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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.

Respondents' Petition for Review

# RESPONDENTS' PETITION FOR REVIEW

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Respondents Joel Barth Shapiro, Walter William Anthony Boden, III, Donald David Zell, Jr., Gordon Jones, II (collectively, the "Partners"), and Timbervest, LLC hereby petition the Commission for review of the Initial Decision of Administrative Law Judge Cameron Elliot rendered on August 20, 2014, which arbitrarily and capriciously found violations of §§ 206(1) and (2) of the Investment Advisers Act and imposed sanctions that are impermissible under the law and facts. Respondents file this Petition pursuant to SEC Rule 410 and urge the Commission to review and overturn the Initial Decision entered in this matter.

## I. Factual and Procedural Background

In what may be the most dated case in SEC history, the Initial Decision found violations of §§ 206(1) and 206(2) of the Investment Advisers Act and imposed severe penalties on Respondents. These findings were based on inferences drawn from gaps in documentation and faded memories in an action wholly barred by the statute of limitations. The Division brought charges on two theories, the relevant events for which began in 2002—*twelve years ago*—and fully ended in 2007, more than seven years ago and six years before charges were filed.

The first theory relates to the payment of two fees in 2006 and 2007 to Mr. Boden. These fees were paid pursuant to an advisory fee agreement that Mr. Boden negotiated in 2002, when he became an independent consultant for Timbervest. He worked under this agreement until 2004 with no compensation and earned his fees during this period. After Mr. Boden became a Timbervest partner, the fee agreement was disclosed to the fiduciary for Timbervest's client. But because of the time that has elapsed since then, memories have faded about the disclosure conversation and any documents that may have existed showing the disclosure have been lost or destroyed.

The second theory relates to the sale of one of Timbervest's managed properties in 2006 to an unrelated third party at a price well above its internal valuation and the later purchase of

that same property by another Timbervest fund in 2007 (the "Chen Transactions"). Timbervest's client had directed that properties be sold, so Timbervest undertook to sell the property, which did not otherwise fit within the client's investment goals. The sale was negotiated in early summer 2006 and a draft contract was dated June 23, 2006. The sale eventually closed on October 17, 2006 at price that was nearly 12% above carrying value. Later, on February 1, 2007, Timbervest purchased the property for another fund. Because market conditions had changed markedly, the purchase price was higher than the sales price had been, but it was still fully supported by the economic metrics available at the time.

Neither of these theories was supported with credible evidence of a violation of the Advisers Act. The ALJ therefore erred in finding primary violations by Timbervest, aiding and abetting, and causing violations by the Partners and in imposing severe sanctions against all Respondents.

### A. Mr. Boden received two fees as compensation for his consulting services pursuant to a fee agreement that was disclosed to the fiduciary of Timbervest's client.

The Division first alleged that Timbervest violated the Advisers Act because Mr. Boden received advisory fees on two transactions conducted on behalf of New Forestry, a Timbervest fund. Specifically, Mr. Boden received $470,750 in connection with the sale of the Tenneco core timberlands (the "Alabama Property") on October 17, 2006 and $685,486.25 in connection with the sale of timberland property in Kentucky (the "Kentucky Property") on April 3, 2007. These fees were realized from a bona fide consulting agreement entered into with Timbervest in 2002.

Mr. Boden earned the fees at issue during the 2002 to 2004 time frame in connection with his agreement with Timbervest to create value and sell properties for New Forestry. This arrangement reflected New Forestry's then-existing goals, the economic realities of selling timberland, and the organization of Timbervest at the time. By the time Mr. Boden became a

partner in Timbervest in 2004, he had already earned his fees based on the work he had done as an unpaid consultant since 2002. He therefore had a vested property interest in his fees when he became a Timbervest partner.

The Division alleged that Timbervest failed to disclose Mr. Boden's fee arrangement to New Forestry. However, in 2005,Timbervest disclosed to ORG, the investment manager and fiduciary for New Forestry, that Mr. Boden was entitled to fees. Ed Schwartz, ORG's representative, approved of the arrangement so long as no other commission was paid. Mr. Schwartz, the Division's key witness on the disclosure, has given inconsistent statements regarding the 2005 disclosure. But regardless of the dispute over what exactly was said in that 2005 disclosure, there is no dispute that there was an attempted disclosure of the agreement.

**B. The Alabama property was sold under the client's directive and provided excellent value to both Timbervest funds.**

The Division also alleged that Timbervest violated the Advisers Act because it had a "parking arrangement" with Chen Timber. Timbervest sold the Alabama Property in 2006 on behalf of New Forestry to Chen Timber, an unrelated third party. In a separate independent transaction, it then later purchased the property from Chen Timber in 2007 on behalf of TVP, a separate Timbervest-managed fund. The Division alleged that these two transactions represented a "parking arrangement" that Mr. Boden entered into with Lee Wooddall, the principal of Chen Timber.

Timbervest sold the Alabama Property to Chen because New Forestry mandated a reduction in the size of its portfolio from $471 million down to $250 million by year-end 2009, with a specific emphasis on selling non-income producing properties such as the Alabama Property. Mr. Boden and Mr. Wooddall first negotiated the sale of the property in the early summer of 2006. These negotiations resulted in a draft contract dated June 23, 2006. The final

contract was signed on September 15, 2006, and the transaction closed on October 17, 2006. At the time of the negotiations and at the time of the sale, all the economic metrics available to Timbervest indicated that it was a good sale for New Forestry that would bring value and liquidity at a sale price well above its independently appraised value and Timbervest's internal valuation for the property. The analysis Timbervest used on this transaction was in accordance with the terms of its valuation policy and the same that was used on the hundreds of other property sales effectuated by Timbervest management.

On February 1, 2007, Timbervest purchased the Alabama Property on behalf of TVP. Timbervest and Chen executed a purchase and sale agreement for this transaction on December 15, 2006. Timbervest considered the purchase for TVP because the Alabama Property fit within TVP's objectives, which were focused on long-term growth and value creation, and not on immediate income generation. And while TVP paid more for the Alabama Property, the economic indicators available at the time of the purchase showed that TVP was able to acquire the property below the increased market value. For example, nearly the entire increase in purchase price can be accounted for by the documented increased volume and value of the timber on the property. Moreover, the market value of the Plum Creek REIT, which was, at the time, the only publicly traded timberland REIT in the country, increased 15% between the contract dates of the two transactions and more than 16% between the closing dates of the two transactions, while Timbervest secured the purchase for TVP at an increase in price of less than 8%.

