UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15519

In the Matter of

Timbervest, LLC,

Joel Barth Shapiro,
Walter William Anthony Boden, III,
Donald David Zell, Jr.,
and Gordon Jones II,

Respondents.

Donald David Zell Jr.'s
Appeal to the Commission

DONALD DAVID ZELL, JR.'S APPEAL TO THE COMMISSION

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The Commission should reverse the Initial Decision of Administrative Law Judge Cameron Elliot rendered on August 20, 2014 (the "Decision") because the evidence fell woefully short of supporting its findings that Zell aided and abetted and caused violations of §§ 206(1) and 206(2) of the Investment Advisers Act. During the relevant period, Zell served as the Chief Operating Officer and was a principal of co-respondent Timbervest, LLC, a registered investment adviser.

Despite a wealth of evidence demonstrating that Zell acted in good faith at all times in this matter, the Decision found that he acted with scienter with respect to the sale of a property by one Timbervest client and the subsequent purchase of that property by a Timbervest fund, and that he acted negligently in connection with fees received by one Timbervest partner that were disclosed to a client representative by another Timbervest partner. (Decision at 46-47, 53-54.) As discussed more fully below, the evidence showed that Zell acted reasonably at all times and without scienter or negligence on these issues. Furthermore, for the reasons discussed in Timbervest's brief, the Decision improperly concluded that Timbervest violated §§ 206(1) and 206(2) and improperly awarded disgorgement and interest against Timbervest and Zell.

I. There is no evidence that Zell acted recklessly or negligently with respect to the Chen Transactions.

The ALJ's Decision found that Zell acted with scienter in connection with the sale of a property by Timbervest's client, New Forestry, to Chen Timber, and by the subsequent purchase of that property by Timbervest Partners, LP, a fund managed by Timbervest. (Decision at 46-47.) The Decision offers no sound reasoning for finding Zell acted with scienter.

The Decision's stated basis for finding Zell acted with scienter in connection with the Chen Transactions was because "he would have been aware that Timbervest's official valuation of Tenneco Core in August 2006 was not consistent with the Tenneco Noncore data, and that the time lapse between the sale and repurchase was unusually small, and he testified that he could not recall any instances where Timbervest sold a property and then bought it back." (Dec. at 47.)

These reasons are fatally flawed. The Decision also suggests, without any reasonable basis, that Zell's testimony about his understanding of ERISA supports a finding that he acted with scienter.

A. Zell had no reason to question Timbervest's official valuation of Tenneco Core

Zell's only involvement in the transactions was as a member of Timbervest's Investment Committee. He did not have day-to-day responsibility for reviewing purchase and sale contracts, nor was he involved in the negotiation of either the sale or the purchase of any of the properties. (Tr. at 1640, 1648.) Zell's role was to review the purchase and sale to make sure that it fit the client's needs. (Tr. at 1567.) He evaluated the transactions as a member of the Investment Committee and ultimately decided that each transaction was a good deal for each client. (Tr. at 165-67.) First, the sale of Tenneco Core was in line with the client's investment mandate. In 2006, New Forestry wanted a substantial reduction in its timberland holdings. (Div. Ex. 47.) The ALJ found that "I agree with Respondents that [the sale of Tenneco] . . . furthered BellSouth's stated goal of generating liquidity . . . ." (Decision at 44.) In fact, it wanted more than $220 million in sales over a three-and-a-half year period. (Div. Ex. 47; Tr. at 102-03, 476.) For those properties that remained in its portfolio, New Forestry wanted properties that would generate cash flow of 2% per year. (Div. Ex. 47.) Tenneco Core, though, consisted of 75% pulpwood, meaning that the majority of trees were young and would not be income-producing for quite some time. (Tr. at 201, 483-84.) Selling Tenneco Core would therefore fit both of New Forestry's investment mandates: dispositions to reduce its timberland holdings and dispositions of property that would not generate substantial income.

