approved claims process did not require the filing of a “paper” claim unless the investor disagreed with the Receiver’s posted claim or the claim was marked “disputed” on the Receiver’s confidential claims database. Unfortunately, some investors with allowed claims nevertheless filed duplicative paper claims.

Following return of those materials to the Receiver's office, the Receiver's staff cataloged the Investor Questionnaires and W-9 forms, marked and updated the database indicating those which had been returned and began preparation for review of those materials.

The Receiver announced on March 9, 2017 in a website update that the distribution range estimated in the Receiver's April 19, 2016 posting remained the same, which would result in approximately 13.5 to 21.7% being distributed to investors.

On April 13, 2017, the Receiver's staff completed the cataloging of all Investor Questionnaires and W-9 forms which had been returned by that date with claim review then underway. As of this date, five Payment Schedules of First Investor Distributions have been filed with the Court aggregating 508 total investor claims, with a total distribution value of \$1,465,434.00. The First Investor Distribution will be made at ten percent of the amount of each allowed claim. The Receiver expects that all properly completed allowed claims will be reviewed and processed for the First Investor Distribution by approximately August 14, 2017, subject to whether the Court intends to further review or approve Distribution Schedules as indicated in Docket No. 908.

### **Claims Objections**

The Receiver expects to file by August 4, 2017 a motion to expunge duplicate claims. The 2012 claims process did not require investors to file paper claims unless they disagreed with the Receiver's posted claims. Unfortunately, some investors filed paper claims. This results in investors having duplicate claims, and a customary claims process involves the need to expunge the duplicate claims which the Receiver will do in an omnibus motion. Many investors have

written to voluntarily expunge the duplicate paper claim when the situation has been explained to them.

Additional claims objection motions will be made thereafter on an ongoing basis for disputed claims, which are largely due to certain investors having received preferred treatment or engaged in conduct or had a relationship making it inequitable or unlawful to distribute monies to those disputed investors. The outcome of the disputed claims objections will affect the percentage of eventual allowed investor claim recoveries.

### **Various Tax Issues**

There have been a few different tax issues which required resolution in this action. The first occurred in 2012 and 2013 causing the Receiver to initiate a motion (Docket No. 658) establishing the priority of victim investor claims over the IRS and declaring the Receiver not personally liable for tax liabilities of the Receivership, the MS Entities or other defendants on account of distribution of assets in accordance with Court Orders. The motion resulted in the Department of Justice Tax Division providing the Receiver with a April 3, 2015 letter confirming that the IRS would permit distributions to investors with priority over the IRS provided that the Receiver dealt separately with the tax claims against the personal assets of the Smith Trust and the Smiths such as their brokerage account, which might eventually be included within estate assets for distribution purposes.

More recently, as a result of the effective substantive consolidation provided for by the Plan, the Receiver is reviewing if any taxes might be due as a result of that approach and also as a result of the sale of the Smith Vero Beach house, the Smith Sacandaga property and brokerage account assets being incorporated into investor distributions.

Given that the Receivership includes 80 entities, there have been over 530 tax returns filed and which will continue to be filed until final tax returns can be filed following all distributions having been made.

### **Remaining Assets**

The Receiver continues to collect modest installment payments by certain parties which settled claims with the Receiver. Those monies are deposited into the Receiver's accounts and will continue to be received until paid in full.

There is one relatively significant remaining asset to be collected which is commonly known as the CMS investment. It is an equity position in the Coventry Healthcare entities. The position appears to be illiquid. While the Receiver had reached a Memorandum of Understanding in 2014 with CMS to raise funds in order to buy out the McGinn Smith position, CMS was not successful in being able to raise those monies. The Receiver continues to monitor the situation for an opportunity to liquidate the investment.

### **SEC Proceeding Against McGinn Smith Brokers**

As reported on the Receiver's website on September 24, 2013, the SEC charged ten McGinn Smith brokers with ignoring red flags which should have led them to conduct more due diligence into the securities they were recommending to their customers. The Receiver testified twice in the proceeding on behalf of the SEC. On February 25, 2015, the SEC prevailed in the broker proceeding. Among the remedies granted was disgorgement of commissions plus interest against seven brokers and a civil money penalty which, if the broker decision is upheld on appeal



and collected, will be added to defrauded investor recoveries. The broker decision is currently on appeal and will be heard on appeal by the Commission on August 15, 2017.