### C. Procedural History

The Staff first began looking at Timbervest in 2009. At that time, the Division's investigation focused on Timbervest's valuation methods.[1] During the course of that investigation, in April 2012, Timbervest voluntarily disclosed to the Staff the fact of Mr. Boden's fees, even though the Staff had never requested such information. The Division then waited until September 24, 2013 to obtain an Order Instituting Proceedings, which charged violations of the Advisers Act based on the two theories listed above.

After an evidentiary hearing conducted in January and February of this year, the ALJ issued his Initial Decision finding violations of §§ 206(1) and (2) by Timbervest and aiding and abetting and causing violations by the Partners and ordering that the Respondents cease-and-desist from future securities law violations and pay more than $1.8 million in "disgorgement" of Timbervest's disposition fees from the sale of the Alabama and Kentucky Properties.

## II. The evidence does not support a finding of violations.

In his Initial Decision, the ALJ found that Timbervest violated §§ 206(1) and 206(2) of the Advisers Act. Those findings were in error, however, because the Division did not meet its burden of proving that there was a material misstatement or omission and did not prove that the Respondents acted with scienter or negligently. The Initial Decision should therefore be overturned on this basis.

### A. There was no evidence of a material misstatement or omission.

To prove a violation of § 206(1) or § 206(2) of the Advisers Act, the Division was required to submit proof of a material misstatement or omission by Timbervest. *See, e.g.*, *Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003); *SEC v. Lauer*, 2008 WL 4372896, at *24

[1] The Division has never brought charges against Timbervest or the Partners related to Timbervest's valuation methods.

(S.D. Fla. Sept. 24, 2008), *aff'd*, 478 F. App'x 550 (11th Cir. 2012). The Division did not contend, and the Initial Decision did not find, that Timbervest made any material misstatement. A claim under the Advisers Act could therefore proceed only if the Division proved Timbervest made a material omission. But it did not make this showing with respect to either Mr. Boden's fees or the Chen Transactions.

First, with respect to Mr. Boden's fees, the Division did not prove that Timbervest failed to disclose the fee arrangement to its client, BellSouth. The Division did not offer testimony from anyone at BellSouth about whether he or she knew about Mr. Boden's fee arrangement, despite having listed such witnesses on its witness list. Instead, it offered only the testimony of Frank Ranlett, the director of investment management at AT&T, who never worked at BellSouth and who had no day-to-day involvement with New Forestry until *after* Mr. Boden's fees had already been paid. Judge Elliot plainly erred in finding that there had been a material omission and, in fact, impermissibly shifted the burden to Respondents to prove that it had made a disclosure.

The Division also offered the testimony of Ed Schwartz, a principal at ORG, and the person to whom Mr. Shapiro disclosed the fee arrangement back in 2005. Neither Mr. Shapiro nor Mr. Schwartz had a perfect memory of the nine-year-old conversation, but, as discussed below, Mr. Schwartz offered testimony at the hearing that was materially different than his prior statements to the Staff and that materially benefited his own position. But the ALJ ignored his many inconsistent statements and credited Mr. Schwartz's inconsistent and incredible testimony above the Respondents' testimony. By doing so, the ALJ improperly placed the risk of faded memories (and lost documents) on Timbervest, instead of on the Division, which was responsible for the extreme delay in bringing charges. This was in error.

Second, with respect to the Chen Transactions, as discussed more fully below, the Division did not prove, and the Initial Decision did not find, that Timbervest failed to disclose a parking arrangement, as pled by the Division. Nor did the Initial Decision find that Timbervest failed to disclose even a cross trade, as later argued by the Division. Both parking arrangements and cross trades are terms of art that do not apply here. Instead, the ALJ impermissibly found a violation that is based on neither of these technical terms and that has no basis in law. This finding was in error.

Specifically, the Initial Decision found that the Chen Transactions violated the Advisers Act because Timbervest supposedly "undervalued the [Alabama] property when selling it to Chen." (Decision at 41.) This finding, however, was not based on anything the Division alleged or any evidence the Division presented at the hearing. In fact, all the evidence presented points to the conclusion that the deal was a good one for New Forestry. The most up-to-date appraisal that Timbervest had at its disposal that was well within Timbervest's appraisal guidelines set by the client showed that the sales price was more than 11% higher than the property's appraised value (and that the bare land value on the sale was an impressive 25% higher than the appraised bare land value). And based on Timbervest's own valuations, the sales price for the Alabama Property exceeded its value by $1.4 million, or 11.7%. Even Mr. Wooddall (the third party purchaser) testified that he believed the price was "fair" and that the property was not undervalued. Instead of recognizing these facts, the ALJ relied on evidence from offers to purchase small portions of nearby properties first received in *November 2006* to find that the price of the deal that closed in *October 2006* and was negotiated in *July 2006* was too low. This fundamental misunderstanding of the chronology of events is a significant error in the Initial Decision.

The November contracts (all but one of which did not actually close until 2007 and all of which were handled by a third party broker and not by Timbervest internally), were used by Timbervest to evaluate the potential acquisition of the Alabama Property for TVP, but they could not have been used to evaluate the original sales price, which was negotiated in early summer 2006. Respondents had no crystal ball: there was no way that Timbervest could have known what those sales prices were going to be until the properties actually went under contract. Yet the Initial Decision states that it was "misleading" for Timbervest to suggest that the data from these sales were not available until November 2006. (Decision at 46.) This finding was clearly in error and undermines the ALJ's entire decision that the Chen Transactions were improper.

Additionally, the ALJ erred in relying on a lender appraisal used by the purchaser to obtain financing for the purchase that Timbervest never saw or used in any way. The ALJ gave credit to this appraisal without hearing any testimony or receiving any documents supporting the reliability and credibility of this appraisal, which neither Timbervest nor Chen Timber knew existed when they negotiated their terms. Finally, he erred in ignoring that Timbervest followed its set valuation policy in evaluating the sale of the Alabama Property, when all Timbervest investors, including BellSouth, had received and approved of this policy.[2] By disregarding that Timbervest followed its own approved policies to a tee, the ALJ erred and essentially implied that Timbervest should have ignored its set policies.[3]

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[2] Further, PwC, New Forestry's auditor, described Timbervest's valuation policy as "top notch" and noted that Timbervest's "valuations are more site-specific than any others in the field."