The terms of the sale also were excellent for New Forestry. Based on Timbervest's own timberland valuation policy, which every client, including New Forestry, understood and approved of, the $13.45 million sales price exceeded Tenneco's value by $1.4 million, or 11.7%. (Tr. at 206-07.) Moreover, an August 2005 appraisal from a premier timberland appraisal firm, James Sewall Company (the most recent appraisal available to Timbervest based on its valuation policy), valued Tenneco Core at $12.13 million. (Resp. Ex. 52; Tr. at 207, 211, 1665.) The final sales price exceeded the appraised value by 11%. And importantly, Sewall appraised the bare land at $438 an acre, whereas the sale to Chen Timber provided New Forestry with $547 an acre for bare land—and increase of almost 25% in the land alone. (Resp. Ex. 52; Tr. at 200-01, 207, 210.) With these facts, it is impossible to say that Zell was reckless or negligent with respect to the valuation of Tenneco Core, and the ALJ's finding to this extent was in error.

Contrary to the ALJ's finding, there is simply no evidence showing that Zell "would have been aware that Timbervest's official valuation of Tenneco Core in August 2006 was not consistent with the Tenneco Noncore data" because that factual assumption is wrong, and, even if it were correct, there is no evidence that Zell knew or should have known that to be the case. (Decision at 47.)

First and foremost, the value of the Tenneco Noncore properties was largely irrelevant to the value of the Tenneco Core because the two properties had different sizes, locations, property features, valuations, and markets of potential buyers. The Wolf Creek properties were smaller tracts, more affordable for individual buyers interested in recreational properties, and were therefore worth much more on a per acre basis. (Tr. at 233.) The sales were handled exclusively by a third-party sales agent under an auction and direct sale arrangement. (Div. Ex. 128.) Information regarding the first few actual sales was not known to Timbervest and Zell until October 30, 2006. Importantly, even at that time, the pricing from the first few sales only represented four sales from the initial auction process conducted by the third party sales agent.

Moreover, the August 2006 report to which the Decision cites as evidence that Zell knew about the Tenneco Noncore data before Tenneco Core sold did not report values based on actual sales. (Div. Ex. 16.) It simply reported estimated sale prices that Timbervest hoped to get for a number properties. (*Id.*) It did not report actual sales or prices that were assured in any manner. In fact, the complete sales program for the Wolf Creek properties would ultimately encompass over eighteen separate property sales spanning more than four years and yield average prices materially below those of the first four sales in November 2006, belying any contention that the August 2006 report's estimate sales price showed a guaranteed return.

The purchase transaction was also a good one for TVP. In 2006 and 2007, TVP was looking for properties that would fit its long-term growth investment strategy. TVP was willing to inject capital into property—necessary for the future success of Tenneco Core, given its younger timber profile and "big, bulky tracts." (Tr. at 233-34.) And all the economic indicators available to Timbervest showed the repurchase price to be fair. First, between the sale and purchase, the value of the timber on the property increased by more than $950,000—making up nearly the entire price differential. (*See* Tr. at 200-01.) Moreover, the price was supported by the initial sales from the nearby Wolf Creek tracts, which were averaging $1,461 per acre. (Div. Ex. 128.) In contrast, TVP secured the property at a price of $1,116.37 per acre. During this period, the NCREIF timberland index had an 8.5% increase in value, and the Plum Creek REIT saw a 15% increase in value over the same timeframe, both signs of strengthening timberland markets. (Div. Ex. 83; Tr. at 205, 853-54.) TVP secured the property at an increase in price of less than 8%. Given the strengthening market, TVP got a good deal on this acquisition and saw value from day one.

B. Zell had no reason to question the timing of the transactions

Apparently recognizing the weakness in finding Zell was reckless or negligent in valuing the properties, the ALJ's Decision finds that Zell was reckless because the timing of the two transactions was ostensibly suspicious. (Decision at 47.) However, this finding is unsupported by the evidence. The evidence showed that nearly seven months passed between the two points when Zell would have been evaluating the two transactions – that is, when the Investment Committee would have evaluated the sale and when it would have evaluated the purchase. The Investment Committee most likely would have evaluated the sale to Chen Timber in May or June 2006 because, on dispositions, the Investment Committee evaluates the transaction during negotiations with the other party and before a contract is signed. (Tr. at 1422-24.) As Wooddall testified, these negotiations took place 40 to 50 days prior to Wooddall sending the draft contract on July 7, 2006. (Tr. at 856.) It then would have evaluated the acquisition in January 2007, during the acquisition due diligence period, because when evaluating acquisitions, the Investment Committee evaluates deals shortly before the due diligence period ends and earnest money goes hard. (Tr. at 1422-24.) Nothing in the record supports a finding that it would have been suspicious for one client to sell a property in June and another client to purchase the same property the following January. In addition, market indicators supported each deal at the time it was made.

