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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 Reply Brief in Support of his Appeal to the Commission**

DONALD DAVID ZELL, JR.'S REPLY BRIEF IN SUPPORT OF HIS APPEAL TO THE COMMISSION

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

The evidence presented at the evidentiary hearing 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. Nothing in the Division's Response to Respondents' Appeals to the Commission (the "Division's Brief") changes this inevitable conclusion. Accordingly, the Commission should reverse the Initial Decision of Administrative Law Judge Cameron Elliot rendered on August 20, 2014 (the "Decision").

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.) But the evidence presented at the hearing showed that Zell acted reasonably at all times and without scienter or negligence on these issues.

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

As explained in Zell's Appeal to the Commission, he acted reasonably with respect to the Chen Transactions, and not recklessly or negligently. 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.) Zell was not involved in the negotiations for the two transactions and had no knowledge about any conversations between

Wooddall and Boden. Nor did he have any reason to suspect that Wooddall and Boden agreed to any sort of arrangement whereby Timbervest agreed to sell the property to Chen and then later repurchase it at a higher price. In these circumstances, there is no support for the Decision's finding that Zell acted recklessly or negligently.

Simply glomming onto the Decision's findings, however, the Division contends that Zell acted recklessly because he was "aware that ERISA prohibited cross-trading of plan assets;" he "would have known that Tenneco Core was undervalued since the Wolf Creek properties were fetching prices that were anticipated as early as August 2006;" and the timing of the two transactions presented a red flag.[1] (Div. Br. at 21.) None of these arguments holds any water, however, and the Commission should find, consistent with the evidence presented at the hearing, that Zell acted reasonably, and not negligently or recklessly with respect to the Chen Transactions.

A. Zell's testimony about ERISA shows he was honest and did not act with scienter.

The Division (without any citation to the record) contends that, "[a]ccording to Barag's testimony, [Zell] was aware that ERISA prohibited cross-trading of plan assets." (Div. Br. at 21.) The Division contends that this alleged knowledge of ERISA shows that Zell acted recklessly in approving the sale and later purchase of the property. The only conversation about ERISA cross trades that Barag testified to was a 2003 or 2004 conversation about potentially transferring properties from New Forestry to a new Timbervest REIT in an *actual* cross trade. (Tr. at 1933-1936.) A vague memory of a conversation from 2003 or 2004 is not evidence that supports that Zell had ERISA in mind when engaging in the Chen Transactions. Indeed, in response to the idea of cross trading properties between New Forestry and the REIT, Barag testified that Zell did not

[1] The Division's Brief actually says that there were "numerous red flags presented" by the transactions but then points to only one—"the short time frame of the transaction." (Div. Br. at 21.)

want to engage in such transactions because it would suggest that "Timbervest was more interested in getting control of the assets than maximizing performance of the separate account." (Tr. at 1936-37.) Barag did not testify that Zell had referenced ERISA in rejecting the proposed transaction, only that Zell thought that the cross trade "would indicate that . . . Timbervest was more interested in getting control of their assets than maximizing performance of the separate account." Tr. at 1937. The Division has no explanation for why Zell would have refused to engage in a cross trade earlier but then supposedly approve of one later.

Moreover, Zell's testimony establishes that he was not an ERISA expert who would have recognized that, as he understood it, two separately negotiated transactions would be a prohibited transaction under ERISA. Indeed, 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." (Tr. at 1568.) It is reasonable to assume that Zell did not see the Chen Transactions as an ERISA cross trade because they were not a cross trade—*i.e.*, the transactions did not involve the transfer of a property directly between two Timbervest-managed funds. Zell testified that he has a general knowledge of ERISA but never testified that he was an expert (Tr. at 1670-74.) 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.)

Given Zell's understanding that the two transactions were negotiated separately and his prior insistence on not cross trading properties, the only reasonable conclusion to draw is that

Zell did not view the Chen Transactions as a prohibited cross trade under ERISA. Thus, the Division's argument to the contrary falls flat.

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

The Division next argues that Zell acted recklessly because he supposedly should "have known that Tenneco Core was undervalued since the Wolf Creek properties were fetching prices that were anticipated as early as August 2006." (Div. Br. at 21.) But this argument rests on a flawed understanding of the August 2006 report.

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 November 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.

In reality, the terms of the sale were excellent for New Forestry. Based on Timbervest's own timberland valuation policy, which every client, including New Forestry, understood and approved, 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.