[3] It bears repeating that the Staff investigated Timbervest's valuation policies and procedures for three years but ultimately did not bring charges. Ironically, the Staff's concern involved an alleged deviation from the valuation policy, something Judge Elliot believed Timbervest should have done here.

## B. There was no evidence of scienter or recklessness.

The ALJ also erred in finding that the Division met its burden of proving scienter or recklessness, as required to prove a violation of § 206(1), and each factual finding supporting the legal conclusion was also in error. The evidence showed that the Respondents, at all times, acted in good faith and with the reasonable belief that they were acting in the best interests of their client.

With respect to Mr. Boden's fees, the evidence showed that Mr. Boden had a vested right in and earned his fees years before 2006. He earned his fees pursuant to his fee arrangement and had a good-faith basis to believe that he was entitled to the fees. The evidence also showed that Mr. Shapiro made a disclosure about the fee arrangement to New Forestry's fiduciary in 2005 and that all the Partners reasonably believed that the arrangement had been disclosed. In these circumstances, it was error for the ALJ to conclude that the Respondents acted with scienter or acted recklessly, and all findings contrary to this evidence were likewise in error.

In finding that Messrs. Boden and Shapiro acted with scienter and that Messrs. Zell and Jones acted negligently, the Initial Decision puts much weight on the fact that Mr. Boden contacted an attorney and then received his fees through two LLCs, but this was in error. There was nothing inherently suspicious with the use of LLCs—they are a common asset protection strategy, and Mr. Boden wanted to avoid any potential claim to his fees. Mr. Boden was particularly concerned about claims by unknown third-party brokers who might claim to have a right to a fee on the disposition of the property. Mr. Boden's concern in this regard was justifiable—shortly before the LLCs were formed, Mr. Boden became aware of a broker who claimed to have a right to a fee on the disposition of certain New Forestry properties under an oral fee agreement that the prior management at Timbervest had entered into years earlier. Mr. Boden was therefore wary that there may be other unknown fee agreements.

Nor was there anything suspicious about using an attorney. If anything, that shows that Mr. Boden acted in good faith in following an attorney's advice as to how best to receive his fees. These findings therefore were in error and cannot support the conclusion that Respondents acted with scienter or negligently.

The Initial Decision also stated that an August 2012 letter from Timbervest's in-house counsel was "misleading" because "it failed to disclose [the outside lawyer's] involvement and the fact that [the LLCs] were shell companies." (Decision at 54.) But this finding was in error because, as mentioned, there was nothing improper about using LLCs. Likewise, the attorney's involvement in the creation of the LLCs simply showed Mr. Boden's good faith. Moreover, Timbervest's in-house counsel could not reveal the details of the attorney's fee structure and role in setting up the LLCs without violating the attorney-client privilege. Mr. Boden did not waive that privilege until November 2012—three months *after* the letter was sent.

With respect to the Chen Transactions, the evidence showed that each of the two transactions provided value to Timbervest's clients. It also showed that Mr. Boden was the only Partner involved in the negotiations and that he did not enter into any sort of binding agreement with Mr. Wooddall to repurchase Tenneco, nor could he have done so under Timbervest's management guidelines. And at most, the evidence showed that Mr. Boden raised the possibility of another fund purchasing Tenneco at some point in the future as a sales tactic meant to induce Mr. Wooddall to purchase the property. Timbervest was never under any obligation to repurchase the property and would suffer no loss if it refused to repurchase the property. Indeed, Mr. Wooddall characterized the agreement as a non-binding "verbal option" and explained that he was free to do as he wished with the property. There was simply no basis to conclude that

Respondents acted with scienter or acted recklessly or negligently, and all findings contrary to this evidence were in error.

For example, it was error to find that Mr. Zell, Mr. Shapiro, and Mr. Jones acted recklessly because they "would have been aware" that Timbervest's August 2006 valuation of the Alabama Property was not consistent with the November sales contracts and because "the time lapse between the sale and repurchase was unusually small." (Decision at 47.) As discussed above, the ALJ's findings that Respondents knew months in advance what the terms of the November sales contracts would be are wrong. Moreover, the ALJ apparently has collapsed the timeline between the sale and repurchase. While the sale closed on October 17, 2006, and a draft purchase contract was dated November 30, 2006, those dates are not the relevant ones for evaluating the time span. Testimony at the hearing established that the price for New Forestry's sale of the property was not established on the closing date. Rather, the Partners determined that the price of the contract was a great deal for New Forestry based on the value of Tenneco and would have approved the sale price before the first contract was signed in June. On the purchase side, the Partners determined that the contract price for TVP's purchase of the property was appropriate given the value of the timberland at the end of the due diligence period (January 15, 2007), not at the time of the draft contract or even the executed contract (December 15, 2006). Therefore, when comparing the correct relevant dates, the actual timeline was closer to six months than the six weeks the ALJ apparently relies on, and this timeline cannot support a finding of recklessness.

In any event, Messrs. Jones, Shapiro, and Zell knew only the relevant financial metrics—they were not involved in any negotiations with Mr. Wooddall. And in the case of both transactions, they made decisions based solely on the best interest of the clients. To find that they

acted with scienter or recklessly or negligently based purely on the amount of time elapsed is nonsensical and undercuts the rationale and economic realities of millions of transactions that occur every day.

## III. The ALJ found a violation of the Advisers Act based on a theory that was not pled by the Division and that is unsupported by the evidence.

Judge Elliot found that there was a violation of the Advisers Act with respect to the Chen Transactions "because Timbervest undervalued the property when selling it to Chen and failed to disclose the conflict of interest the repurchase agreement presented." (Decision at 41.) But this decision was in error because the Division never pled (or even explicitly argued) that Tenneco was undervalued when Timbervest sold it on behalf of New Forestry. Nor did the Division plead that a general conflict of interest was not disclosed. Instead, it pled that a *parking arrangement* was not disclosed. The bases for Judge Elliot's finding of a violation vary materially from the Division's pleading, and they should be overturned.

It is axiomatic that "a party is entitled to advance notice that an issue is going to be tried and determined by a court." 61B Am. Jur. 2d Pleading § 862 (2010); *see also* 15 U.S.C. § 80b-3 (requiring "notice and opportunity for hearing" before the SEC can impose administrative sanctions). The pleadings give that advance notice by defining the issues to be tried. To avoid unfair surprise, "[a] court may not decide an unpleaded issue, as it lacks jurisdiction over such issues." 61B Am. Jur. 2d Pleading § 862 (2010). When a court decides unpled issues, it is subject to reversal when the finding constitutes a material variance from the pleadings. *See Standard Oil Co. v. Brown*, 218 U.S. 78 (1910). The test is whether the pleading and the proof "substantially correspond." *Id.* Thus, if liability is found "on a substantially different scheme from that pleaded," it cannot stand. *United States v. Miller*, 728 F.2d 1269, 1270 (9th Cir. 1984).