The Decision suggested that Zell somehow contradicted himself by explaining that he viewed the two transactions as "very separate," but also not disputing how the nature of the transactions made the conflict of interest "seemingly obvious." (Decision at 47.) This finding was clearly in error. The Decision cites transcript pages 1566-67 for this proposition, and a review of this testimony shows that Zell did, in fact, dispute that there was a "seemingly obvious conflict of interest." That phrase was used only by the Division's attorney and never by Zell. (Tr. at 1566-67.) Zell disputed this conclusion by explaining that the two transactions from what he had seen were completely separate transactions. (*Id.*) They were evaluated separately, and to his knowledge, they were negotiated separately. (Tr. at 1566-67.) Separate transactions are not a conflict of interest and cannot give rise to one. Accordingly, the Decision erred in finding that Zell acted recklessly based on the timing of the two transactions.

C. <u>Zell had no reason to question the unique nature of these transactions</u>

The Decision found Zell acted with scienter because "he testified that he could not recall any instances where Timbervest sold a property and then bought it back." (Decision at 47.) Without any explanation, the ALJ faults Zell because this was the only time these circumstances presented themselves. (Decision at 47.) The current principals of Timbervest acquired the adviser in 2005. (Tr. at 1404.) Every transaction and deal in the days, months, and first year or two following the acquisition was sure to be unique to them at that time. With perfect hindsight, it is easy to look back over eight years and to highlight how one transaction was different from any other transaction that occurred over the next eight years. But there is no evidence in the record that Zell perceived these transactions to be unique or otherwise suspicious at the time in a way that would cause him to do more than he did.

As discussed above, Zell appropriately reviewed the economics of each transaction, and the data available at the time of each review fully supported Zell's approval of each transaction. The Decision erred in faulting Zell for not doing more than he did simply because this transaction pattern did not repeat itself in the following eight years.

D. <u>Zell's testimony about ERISA shows he was honest and did not act with scienter.</u>

The Decision also criticized Zell for his candid answers about his level of understanding ERISA issues, but it offered no credible explanation for how Zell's understanding of ERISA could support a finding of scienter. (Decision at 46.) The Decision cites Zell's testimony that "he has a general knowledge of ERISA, and that he would not have thought about a proposed sale and repurchase of Tenneco Core in terms of ERISA." (*Id.*) The Decision faults Zell for explaining that he did not have "any expertise" in the question of whether "ERISA would be violated if the amount of the offer for the repurchase had been agreed upon prior to the initial sale." (*Id.* at 46-47). The ALJ unfairly criticized Zell by saying he "disingenuously downplayed his knowledge of ERISA," yet provided no evidence that Zell had any legal training in ERISA or any other area of the law because, in fact, he had no such training. (*Id.* at 46.) Zell testified that he has a general knowledge of ERISA but never testified that he was an expert (Tr. at 1670-74.) All that Zell denied was knowing the answers to very specific questions about ERISA. (Tr. at 1671-74) Even the Division's key witness, Schwartz, who testified as an expert in other ERISA matters and described that he had "a good familiarity with ERISA," when asked whether ORG, as a qualified plan assert manager, could approve the Boden fee arrangement under ERISA, testified that he could not answer the question without speaking to legal counsel because "ERISA is pretty technical and complicated." (Tr. at 2048, 2146.) It is simply unreasonable to criticize Zell for not knowing answers to complex ERISA questions when even lawyers who specialize in ERISA matters disagree about the answers to those questions. ERISA law is considered one of the most complex areas of law, and even very experienced lawyers routinely defer ERISA questions to ERISA specialists. Indeed, the two esteemed experts who testified at the hearing did not agree about how ERISA should be interpreted on seemingly simpler questions. (Div. Ex. 137; Resp. Ex. 124.)

