

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 4245/October 12, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-16462

In the Matter of

	:	
LYNN TILTON;	:	
PATRIARCH PARTNERS, LLC;	:	
PATRIARCH PARTNERS VIII, LLC;	:	ORDER
PATRIARCH PARTNERS XIV, LLC; and	:	
PATRIARCH PARTNERS XV, LLC	:	

The Securities and Exchange Commission instituted this proceeding with an Order Instituting Proceedings (OIP) on March 30, 2015. The OIP alleges that Respondents violated the antifraud provisions of the Investment Advisers Act of 1940 in their operation of three collateral loan obligation funds (known as the Zohar Funds) by reporting misleading values for the assets held by the funds and failing to disclose a conflict of interest arising from Lynn Tilton's undisclosed approach to categorization of assets. The proceeding was stayed by order of the U.S. Court of Appeals for the Second Circuit between September 17, 2015, and June 2016. *See Tilton v. SEC*, No. 15-2103, 2016 U.S. App. LEXIS 9970, at *37 (2d Cir. June 1, 2016); *Tilton v. SEC*, No. 15-2103, ECF Nos. 76, 125. The hearing is currently scheduled to commence on October 24, 2016.

Under consideration are several motions *in limine* filed by Respondents, seeking to exclude various categories of potential evidence from the record, and responsive pleadings. Specifically, they are motions to:

- (1) Preclude Testimony and Evidence Regarding the Subjective States of Mind of Zohar Fund Investors (August 22, 2016);
- (2) Preclude Evidence Concerning Recklessness and Negligence and to Require the Division to Prove Intentional Misconduct (August 26, 2016);
- (3) Exclude Transcripts of Investigative Testimony, including Division Exhibits 194 Through 206 (September 1, 2016);
- (4) Exclude the *Zohar CDO 2003-1, LLC, et al., v. Patriarch Partners, LLC, et al.*, Case No. 12247-VCS (Del. Ch. Aug. 9 & 10, 2016) Trial Transcripts Marked Division Exhibits 207 and 208 (September 2, 2016);
- (5) Strike as Inadmissible, in Whole or in Part, Certain Lay Opinion Testimony (September 6, 2016);

- (6) Exclude Division Exhibits 71 Through 73 (Ms. Tilton's Testimony, Declaration, and Affidavit from Other Proceedings) (September 12, 2016);
- (7) Preclude the Admission of Any Portions of Investigative Testimony Transcripts without the Introduction of Corresponding Portions of Audio Recordings of the Testimony, and to Exclude Transcripts for which Audio Recordings were not Preserved and Produced (September 12, 2016);
- (8) Preclude the Introduction of Division Exhibits 118-123 (Letters from Respondents' Counsel) (September 12, 2016); and
- (9) Preclude the Division from Introducing into Evidence Exhibits or Portions of Exhibits Containing Unreliable Hearsay, Including (but not Limited to) Exhibits 129, 140, 142, 174, 184, and 190 (September 12, 2016).

General Considerations

The threshold for admissibility of evidence in Commission proceedings is quite low. *See Herbert Moskowitz*, Securities Exchange Act of 1934 Release No. 45609, 2002 SEC LEXIS 693, at *46 n.68 (Mar. 21, 2002) (granting the Division's motion to admit in evidence an indictment of respondent's brother, "while noting the limited relevance and utility of the indictment" to the proceeding and reminding administrative law judges to "be inclusive in making evidentiary determinations"); *City of Anaheim*, Exchange Act Release No. 42140, 1999 SEC LEXIS 2421, at *4-5 & nn.5-7 (Nov. 16, 1999). To the extent that Respondents reference the Federal Rules of Evidence (FRE) in their motions to exclude evidence, the Commission has stated many times that the FRE are not applicable in its administrative proceedings. *See Del Mar Fin. Servs., Inc.*, Securities Act of 1933 Release No. 8314, 2003 SEC LEXIS 2538, at *28 (Oct. 24, 2003), *recons. denied*, Securities Act Release No. 8386, 2004 SEC LEXIS 331 (Feb. 17, 2004); *see also City of Anaheim*, 1999 SEC LEXIS 2421, at *4 ("The Federal Rules of Evidence are designed for juries and do not apply to administrative adjudications. Administrative agencies such as the Commission are more expert fact-finders, less prone to undue prejudice, and better able to weigh complex and potentially misleading evidence than are juries. Our law judges should be inclusive in making evidentiary determinations." (footnotes omitted)); *see also* Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50212, 50226-27 (July 29, 2016) (explicitly rejecting FRE as to hearsay).

Further, the Commission's policy concerning the admissibility of investigative testimony is quite expansive. *See Del Mar Fin. Servs., Inc.*, 2003 SEC LEXIS 2538, at *27-30 (admitting investigative testimony of a respondent, who was unavailable by virtue of "taking the Fifth," for use against other respondents whose interests were adverse to his, while acknowledging that the testimony was "self-serving and unreliable"). However, if either party wishes to offer investigative testimony in evidence, it should offer specific portions, not an entire transcript. *See id.* at *30.