The Division's OIP was clear and specifically pled that the Advisers Act was violated because Timbervest and the Partners allegedly failed to disclose a parking arrangement between Mr. Boden and Mr. Wooddall. The Respondents were therefore on notice that they had to defend against the failure to disclose a parking arrangement. They were not on notice that they had to defend against an allegation that Timbervest materially undervalued the Tenneco property to New Forestry's detriment. This is particularly true in light of the fact that the Division had investigated Timbervest's valuation methodologies for years but ultimately decided not to bring any charges related to valuation. Undervaluing property and failing to disclose a parking arrangement are substantially different schemes, and Judge Elliot therefore had no jurisdiction to decide that Timbervest had undervalued the sale of the Alabama Property. His finding to that effect was in error.

It was likewise error for Judge Elliot to determine there was a violation of the Advisers Act because the Chen Transactions were "functionally a cross-trade." (Decision at 36 n.15.) The OIP did not allege a cross trade. It alleged a parking arrangement. As the evidence conclusively demonstrates, there was no parking arrangement. The hallmark of a parking arrangement is "the sale of securities subject to an agreement or understanding that the securities will be repurchased by the seller at a later time and at a price which leaves the economic risk on the seller." *In the Matter of Warren G. Trepp*, SEC Release No. 115, 1997 WL 469718, at *18 (Aug. 18, 1997). There is no dispute that Chen (the buyer) bore the economic risk of the Chen Transactions, that neither New Forestry nor Timbervest (the seller) retained *any risk*, and that there was no parking arrangement.

Instead, he looked to whether there was a "cross trade." But the Division never pled that there was a cross trade. The first time it ever even made such an argument was in response to

Respondents' Motion for Summary Disposition. But even assuming that this argument, made only in a response brief (and in the Division's Post-Hearing Brief), could somehow amend the Division's pleading (which it could not), it is clear that there was no cross trade. A cross trade is a term of art that applies *only* when an adviser has clients on both sides of the *same transaction.* 17 C.F.R. § 275.206(3)–2 (requiring disclosure of cross trades only when an investment advisor has clients on both sides of the very same transaction). Because there were two separate transactions with respect to the Tenneco property, there is no doubt that there was no cross trade. Judge Elliot agreed: "Timbervest correctly notes that the Tenneco Core transactions were not technically a cross trade." (Decision at 36 n.15.) Yet, the Initial Decision goes on to conclude that because the verbal option was "functionally a cross trade," it was a violation not to disclose it. This conclusion is nonsensical: either the transactions were a cross trade (and arguably violated the Advisers Act), or they were not. There are specific disclosure rules regarding cross trades. There are not specific disclosure rules regarding "functional cross trades," and the ALJ's attempt to create such rules here represents a variance from the pleadings and an improper attempt to enlarge the scope of the Advisers Act. Therefore, the conclusion that Timbervest violated the Advisers Act with respect to the Chen transactions (and that the Partners aided and abetted and/or caused those violations) is improper and should be overturned.

## IV. The ALJ erred in admitting and relying on evidence pertinent only to matters not pled by the Division.

Relatedly, the ALJ erred by (1) admitting at the evidentiary hearing and (2) relying on in his Initial Decision evidence relating to the Glawson property. This evidence introduced and relied on related to a proposed sale of a New Forestry property in 2005 and the later development of the property in 2008 to best situate it for eventual disposition. But the Division never made any allegations related to the Glawson property. It is black letter law that "[e]vidence of matters

outside the issues as made by the pleadings is irrelevant and inadmissible." 61B Am. Jur. 2d Pleading § 866 (2010). That is, a party is precluded from proving a fact not alleged. *Garrett v. Louisville & N.R. Co.*, 235 U.S. 308 (1914).

But nowhere in the OIP did the Division allege that Glawson had anything to do with the matters pled. There was no separate claim brought with respect to the proposed sale or later development of the property. Nor was there even a reference to the Glawson property as allegedly relevant to one of the two charges actually brought. Essentially, Respondents were forced to defend against issues that they did not know would be raised in the evidentiary hearing, without adequate warning, and then were punished when they could not adequately respond to all of the Division's diversions into irrelevant evidence. The introduction and reliance on evidence related to Glawson was contrary to law and prejudicial to Respondents. Therefore, each and every statement in the Initial Decision relating to the Glawson property was in error.

## V. The sanctions imposed are improper.

### A. The evidence does not support disgorgement, and the ALJ misapplied the law of disgorgement.

The Initial Decision ordered Respondents to disgorge the disposition fees Timbervest received on the sale of the Alabama and Kentucky properties. Timbervest was entitled to disposition fees on the sale of New Forestry properties under its fee agreement. The disposition fees were put in place by the client (along with a concomitant reduction of Timbervest's management fees) to encourage sales of New Forestry properties. Ordering Respondents to disgorge these fees was in error both because the evidence does not support the ALJ's conclusion that the disposition fees would not have been earned absent the Respondents' alleged conduct and because the Initial Decision applied the wrong standard for disgorgement.

#### 1. Timbervest would have earned its disposition fees absent the alleged conduct.

The Initial Decision found that "Timbervest would not have earned disposition fees absent Respondents' . . . conduct." (Decision at 69.) But this finding was in error because all the evidence points to the conclusion that Timbervest would have received its disposition fees even without the alleged parking arrangement and even without the payment of Mr. Boden's fees.

The evidence does not support the finding that Timbervest would not have earned a disposition fee on the sale of the Alabama Property absent the alleged misconduct. Timbervest was contractually entitled to the disposition fee and would have received it even if there had been no verbal option to repurchase the property and even if Mr. Boden had not received a fee on the transaction. New Forestry specifically directed Timbervest to dispose of properties. Moreover, New Forestry mandated that Timbervest be paid with a disposition fee and a reduced management fee to incentivize Timbervest to sell properties. Timbervest did so at the client's direction and therefore earned its disposition fee.