The Decision notes that when Zell was asked "how the sale and repurchase of Tenneco Core could have been seen as a mechanism to avoid ERISA restrictions," his candid answer was "I guess it could be interpreted that way." (Decision at 47). What the ALJ did not explain is how such an honest answer evidences any scienter on his part. It simply does not. Similarly, the Decision observed that when Zell was asked "if the unusual nature of the transaction caused him any concern from an ERISA, conflict of interest, or Advisers Act perspective," Zell stated, "I just looked at them as two very separate transactions and they stood alone, so I did not think in those terms." (Decision at 47; Tr. at 1568.) Not only does the Decision simply fail to explain why such an answer could possibly support a finding of scienter, it fails to recognize this answer was the honest answer showing that Zell did not believe and had no reason to believe that these transactions were not good for each client separately and posed no conflict of interest. The answer reflected how these two transactions were perceived by Zell at the time. One transaction he likely reviewed as an Investment Committee member in May or June 2006, and the other he likely reviewed in January or February 2007. (Tr. at 1422-24.) There certainly is no evidence contradicting Zell's testimony about his perception.

II. There is no evidence that Zell acted negligently with respect to Boden's fees.

Zell understood that Shapiro disclosed the agreement to the client's representative, ORG and Schwartz. (Tr. at 1541.), and as the ALJ recognized, Zell was "entitled to rely on Shapiro's representation . . . that he had obtained consent [for Boden's fees] from Schwartz." (Decision at 54.) That uncontested evidence clearly shows that Zell did not cause or aid and abet any violations of Section 206 of the Advisers Act, and that should be the end of the analysis.

The Decision, however, found that Zell acted negligently for three reasons. The ALJ faults Zell for not giving any thought to buying Boden out of his fee agreement. (Decision at 53.) It faults him for signing a $300 check to Boden's LLC in connection with the $13.45 million transaction. (Decision at 54.) Finally, based on Zell's ERISA experience, the Decision found Zell negligent for not exercising more care in documenting Shapiro's disclosure of and the client representative's consent to the fee. (*Id.*)

A. <u>Zell was not negligent for failing to buy out Boden's fee agreement.</u>

First, the Decision's finding that Zell was negligent because he failed to consider buying Boden out of his fee agreement (Decision at 54.), is nonsensical. Had Timbervest purchased the fee agreement, the conflict would not cease to exist. It would continue to exist. Timbervest would have been entitled to collect the fees rather than Boden. To be sure, this would have moved the conflict to Timbervest, for whom the client already decided that it was appropriate to be conflicted by paying it a disposition fee and a reduced management fee to motivate Timbervest to sell its properties. (*See* Div. Ex. 47.) But this would not provide any better solution than disclosing Boden's conflict to the client's representative, which the Respondents all believed had happened.

Therefore, failing to consider buying Boden out of his fee agreement was not negligent.

B. <u>Zell was not negligent for signing a $300 check.</u>

Second, the Decision unreasonably found that Zell was negligent because he signed a $300 check to Fairfax Realty Advisors, LLC—the company through which Boden received his fee on the sale of Tenneco Core. (Decision at 54.) This check corrected a mathematical error in Boden's fee perpetuated on the closing statement. (Tr. at 670.) The ALJ found that, based on signing this check, Zell should have known that an LLC was involved in the transaction. (Decision at 54.) But signing the check and seeing that an LLC was involved do not make Zell negligent. As the Decision recognized, Zell routinely received a stack of checks with supporting documentation, including appropriate approvals, and would sign them in one sitting. (Decision at

54; *see also* Tr. at 1569-70, 1656.) There is no evidence that, based on signing the check at issue, Zell would have any reason to question the details of a fully-approved and completed transaction. It was simply a $300 check correcting a calculation error at closing in connection with the sale of a property. (Tr. at 670.) This would not have reasonably caused Zell to question whether, how, or why Boden's lawyer had established the LLC. Zell had no reason to know whether this was Boden's LLC or that of someone else who was due to receive a payment in connection with the closing of the transaction.