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.) The Division argues that NCREIF is not relevant to determine the value of an individual property, such as Tenneco Core, but this misses the point. The Respondents have pointed to NCREIF, not as a valuation of Tenneco Core, but rather as independent, additional market data confirming that timber properties experienced substantial appreciation in this time period.

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.

Because Zell had no evidence that indicated that the sale of Tenneco Core was undervalued, and instead, approved the transactions because each provided excellent value for Timbervest's clients, respectively, there is no basis to find that he acted recklessly or negligently in approving the transactions.

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

Finally, the Division argues that "the short time frame of the transaction" presented "numerous red flags" to Zell. (Div. Br. at 21.) However, this argument 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, as discussed above, market indicators supported each deal at the time it was made.

Each of the Division's arguments that Zell acted recklessly is unsupported by the evidence. Instead, the evidence shows that Zell acted reasonably in approving the two transactions as a member of the Investment Committee, which transactions he understood had been negotiated separately and each of which provided excellent value to Timbervest's clients. In these circumstances, the Commission should reverse the Decision's finding that Zell acted recklessly and negligently with respect to the Chen Transactions.

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

The Commission should also reverse the Decision's finding that Zell acted negligently with respect to Boden's fees. As explained in Zell's Appeal to the Commission, he understood that Shapiro disclosed the agreement to the client's representative, ORG and Schwartz and was entitled to rely on the representations of his partner. (Tr. at 1541.) That uncontested evidence clearly shows that Zell did not cause any violations of § 206 of the Advisers Act, and that should be the end of the analysis.

The Division, however, contends that Zell acted negligently because he "ignored the numerous red flags raised by the payments to Boden." (Div. Br. at 23.) Specifically, the Division first argues that Zell "had many reasons to be highly skeptical, even incredulous, of Shapiro's claim that the client had consented to the payment . . . ." because he was supposedly knowledgeable about ERISA and because Timbervest's management agreement stated that Timbervest would not engage in prohibited transactions under ERISA (*Id.*) Finally, the Division assumes that because Boden split his fees with all the Partners, including Zell, he acted "in collusion . . . with the intent to defraud" Timbervest's client. (*Id.*) But both these arguments are easily dismissed and do not show that Zell acted negligently.

A. Zell was entitled to rely on Shapiro's representations.

The Division contends that Zell acted with scienter based on the theory that Zell should have been "highly skeptical, if not incredulous, of Shapiro's claim that the client had consented to the payment of fees outside of the management agreements." (Div. Br. at 23.) The Division bases this specious argument on the fact that Barag testified at the hearing that "Zell [was] aware of ERISA's requirements and of [his] responsibilities as [an] ERISA fiduciar[y]." (*Id.*) While the Division does not provide any citation to Barag's testimony, presumably it is relying on his testimony that, on his way out the door in 2004, he had a conversation with Jones and Shapiro in which he told them that Timbervest could not receive payment outside of the management agreement. (Tr. at 1948-1949.) But there is no evidence that Zell was involved in this supposed conversation at all. Moreover, the fees at issue were not paid to Timbervest, but rather to Boden under a pre-existing advisory fee arrangement Zell reasonably believed was approved by the client.

Moreover, that Barag recalls such a conversation from nearly ten years ago regarding an account that he admittedly had "very little to do with" and that was "almost entirely run and managed by David Zell," while being unable to correctly account for the most basic facts regarding his tenure at Timbervest is questionable.[2] (Tr. at 1924.) Regardless, there is no

[2] For example, Barag testified that Timbervest had a third, small Missouri account in 2003, and he "remembered" that it was a $20 million account with one or two small timberland assets overseen by regional foresters. (Tr. at 1979-80.) No such account ever existed; yet he was able to "recall" details about its size, assets and management. (Tr. at 2234-35.) He testified that New Forestry did not want to sell properties during his tenure at Timbervest, yet at the time he joined Timbervest the account was under a disposition mandate. (Tr. at 1930-31, 1697, 1739-40.) He testified that New Forestry did not make any acquisitions during his tenure at Timbervest, but the record shows otherwise. (Tr. at 1969-70; Resp. Ex. 140.)

evidence that a single, vague conversation years before was in the Partners' minds in seeking consent to the agreement from Schwartz. And the Division completely ignores that later in his testimony, Barag specifically testified that he had no conversation with the Partners about commissions, rather his "advice was to be mindful to take care of their client, BellSouth." (Tr. at 2012-13.) He testified quite clearly that there was "[n]ever" a discussion about commissions. (*Id.*)

Additionally, Zell was not an expert in ERISA. Although he had worked with pension plans (strictly on the investment side), he did not know the minutiae of a very complex and technical statute. Even Schwartz, the Division's witness who served as an expert in ERISA in another matter, testified that "ERISA is pretty technical and complicated," and when pressed to answer specific questions about ERISA, he would need to seek the advice of qualified legal counsel on ERISA matters. (Tr. at 2146, 2091.) There is no evidence that Zell knew more about ERISA than he testified to.