The Division presented no evidence to counter this conclusion or to show that Timbervest would not have received its disposition fee absent the alleged violations. No representative of New Forestry testified that Timbervest would not have received the fee. No testimony of any kind was presented that even remotely suggested Timbervest would not otherwise have earned its disposition fee. The Initial Decision's conclusion to the contrary is in error and should be reviewed. The only finding of the ALJ that would taint the disposition fee with improper conduct is the incorrect conclusion that the sale was not a good deal for New Forestry. As discussed above, however, that finding was factually incorrect, and the ALJ had no jurisdiction to make such a finding.

Similarly, there is no basis to order disgorgement of the disposition fee earned in the sale of the Kentucky Property, and the ALJ's decision to do so was in error. Just like with the Alabama Property, Timbervest was contractually entitled to its fee, and Timbervest's client had directed dispositions of properties and a fee structure that incentivized dispositions. No evidence of any kind was introduced to suggest that Timbervest would not have otherwise been entitled to its disposition fee, and the ALJ's finding to the contrary was in error. Moreover, the Initial Decision articulates *no basis* for concluding that the Kentucky Property was not a good transaction that provided excellent value to New Forestry. In these circumstances, and with no evidence supporting the conclusion, it was error for the ALJ to order disgorgement of Timbervest's disposition fee from the sale of the Kentucky Property.

**2. The ALJ applied the wrong legal standard in ordering disgorgement.**

The ALJ also found that because there was supposedly a "sufficient nexus between Respondents' receipt of disposition fees and their . . . conduct," disgorgement was proper. This is not the correct standard to determine whether disgorgement is appropriate, and the Initial Decision erred in applying it.

Disgorgement is supposed to be an equitable remedy designed to prevent defendants from profiting from illegal activity. *See, e.g., SEC v. Contorinis*, 743 F.3d 296, 301 (2d Cir. 2014). The primary purpose of disgorgement is to correct unjust enrichment and restore Respondents to the status quo ante. *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir. 2004). Disgorgement therefore must be *directly* tied to ill-gotten gains received from the fraud and cannot be imposed above an amount wrongfully acquired. *See SEC v. Bear, Stearns & Co.*, 626 F. Supp. 2d 402 (S.D.N.Y. 2009); *SEC v. Jones*, 476 F. Supp. 2d 374 (S.D.N.Y. 2007). Indeed, the Division bears "the burden of demonstrating a reasonable approximation of the profits *causally connected to the violation*." *In the matter of Jay T. Comeaux*, A.P. File No. 3-15002, 2014 WL 4160054, at *3

(Aug. 21, 2014) (emphasis added) (setting aside disgorgement order when Division failed to meet its burden of proof).

The Initial Decision did not apply these standards.[4] It ordered disgorgement of Timbervest's disposition fees because "there is a sufficient nexus between Respondents' receipt of disposition fees and their . . . conduct." (Decision at 69.) Essentially, the ALJ found that because the disposition fees were earned on transactions in which he determined violations, which were completely unrelated to the disposition fees, occurred, they were subject to disgorgement. In explaining why disgorgement was appropriate, Judge Elliot found: "Respondents sold [the Alabama Property], and collected the disposition fee, as part of a fraudulent arrangement to repurchase the property. Respondents sold both [the Alabama Property] and the Kentucky [Property] as part of a fraudulent and undisclosed arrangement to collect unlawful brokerage fees." *Id.*

A federal court just recently rejected a similar approach in *SEC v. Wyly*, 2014 WL 3739415 (S.D.N.Y. July 29, 2014). There, the SEC argued that all profits made on trades in which the defendant's interest in the transaction was not disclosed were subject to disgorgement. The federal court soundly rejected this argument: "Such a rule would eliminate the requirement that the government provide a reasonable approximation of the profits that are causally connected to the violation. There would be no need for any approximation—reasonable or otherwise—if the required disgorgement is always one hundred percent." *Id.* at *6. Here, the ALJ imposed disgorgement on disposition fees that were not caused by or related to the violations. This was in error, and the Commission should not allow the ALJ to write out the Division's burden of proof on disgorgement.

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[4] The Initial Decision did cite the correct standard but then erred in not applying it.

### B. All the sanctions imposed are penalties that are barred by the statute of limitations.

The cease-and-desist order and the disgorgement ordered in the Initial Decision were in error because they are time-barred by the statute of limitations set forth in 28 U.S.C. § 2462. Section 2462 provides that "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ." A claim first accrues under § 2462 "when the factual and legal prerequisites for filing suit [are] in place." *SEC v. Jones*, 476 F. Supp. 2d 374, 381 (S.D.N.Y. 2007). Here, the claims accrued, at the latest, on June 1, 2007, when Mr. Jones deposited the check from Mr. Boden representing a share of Mr. Boden's advisory fee from the sale of the Kentucky property. But the Division did not file the Order Instituting Proceedings until September 24, 2013—more than six years from the latest possible date of accrual.

The only question is whether this is a "proceeding for the enforcement of any . . . penalty." If so, § 2462 dictates that the relief is unavailable. *Jones*, 476 F. Supp. 2d at 381 ("[Section 2462] applies to civil penalties and equitable relief that seeks to punish, but does not apply to equitable relief which seeks to remedy a past wrong or protect the public from future harm."). A penalty is "a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond the damage caused to the harmed parties by the defendant's actions." *Johnson v. SEC*, 87 F.3d484, 488 (D.C. Cir. 1996). Because both a cease-and-desist order and the disgorgement of Timbervest's disposition fees would operate as a penalty in this case, they are barred by the statute of limitations, and the Initial Decision erred in imposing them.

### 1. The cease-and-desist order is penal and barred.

Several federal courts have held that a claim for injunctive relief, the judicial analog to an administrative cease-and-desist order, can be penal and barred by § 2462. *See, e.g.*, *Bartek*, 484 F. App'x 949, 956 (5th Cir. 2010) (holding that § 2462 applied to the SEC's claim for injunctive relief); *SEC v. Graham*, 2014 WL 1891418, at *9 (S.D. Fla. May 12, 2014) ("[T]he injunctive relief sought by the SEC in this case forever barring defendants from future violations of the federal securities laws can be regarded as nothing short of a penalty 'intended to punish' . . . ."); *Jones*, 476 F. Supp. 2d at 384 (statute of limitations applied to requested injunction).

To show that a C&D order would be remedial, the Division must "go beyond the mere facts of past violations and demonstrate a realistic likelihood of recurrence." *Jones*, 276 F. Supp. 2d at 383-84. The Initial Decision ignores this standard and, in fact, specifically states that "a finding of a [past] violation raises a sufficient risk of future violation." (Decision at 64 (alteration in original) (quotation omitted).) The Decision's conclusion that there is a risk of future violations is in error.