Even if Zell had learned that this particular check was going to an LLC for the purpose of receiving Boden's fee, he would have had no reason to question this fact as unusual or suspicious. He understood Boden would be receiving a fee. (Tr. at 397-98.) He also understood, as the Decision recognized (Decision at 54.), that the fee was disclosed to the client's representative. (Tr. at 1541.) With that foundational knowledge, there would have been no reason to question Boden's or his lawyer's decision to use an LLC. The Decision's conclusion that this would be suspicious is simply a function of the ALJ lacking experience in real estate transactions and reaching to find scienter.

C. <u>The lack of documents do not prove Zell's negligence.</u>

Finally, the Decision found that Zell should have known to exercise more care, based on his experience as a long-time manager of pension plan assets, to document Boden's fees and the client representative's consent to them. (Decision at 54.) This finding is fundamentally flawed because no evidence establishes that Zell had any responsibility for documenting the fees or the consent. Moreover, it is entirely unreasonable to fault Zell for a lack of documentation in a case filed over six years after the events in question.

The ALJ blames Respondents for the loss of files, when in reality, it is not unreasonable for documentation to have been lost or destroyed given the passage of time. The Decision reasons that, because the Staff issued a subpoena to Timbervest on August 26, 2010, and because the document retention period for investment advisers is generally five years, the Partners were "on notice to preserve any pertinent documents dating back to no later than August 2005." (Decision at 63.) But this finding ignores that the August 26, 2010 subpoena had nothing to do with the two theories eventually charged by the Division—it came at a time when the Staff's investigation was focused solely on Timbervest's valuation methodologies—and it ignores that the subpoena itself called for emails dating back only to 2008. (Div. Ex. 110.) This subpoena, therefore, could not have possibly put Zell on notice that he was required to retain emails and other documents on unrelated topics past the document-retention period.

In sum, there is no evidence supporting a finding that Zell acted negligently with respect to Boden's fees, and the ALJ's findings to the contrary were in error.

III. The sanctions imposed against Zell are improper.

Because Zell did not act recklessly or negligently with respect to the Chen Transactions and did not act negligently with respect to Boden's fees, the Decision erred in imposing disgorgement and a cease-and-desist order against him.

Moreover, both sanctions are barred by the statute of limitations because they amount to penalties within the meaning of 28 U.S.C. § 2462. First, disgorgement is a penalty for the reasons discussed in Timbervest's Appeal to the Commission at 20-23. Second, a cease-and-desist order, when imposed against Zell, is penal in nature. Zell is currently a chartered financial analyst, but a cease-and-desist order may result in revocation of that status. (Tr. at 1591.) A cease-and-desist order will also constrain Zell in his current job and in any future job he may have by labeling him a "bad actor." 17 C.F.R. § 230.506(d)(v)(A) (defining as a "bad actor" someone who has been ordered to cease and desist from committing or causing a violation or future violation of, *inter alia*, § 206(1) of the Advisers Act). A "bad actor" is barred from participating in a Rule 506 offer for five years. Thus, Zell would not be able to work for Timbervest if it needed to raise funds via a Rule 506 offer. On top of that, Zell would not be able to work for *any other company*, whether in the investment advisory business or not, that needed to raise funds using Rule 506. Because a cease-and-desist order will cause severe limitations on Zell's ability to pursue a career, it is penal and therefore barred by the statute of limitations.

IV. Conclusion

The Decision erred in ordering Zell to cease and desist from securities laws violations and to disgorge, jointly and severally with Timbervest and the other Partners, the disposition fees Timbervest earned on the sale of Tenneco Core and the Kentucky Properties. Zell committed no violations, and the ALJ's proposed sanctions against Zell are excessive and inappropriate.

The Decision plainly erred in finding that Zell acted recklessly with respect to the Chen transactions and negligently with respect to Boden's fees. The evidence shows that he acted in good faith and was not involved in any of the issues giving rise to the supposed violations. For these reasons, as well as those discussed in Timbervest's brief, the Commission should reverse the Initial Decision's findings of violations against Zell, and reject the Division's requested relief.

This 30th day of October, 2014.

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