Specific Motions

(1) Motion to Preclude Testimony and Evidence Regarding the Subjective States of Mind of Zohar Fund Investors. Respondents ask that the Division be precluded from introducing evidence of the subjective states of mind of investors in the funds to which

Respondents served as investment advisers, including what investors thought about Respondents' intent or state of mind or the materiality of particular disclosures or non-disclosures. In response, the Division states that it does not anticipate asking investor witnesses about Respondents' intent or state of mind but rather about the details of their investment, including how Respondents' conduct compared with their representations and what an investor viewed as important in making his decision to invest. The Division will not be precluded from offering such proposed evidence. Materiality, of course, is a mixed question of law and fact to be decided by the undersigned.

(2) Motion to Preclude Evidence Concerning Recklessness and Negligence and to Require the Division to Prove Intentional Misconduct. Respondents argue that only “intentional misconduct” – and not “evidence relating to, or in support of, recklessness or negligence standards of liability” – is within the scope of the OIP. This argument is not well taken and is, in fact, frivolous. The OIP alleges that Respondents violated Sections 206(1), 206(2), and 206(4) of the Advisers Act. Scienter is required to establish violations of Section 206(1) of the Advisers Act. *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). Recklessness can satisfy the scienter requirement. *See David Disner*, Exchange Act Release No. 38234, 1997 SEC LEXIS 258, at *14-15 & n.20 (Feb. 4, 1997); *see also SEC v. Steadman*, 967 F.2d at 641-42; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990). Scienter is not required to establish a violation of Section 206(2) or 206(4) of the Advisers Act; a showing of negligence is adequate. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *SEC v. Steadman*, 967 F.2d at 643 & n.5; *Steadman v. SEC*, 603 F.2d 1126, 1132-34 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

(3), (4), (6) Motions to Exclude: Transcripts of Investigative Testimony, including Division Exhibits 194 Through 206; the Zohar CDO 2003-1, LLC, et al., v. Patriarch Partners, LLC, et al., Case No. 12247-VCS (Del. Ch. Aug. 9 & 10, 2016) Trial Transcripts Marked Division Exhibits 207 and 208; Division Exhibits 71 Through 73 (Ms. Tilton's Testimony, Declaration, and Affidavit from Other Proceedings). Respondents request that transcripts of investigative testimony and testimony from other proceedings be excluded. Except for the Tilton materials, the Division disavows any intention to introduce these materials wholesale and states that it intends to use them to impeach or to refresh recollection. The Division is reminded that it must comply with the requirements of 17 C.F.R. § 201.235 should it wish to introduce prior sworn statements of non-party individuals who are unavailable because of death, imprisonment, sickness, or other conditions specified in the rule. The Division argues that the Tilton materials are admissible as party admissions. The Division should specify the portions of the Tilton materials that it proposes to introduce by October 19, 2016. The Division may supplement its designations and Respondents may offer counter-designations by the close of the record of evidence.

(5) Motion to Strike as Inadmissible, in Whole or in Part, Certain Lay Opinion Testimony. Respondents ask that lay opinion testimony, whether contained in testimonial transcripts or live testimony, that lacks foundation, contains legal conclusions, or is based on specialized knowledge be excluded. In light of the fact that this case is being tried to the undersigned and not to a lay jury, it is unnecessary to specifically order in advance that such

evidence be excluded. If such evidence that Respondents consider inappropriate comes into the record, Respondents may argue against its weight in their post-hearing briefs.

(7) Motion to Preclude the Admission of Any Portions of Investigative Testimony Transcripts without the Introduction of Corresponding Portions of Audio Recordings of the Testimony. In response, the Division notes that the investigative testimony was memorialized by court reporters who certified the transcripts to be accurate. The Division has also obtained and provided to Respondents audio recordings of investigative testimony taken from six individuals, including Respondent Tilton, and does not have access to any additional audio recordings that may exist. The motion will be denied. To the extent that investigative testimony is admitted in evidence in Commission proceedings, it is routinely in the form of transcripts prepared by court reporters. Similarly, hearing testimony enters the record in the form of written transcripts.

(8) Motion to Preclude the Introduction of Division Exhibits 118-123 (Letters from Respondents' Counsel). The letters are from Respondents' Counsel to the Division, sent between August 2011 and February 2015 concerning various aspects of the Division's investigation, including discovery and background information on Respondents' businesses. The Division's response to the motion does not make clear the purpose for which the Division proposes to introduce the letters. On the one hand, if the Division intends to use the letters to establish uncontested facts, *e.g.*, the dates when Respondents were organized, in an efficient matter, admitting them would be unobjectionable and their weight would be unquestioned. However, to the extent that the letters are used for impeachment or to establish contested facts, they should be authenticated, and arguments about their weight are best made in post-hearing briefs.

(9) Motion to Preclude the Division from Introducing into Evidence Exhibits or Portions of Exhibits Containing Unreliable Hearsay, Including (but not Limited to) Exhibits 129, 140, 142, 174, 184, and 190. The motion, in part relies on the FRE, which are inapplicable. Additionally, several of the objected-to proposed exhibits are email chains that include Respondents; and emails in the chains from others must be included for completeness (not for the truth of what the others said). That being said, any exhibit offered by the Division must be authenticated (unless Respondents agree to the exhibit's authenticity, for example, as a business record).

IT IS SO ORDERED.

/S/ Carol Fox Foelak
Carol Fox Foelak
Administrative Law Judge