There is simply no plausible argument that Respondents pose a risk to the public or present a realistic threat of future violations. Out of the hundreds of transactions (with an aggregate price of more than $1.4 billion) conducted by Timbervest over more than ten years, the Alabama Property is the only property ever purchased on behalf of a Timbervest client that was previously managed by Timbervest on behalf of another client. No other Timbervest partner has a fee agreement entitling him to fees on the disposition of properties. Timbervest was under investigation for more than four years, and the personal financial records of the Partners, their spouses, and their children have been thoroughly reviewed by the Staff. Yet, the Division's allegations of misconduct relate only to two isolated transactions that were wholly completed more than seven years ago.

Moreover, the collateral consequences of a C&D order would be to stigmatize Respondents and "significantly impair [their] ability to pursue a career." *Jones*, 476 F. Supp. 2d at 385. "A [C&D] order has significant impact on a[] [respondent], especially one involved in the securities industry." *In the Matter of David T. Barr*, 2000 WL 1092302, at *21. The current C&D order against the Partners will practically operate the same as a bar because it will significantly impair their ability to find work in the securities industry. Also, if the C&D stands, Mr. Jones faces the risk of irreparable harm to his legal reputation and sanctions by the State Bar of Georgia against him; Mr. Zell faces the risk of irreparable harm to his financial reputation and possible revocation of his status as a chartered financial analyst; Mr. Boden faces the risk of irreparable harm to his real estate reputation and revocation of his Georgia real estate license; and Mr. Shapiro faces harm to his financial reputation. Dire consequences have already befallen Timbervest and the Partners simply from the Division's filing of charges. The Initial Decision therefore erred in imposing a C&D order and in finding that there was any risk of a future violation by Respondents.

**2. Disgorgement of Timbervest's disposition fees is penal and barred.**

The disgorgement of Timbervest's disposition fees is likewise penal and barred by the statute of limitations. When disgorgement goes beyond "remedying the harm caused to the harmed parties" by the respondents, it constitutes a penalty subject to the statute of limitations. *Johnson*, 87 F.3d at 488; *see also Zacharias v. SEC*, 569 F.3d 458, 473 (D.C. Cir. 2009) (explaining precedent holding that "disgorgement may not be used punitively"); *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 735 (11th Cir. 2005) (holding that disgorgement extends only to the amount by which defendant profited and stating that any further sum would constitute a penalty assessment); *SEC v. Willis*, 472 F. Supp. 1250, 1276 (D.D.C. 1978) ("When the amounts to be disgorged cannot be related with sufficient certitude to defendants' securities law

violations, the SEC's disgorgement request takes on the character of a plea for punitive relief."); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment."). In fact, one district court has even recently concluded that disgorgement is generally a penal remedy: "the disgorgement of all ill-gotten gains realized from the alleged violations of the securities laws— i.e., requiring defendants to relinquish money and property—can truly be regarded as nothing other than a forfeiture (both pecuniary and otherwise), which remedy is expressly covered by § 2462." *Graham*, 2014 WL 1891418, at *9.

As explained more fully above, Timbervest's disposition fees are separate and apart from any funds received as a result of the violations. They therefore go above and beyond the amounts Respondents profited from their alleged wrongdoing and are penal, and the Initial Decision erred in ordering disgorgement of Timbervest's disposition fees.

**C. The Initial Decision miscalculated the interest owed.**

The Initial Decision ordered Respondents to pay $155,602.96 in prejudgment interest on the disposition fee from the sale of the Alabama Property, $273,308.82 in prejudgment interest in the disposition fee from the sale of the Kentucky Property, and $244,353.21 in prejudgment interest on Mr. Boden's fees, which Timbervest voluntarily returned, along with interest, to New Forestry before the Commission instituted proceedings. This order was in error for various reasons, including that the ALJ ordered interest on amounts not properly subject to disgorgement. Furthermore, it appears that the ALJ miscalculated the interest that would be permitted by SEC Rule of Practice 600. For all these reasons, the ALJ's order on prejudgment interest should be reviewed.

## VI. The Division of Enforcement and ALJ violated the Commission's *Brady* Rule.

The ALJ erred in refusing to order the Division to produce *Brady* material prior to and during the evidentiary hearing and likewise erred in finding in the Initial Decision that the Respondents' *Brady* rights had not been violated.

Prior to the evidentiary hearing, the Division produced to Respondents two emails dated June 5 and 8, 2012 (the "June 2012 emails") that contain notes from an interview of Mr. Schwartz by Division attorneys. These emails are filled with exculpatory information. For example, at trial, Mr. Schwartz testified that he did not know about Mr. Boden's fee agreement and that the conversation he had with Mr. Shapiro was hypothetical. But the June 2012 emails clearly state:

- Schwartz was "informed of the arrangement and the possibility of . . . payments" to Mr. Boden.

Mr. Schwartz also testified that was unaware that the person who held the fee agreement was Mr. Boden, but the notes make it clear that that testimony was untrue:

- "Schwartz said that he recalls a discussion he had with either Zell or Shapiro about 'a broker who eventually came into the company, Bill Boden.'"
- "Schwartz's understanding was that TV was considering bringing on Boden in some capacity other than that of a broker."
- "Schwartz said that the understanding he reached with Shapiro/Zell was that Boden could finish up whatever he had started in connection with acting as a broker for New Forestry property."

Mr. Schwartz likewise testified that the arrangement would have presented a clear conflict of interest under ERISA and that there was no way he would have consented to the agreement without counsel's advice. But the June 2012 emails show that Mr. Schwartz did not initially see any issue with the fee arrangement:

- "Schwartz said, 'I said, and BellSouth agreed, we didn't think it was appropriate to pay a brokerage fee two times. So, if he was truly acting as

a broker, the same as if it was done outside, and it was not disadvantageous to Bellsouth, that would be okay.'"

- "Schwartz said that the idea was not different than many companies that use in house resources instead of third party resources and charge for them."
- "Schwartz said that from an ERISA / fiduciary standpoint, he saw no problem with the arrangement that he discussed with Shapiro/Zell because services were to be performed by a broker."