In any event, Zell believed that Shapiro obtained consent from ORG, which held itself out to be a qualified pension asset manager ("QPAM"). (Tr. at 2145-46.) Although he was not an ERISA expert, Zell understood and believed that a QPAM could make decisions on behalf of New Forestry and approve the arrangement. Thus, even though the investment management agreement generally precluded engaging in prohibited transactions under ERISA, Zell had no reason to doubt that ORG could consent to the payment of fees.[3] Zell had no reason to doubt that ORG would consent to the fee arrangement when the client had already approved of a similar conflict of interest with respect to Timbervest itself—that is, New Forestry approved, and in fact

[3] The Division's contention that "the receipt of fees by a principal of Timbervest was strictly prohibited by Timbervest's written agreements with the client" is simply wrong. (Div. Br. at 23.) Showing as much, the Division failed to cite to any document or transcript establishing this to be the case. Instead, Timbervest's written agreements with the New Forestry laid out how Timbervest was to be paid but did not prohibit payments to individuals or entities other than Timbervest and did not prohibit a QPAM from consenting to additional payments. (Div. Ex. 47.)

mandated, a fee arrangement whereby Timbervest was paid a fee on the dispositions of property and had its management fee concomitantly reduced. (Div. Ex. 47.) Zell had no reason to think that New Forestry and ORG would consent to one such conflict but not the other. Thus, there was a reasonable basis for Zell's reliance on ORG's approval, given ORG's status as a QPAM and fiduciary.

B. Boden's choice to share his fees does not establish Zell's negligence.

Finally, the Division contends that because Zell "participated in in [sic] actually splitting the fees equally with Boden and Shapiro," Zell acted "in collusion with [his] partners with the intent to defraud their client." (Div. Br. at 23.) But this is a gross mischaracterization of the evidence. Boden chose to share the fees that he earned equally with the other Partners. Sharing these fees was an independent decision that Boden made after considering his business relationship with the Partners. (Tr. at 289.) Zell neither asked nor expected Boden to share his fees. (Tr. at 1556-1557.) Boden and the Partners were equal partners, had purchased Timbervest on an equal basis, and had made numerous other investments on an equal basis. (Tr. at 289.) Boden recognized that he had benefited on an equal basis from the work of and opportunities presented by one or more of the Partners. (*Id.*) Given all these facts, Boden decided that the equitable thing to do was to share his fees. Boden's decision, which was his alone, to share his fees cannot be seen as an indication of negligence on Zell's behalf.

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.

As discussed in Zell's Appeal to the Commission, because he 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. The Division failed to even address the fact that a cease-and-desist order would be punitive as applied against Zell. But, as explained in his Appeal to the Commission, Zell is currently a chartered financial analyst, and 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. This is because the "covered persons" under Rule 506(d) disqualification include issuers, affiliated issuers, owners, directors, general partners, managing members, executive and other officers, promoters and investment managers and its principals, among others. 17 C.F.R. §§ 230.506(d)(v)(A), 230.506(d). And because Regulation D and the Rule 506 exemption are the primary capital offering tools used by all U.S. businesses, irrespective of industry, company type, company size or the amount of the capital raise,[4] the taint of being labeled a "bad actor" can be described as nothing but severe. 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. Moreover, all of the cases cited by the Division for its proposition that cease-and-desist orders are per se remedial all predate the effective date (September 13, 2013) of this collateral consequence resulting from Dodd-Frank.

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. The Division failed to put forth any evidence to the contrary. For these reasons, the Commission should reverse the Initial Decision's findings of violations against Zell, and reject the Division's requested relief.

This 15th day of December, 2014.

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[4] *See* U.S. Securities and Exchange Commission, Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012, July, 2013. Capital raised through Regulation D offerings was over $900 billion in 2012; Regulation D offerings occur with far greater frequency than any other offering method; Rule 506 accounts for 99% of amounts sold through Regulation D and is the primary offering tool for smaller entities; From 1999-2012 there were more than 40,000 Rule 506 issuances by non-financial issuers with a median offer size of less than $2 million (and 50% less than $1 million).

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