Dated: July 19, 2017

PHILLIPS LYTTLE LLP

By /s/ William J. Brown  
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and

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Doc #01-3054152.2

# *Exhibit A*

**William J. Brown, as Receiver  
of McGinn, Smith & Co., Inc., et al.**

Tel: 716.847.7089  
www.mcginnsmithreceiver.com

One Canalside  
125 Main Street  
Buffalo, NY 14203

January 20, 2017

**Claim No. 1234 A**

Re: McGinn Smith Plan of Distribution and Claims Distribution Process

Dear McGinn Smith Investor:

I am pleased to enclose, in my capacity as Receiver, the following documents for you to complete and return which is the next step in returning to investors with allowed claims the money they deserve:

1. Investor Questionnaire (individualized for each investment you hold or claim);
2. W-9 Form; and
3. Self-addressed return envelope.

Please truthfully and accurately complete each Investor Questionnaire you receive in a legible manner. The Investor Questionnaire is to be signed under penalty of perjury and, along with the completed W-9 Form, returned in the enclosed envelope. You must apply postage before mailing the envelope with the completed materials.

As you undoubtedly know from the Receiver's website ([www.mcginnsmithreceiver.com](http://www.mcginnsmithreceiver.com)), the Plan of Distribution filed with the Court on December 30, 2015 at Docket No. 847 was approved by the Court on October 31, 2016 at Docket No. 904 and became final and no longer subject to appeal in December 2016. Given the cost of mailing updates to investors and parties in interest by U.S. Mail, the Receiver's website serves as the place at which investors can receive timely information and updates. I encourage you to check the website every few weeks.

Distributions will be made in groups on a rolling basis to holders of allowed claims as properly completed Questionnaires and W-9 Forms are returned. If your forms are incomplete, illegible or not returned, distributions will be delayed or not made.

In order to maintain an orderly process, I request that all completed materials be returned no later than February 28, 2017.

While the vast majority of investor claims are allowed and not disputed, if your claim is marked as Disputed on the Receiver's website, **D** or **P** is listed next to your Claim No. above, or is otherwise challenged as Disputed, the Receiver intends to file a Motion with the Court with notice given to you of a Court hearing to resolve issues regarding the claim.

**PLEASE RETAIN THIS LETTER SINCE IT CONTAINS YOUR CLAIM NUMBER FOR THIS CLAIM WHICH YOU WILL NEED TO IDENTIFY PAYMENTS TO BE MADE TO YOU.**

I thank you for your anticipated cooperation.

Very truly yours,

William J. Brown, Receiver

Doc #01-3011494.2  
Enclosures

## Securities and Exchange Commission vs. McGinn, Smith & Co. Inc. Investor Questionnaire Pursuant to Receiver's Plan of Distribution

This two-sided form is individualized for each investment you hold or claim per the Receiver's records. A Questionnaire will be mailed to you for each investment. Each form must be completed, properly signed, and returned to the Receiver in the enclosed envelope along with the completed W-9 Form.

No distribution checks will be paid to an Investor with an Allowed Claim until a Questionnaire has been properly completed for each investment and received by the Receiver.

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Name of Investor(s)	Description of Investment	Amount of Investment
John Doe  Claim No. 1234 A	FEIN SECURED SENIOR SUBORDINATED NOTES DUE 01/30/2009	\$10,000

Social Security Number(s) (for each owner) \_\_\_\_\_

Mailing Address:

Street: \_\_\_\_\_ Apt. #: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip Code: \_\_\_\_\_

Telephone Number (\_\_\_\_\_) \_\_\_\_\_  
Area Code

E-Mail Address \_\_\_\_\_

Is this investment held in an IRA? Yes \_\_\_/No \_\_\_. If so, provide name and address of Trustee where payment should be sent.

IRA Trustee Name \_\_\_\_\_

Trustee Address:

Street: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip Code: \_\_\_\_\_

IRA Account No. \_\_\_\_\_

**Collateral Recoveries**

Did you receive, or are you pursuing or intend to pursue, a recovery from any other source related to McGinn Smith? For example, a recovery through FINRA, other lawsuit, or other type of recovery including insurance.

\_\_\_\_\_ Yes      \_\_\_\_\_ No

If so, how much? (List separately for each Collateral Recovery)

	<u>Net Amount Received by Investor**</u>	<u>Source</u>
1.	\$ _____	_____ Name _____ Address _____ City                      State                      Zip Code
2.	\$ _____	_____ Name _____ Address _____ City                      State                      Zip Code
3.	\$ _____	_____ Name _____ Address _____ City                      State                      Zip Code

\*\* The net amount is the amount received by Investor after all fees are applied. Do not pro-rate among investments.

The undersigned certifies under penalty of perjury pursuant to 28 U.S.C. § 1746 that the information contained in this Questionnaire is true and correct.

Dated: \_\_\_\_\_, 2017.

\_\_\_\_\_  
(Printed Name of Investor 1)

\_\_\_\_\_  
(Signature of Investor 1)

\_\_\_\_\_  
(Printed Name of Investor 2)

\_\_\_\_\_  
(Signature of Investor 2)