Under Rule 230(b)(2) and *Brady v. Maryland*, 373 U.S. 83, 87 (1963), the Division is required to turn over all exculpatory evidence to the Respondents. The Division contended that these emails were work product and should be returned. But under Rule 203(b)(2), work product cannot be withheld if the documents otherwise "contain material exculpatory evidence." *See also United States v. Gupta*, 848 F. Supp. 2d 491, 496-97 (S.D.N.Y. 2012) (rejecting argument that SEC attorney work product containing *Brady* material could be withheld from defendant).

Chief ALJ Murray initially ruled that the emails did not constitute *Brady* material and ordered them returned,[5] despite the fact that they conclusively demonstrate that Mr. Boden's fee arrangement was disclosed to Mr. Schwartz, that Mr. Schwartz consented to the fee arrangement, that Mr. Schwartz knew it was Mr. Boden who would be receiving a fee, that BellSouth agreed to the fee arrangement, and that any testimony by Mr. Schwartz to the contrary was incorrest. During the evidentiary hearing, Judge Elliot likewise refused to order the emails produced to Respondents and prohibited Respondents from calling the Division to testify about Mr. Schwartz's statements during the June 2012 interviews. All these decisions were in error and contrary to settled law.

[5] In her order denying Respondents' Motion to Compel *Brady* Material, Judge Murray specifically stated that her order "shall not limit Respondents' right to reference the notes or their contents in any appeal of a determination by the Administrative Law Judge." (Nov. 25, 2013 Order.)

Judge Elliot's conclusion that the June 2012 emails did not contain *Brady* material was based in part on the erroneous finding that Respondents had this information in their possession because Respondents and their counsel had spoken to Mr. Schwartz about his interview with the Staff. But this finding is simply incorrect. The Respondents did not have in their possession the substance of what Mr. Schwartz said to the Staff. The June 2012 emails reflect statements that Mr. Schwartz made to the Staff that are substantively different than what he told Respondents.

Furthermore, apart from the issue of what Mr. Schwartz told Respondents, the June 2012 emails are *Brady* material because they contain prior inconsistent statements by Schwartz. *See United States v. Smith*, 77 F.3d 511 (D.C. Cir. 1996) (stating that "the fact that other impeachment evidence was available to defense counsel does not render additional impeachment evidence immaterial."). As the D.C. Circuit stated in *In re Sealed Case No. 99-3096*, 185 F.3d 887 (D.C. Cir. 1999), information obtained from a witness who provided inconsistent testimony "cannot substitute for information provided by the government itself—particularly when the defense was seeking information from a more trustworthy source in order to corroborate (or, as become necessary, impeach) that individual." *Id.* at 896-97. Typically, the Division overcomes this problem by providing a letter listing any exculpatory information that a witness provides to it. But Respondents received no such letter here.

What Schwartz told the Division in June 2012, as reflected in the June 2012 emails, is materially inconsistent with his SEC testimony and his testimony at the hearing. Respondents' defense was substantially prejudiced from the exclusion of these documents because they could not cross-examine Schwartz effectively without those emails, particularly in light of the age of this case, the missing documents, and the faded memories of the witnesses.

Judge Elliot specifically pointed out that the factual issue of whether Shapiro identified Boden as the fee recipient in the 2005 conversation was "a fact that would have presented a much bigger red flag than any other detail." (Decision at 50.) Judge Elliot went on to credit Schwartz's testimony that he did not know that Boden was to be the fee recipient, despite the Division's notes clearly indicating that in June 2012, Mr. Schwartz recalled knowing that it was Mr. Boden who was to receive the fees.[6] (*Id.* at 51.) Without this incorrect finding, there could be no ruling for the Division here. The production of the *Brady* material set forth in the June emails—which both would have supported the Respondents' factual assertions and reflected prior inconsistent statements by the key witness in the case—would have been used to effectively cross-examine and impeach the credibility of Mr. Schwartz and would have resulted in different findings. *See OptionsExpress*, 2013 WL 5635987 at *3 ("To trigger the disclosure obligation under Rule 230(b)(2), 'the evidence must be material either to the [respondent's] guilt or punishment,' with the test of materiality being whether there is a 'reasonable probability' that the evidence's disclosure would have resulted in a different outcome.").

The Division also had notes from an interview with Mr. Wooddall, but those notes have never been provided to Respondents. Based on conversations with Mr. Wooddall's counsel, Respondents understand that Mr. Wooddall initially told the Division that there had been an agreement to repurchase the Alabama Property but no agreement as to the price to be paid. But at the hearing, Mr. Wooddall testified conversely: that there was an agreement as to the price to be paid upon repurchase but no obligation for Timbervest to actually repurchase the Alabama

[6] Judge Elliot found that Schwartz had a better memory than Shapiro. (Decision at 50 at n.17.) Schwartz, however, testified that he could not even recall the 2005 conversation with Mr. Shapiro when Timbervest first told ORG (in February 2012) that the SEC had raised questions regarding fees paid to Mr. Boden. According to Schwartz, he later remembered the 2005 conversation but not until a May 2012 meeting with Shapiro and Jones. It is just not credible that Schwartz could remember specific details of what was said in a conversation that took place nine years earlier when he could not remember the conversation at all two years earlier.

Property. This difference in testimony was material because without an agreement as to the price to be paid upon repurchase, Mr. Boden did nothing more than have a conversation about another interested party buying the property.

Respondents were unable to question Mr. Wooddall about his prior statements to the Division because, while the Division interviewed Mr. Wooddall and took notes of that interview, it refused to produce its notes, and the Court ruled that those notes did not contain any *Brady* material and that Respondents would not be permitted to call the Division staff who interviewed Mr. Wooddall to testify about Mr. Wooddall's statements. The inability to review those notes materially prejudiced Respondents from being able to impeach Mr. Wooddall's testimony, and the Initial Decision's conclusion to the contrary is in error. This is especially true where, as here, there is essentially no documentary evidence supporting the Division's case involving events and conversations from nine years ago.

## VII. The Commission's arbitrary decision to bring this enforcement action in a biased administrative forum violated Respondents' constitutional rights and the Administrative Procedure Act.

Respondents were forced to try this case before ALJ Elliot, who is the *only* SEC ALJ who has *always* found in favor of the Division (with the exception of Judge Grimes, who has been an ALJ only since June 30, 2014). In February 2014, Reuters reported that Judge Elliott "has issued more than 50 "initial decisions" at the SEC, and while the SEC has not always gotten everything it wanted, he has yet to rule against the agency."[7] And in the more than three years Judge Elliot has served as an ALJ, he has never dismissed an OIP or found that the Division failed to prove at least one violation of the securities laws. Judge Elliot's bias violated the Respondents' due process rights. *See Withrow v. Larkin*, 421 U.S. 35, 47 (1975) (explaining that

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[7] http://finance.yahoo.com/news/sec-judge-took-big-four-123015266.html

there are circumstances in which "the probability of actual bias on the part of the judge or decisionmaker is too high to be constitutionally tolerable"); *Caperton v. A.T. Massey Coal Co., Inc.*, 556 U.S. 868 (2009) (a defendant's Fourteenth Amendment right to due process is violated when a judge displays a probability of actual bias and does not recuse himself).

This bias infected the entire hearing and the Initial Decision. In each circumstance in which a credibility determination had to be made, Judge Elliot found against Respondents and their witnesses and in favor of the Division and its witnesses. Each of these findings was in error. Particularly, the findings that Mr. Schwartz and Mr. Barag gave credible testimony and the finding that Mr. Wooddall's testimony was not subject to doubt because all three witnesses had trouble remembering certain things that might cast themselves in a bad light but little trouble remembering details against Respondents were in error. In these circumstances, testimony cannot be considered credible. *See In the Matter of Next Fin'l Grp., Inc.*, A.P. File No. 3-12738, 2008 WL 2444775, at *19 (June 18, 2008) (when witnesses "became much more guarded and developed poor memories when the inquiry turned to their personal involvement," their testimony was entitled to less weight); *In the Matter of Gregory M. Dearlove*, A.P. File No. 3-12064, 2006 WL 2080012, at *51 (July 27, 2006) (testimony was not credible when "[i]t was plain that [the witness] had no intention of testifying . . . in a manner that might reflect poorly on himself or [his employer").

And in each circumstance in which there was a gap in evidence, due to lost documents or faded memories, Judge Elliot credited the Division's explanation and ignored or rejected the Respondents' explanations out of hand. Each of these findings was also in error.

It is a bedrock principle of administrative law that "an agency may not treat like cases differently." *Eagle Broad. Grp. v. FCC*, 563 F.3d 543, 551 (D.C. Cir. 2009) (quotation and

citation omitted). That means that "[a]n agency must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so." *Kreis v. Sec'y of Air Force*, 406 F.3d 684, 687 (D.C. Cir. 2005) (citation omitted). Under the Administrative Procedure Act, "agency action is arbitrary when the agency offers insufficient reasons for treating similar situations differently." *Dongbu Steel Co., Ltd. v. United States*, 635 F.3d 1363, 1371 (Fed. Cir. 2011).

Although Congress has given the Commission the discretion to bring enforcement proceedings in federal court or in its own administrative forum, that does "not necessarily exculpate it from a claim of unequal protection if the unequal treatment was still arbitrary and irrational." *Gupta v. SEC*, 796 F. Supp. 2d 503, 413 (S.D.N.Y. 2011). The Commission has offered no reason why it chose to pursue this action in an administrative forum when it has chosen to file other similar actions in federal court.

Based on the Commission's recent federal trial court record and comments made by its senior officers, the Commission's decision to treat Respondents differently was a tactical decision so that the Division could gain a substantial advantage in litigation by purposefully depriving Respondents of rights they would have been entitled to in federal court. In the SEC's administrative forum, there is a striking lack of procedural safeguards afforded to the respondents as compared to federal court.[8] For instance, the Director of the Division of Enforcement recently stated that the SEC considers a "whole host of factors," including whether discovery is required, whether the case would play well before a jury, and whether the SEC would need additional time to prepare its case, given the expedited schedule for administrative

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[8] Even the SEC's General Counsel recently said it may be time to modernize the rules around the agency's administrative courts, stating that it is "entirely reasonable to wonder" if the agency rules should be updated, for example, to create more flexibility on trial preparation or allow for depositions. http://www.law360.com/articles/564823/rakoff-stirs-sec-pot-again-with-administrative-law-question.

proceedings.[9] He also said that juries—perceiving the SEC as similar to criminal authorities—apply a "higher standard than the preponderance of the evidence standard" to Commission cases. Each of these considerations is arbitrary and capricious because they are simply designed to disadvantage Respondents. Given the lack of procedural safeguards, coupled with the lack of an impartial jury or Article III judge, it is not surprising that statistical evidence shows that the Commission's success rate in administrative proceedings (88%) is significantly greater than in federal court (63%). *See* At the SEC, A Question of Home-Court Edge, Oct. 5, 2013 N.Y. Times.[10]

Equally unsurprising, the Respondents were severely disadvantaged in this administrative proceeding. Even though the Commission's investigation lasted over four years, the Respondents had to try this case in fewer than 120 days from when the Commission issued the Order Instituting Proceedings. In federal court, Respondents would have been before an impartial Article III judge and, most likely, a jury would have decided the case. Instead, the Respondents were confronted with the insurmountable task of defending against the allegations before an ALJ who always finds in favor of the Division.

On top of that, the Respondents could not obtain discovery that they otherwise would have been entitled to in federal court. The Respondents were unable to speak to, let alone depose, any of the Division's witnesses and potential witnesses after the OIP was issued because each witness refused to speak voluntarily with counsel for the Respondents. This hampered the defense's ability to test and challenge the inferences to be drawn from the Division's witnesses' testimony. Coupled with the Division's refusal to produce exculpatory *Brady* material in disregard of one of the few favorable discovery provisions in the SEC's Rules of Practice, the

[9] http://www.bna.com/sec-pursue-insider-n17179891282/.

[10] http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html.

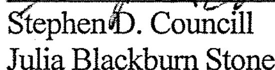
Respondents had no way (other than with their own testimony) to discredit the testimony of the Division's two key witnesses—Mr. Schwartz and Mr. Wooddall.

The Commission's arbitrary decision to bring this matter in its own administrative forum purposefully deprived Respondents of rights they otherwise would have been entitled to if this action had been brought in federal court. By doing so, the Commission violated the Respondents' equal protection rights guaranteed by the Due Process Clause of the Fifth Amendment under the "class of one" doctrine and violated the Administrative Procedure Act.

## VIII. Conclusion

In Judge Elliot's Initial Decision, there are myriad factual and legal errors that necessitate the Commission's review. Respondents therefore respectfully urge the Commission to review and to overturn the Initial Decision in this matter.

This 10th day of September, 2014.

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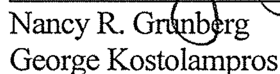

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