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April 1, 2015

VIA FACSIMILE AND FEDERAL EXPRESS

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Fax: 202-772-9324

RE: In the Matter of Harding Advisory LLC, et al, Administrative Proceeding File No. 3-15574

Dear Mr. Fields:

This firm represents Respondents Harding Advisory LLC and Wing F. Chau in the above-referenced proceeding. Enclosed for filing, please find the Respondents' Opening Brief in Support of their Petition for Review.

Thank you for your attention to this matter.

Sincerely,

BROWN RUDNICK LLP

Alex Lipman

Enclosures

cc: Howard Fischer, Esq. (via e-mail)

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **HARDING ADVISORY LLC and** **WING F. CHAU,** **Respondents.**	Administrative Proceeding File No. 3-15574

RESPONDENTS' OPENING BRIEF IN SUPPORT OF THEIR PETITION FOR REVIEW

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2 Tamar Frankel & Ann Taylor Schwing, *The Regulation of Money Managers: Mutual Funds & Advisers*, §14.01 (2d ed. 2011) 21, 22

Having found no intent to defraud with respect to the primary allegations in the Order Instituting Proceedings ("OIP"), ALJ predicated liability on a negligence theory that was at variance with the allegations in the OIP. In any event, ALJs factual findings do not support a finding of negligence because he confuses being negligent in an isolated instance of assets selection with making negligent misrepresentations about the asset selection process that is otherwise unexceptional. Certain factual findings -- for example, that certain assets bought by Respondents were impaired when bought -- are clearly erroneous. Certain of ALJs legal conclusions - for example, his analysis of collateral managers' obligations under deal documents and the Investment Advisers Act -- are also clearly erroneous. Many of ALJs conclusions are premised on unreliable, ambiguous hearsay that is contradicted by uncontroverted hearing testimony. When all facts are appropriately understood and weighed and all legal principles are corrected and properly applied, the sole inescapable conclusion is the Respondents did not commit any violations of the federal securities laws.

In addition, Respondents' due process and equal protection rights have been violated. Among other things: ALJ's initial decision is void because he did not have proper authority to conduct the hearing; at a minimum, he was not properly appointed as an officer of the Commission for purposes of conducting the hearing in violation of the provisions of the federal securities laws authorizing cease-and-desist hearings.

Separately, Respondents were deprived of due process because a case of this complexity, in which the Division of Enforcement's investigative file was the size of the entire Library of Congress, is not fit for an administrative proceeding in which the ALJ was required to issue a decision within 300 days of the service of the OIP and in which rules of evidence are relaxed and civil pre-trial discovery tools are unavailable. Further, the choice of the forum here was made for improper reasons in violation of Respondents' equal protection, due process, and jury trial rights. ALJ's refusal to allow the Respondents to develop a full record for their constitutional challenges was predicated on erroneous understanding of the relevant law and constituted yet another deprivation of Respondents' constitutional rights.

Violations of Respondents constitutional rights constitute independent grounds for reversing the initial decision.

OCTANS

The allegations in the OIP describe a *deliberate* fraud by Respondents' Harding Advisory LLC ("Harding"), a collateral manager ("CM") principally of collateral debt obligations ("CDOs"), and Wing F. Chau, Harding's principal owner, whereby, in sourcing assets for a mezzanine CDO named Octans I CDO Ltd. ("Octans"),[1] Respondents succumbed to pressure from a hedge fund, Magnetar Capital LLC ("Magnetar"), and included in the Octans portfolio assets Harding's own analysts "disfavored." (OIP ¶¶ 2, 4-6; 54-59.) What made this a fraud, according to the OIP, was that Magnetar's interests were not aligned with those of other investors in the deal because, unlike other investors, it stood to profit from Octans' failure. (*Id.*; *see also*, Initial Decision ("ID") at 69 ("the principal pertinent allegation of the OIP is that Harding selected the collateral while under the undue and undisclosed influence of Magnetar").)

Specifically, the OIP alleged that Magnetar wanted Harding to place an index trade involving ABX Index 2006-1 ("ABX Index") – or as many ABX Index component assets as Harding would take – for its own advantage and at the expense of other investors, and that

[1] In May 2006, Merrill Lynch ("Merrill") hired Respondents to select collateral for Octans backed principally by the BBB and BBB- tranches of RMBS. Octans was structured and marketed by Merrill. (RX 118, 123-24.) The $1.5 billion deal closed on September 26, 2006. (RX 2.)

Harding acquiesced to this demand in order to curry favor with Magnetar and Merrill. (OIP ¶¶ 2, 8, 32-40, 54-59.)[2]

After a seventeen-day Hearing, the ALJ found that *none* of those allegations were true. Instead, he concluded that "*in order to find an intent to defraud, I would have to disbelieve every single lay witness who testified on the subject.*" (ID at 66 (emphasis added).) The ALJ found that:

- Harding's analysts did not disfavor the relevant assets (ID at 79);
- the assets at issue were not bad and did not contribute to any CDO failure (ID at 56-57, 92);
- there was no evidence of adverse selection (ID at 57) -- indeed, this fact was disclosed pre-Hearing as *Brady* material;[3]
- "[t]he evidence does not show that Harding employees schemed to accept bonds over the objection of a senior analyst, nor did analysts cave in to pressure to relax standards to ensure that the bonds would pass review" (ID at 78);
- there was no evidence of Chau pressuring Harding analysts to relax standards of review to accommodate Magnetar or Merrill (ID at 80);
- Harding approved the same assets for other deals, unrelated to Magnetar or Merrill, at other times both before and after the day on which these assets were selected for Octans (*see* ID at 46, 66);
- "there is insufficient evidence of pressure by Magnetar to corrupt Harding's credit process" (ID at 73);

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[2] An ABX Index trade involved a simultaneous long position in the index and a short position in the components of the index that the CM did not like. (Tr. 2438:6-2442:3.) The net effect is long exposure only to the component assets of the Index that the manager did like. (*Id.*) The purpose of the trade is to take advantage of an arbitrage opportunity, which, in plain English, permits the purchase of constituent assets on more advantageous terms even when the cost of the trade is taken into account. (Tr. 2160:6-2161:15, 2458:8-2463:17, 4715:20-4716:11; RX 384.)

[3] Note that this disclosure, which goes to the very core of what is in dispute, was made only *four* days before the start of the Hearing and that Division's expert, who did the analysis, had given his finding to Division at least six weeks before that. (RX 884; Tr. 1104:10-18.) Note too, that Respondents had only approximately 20 weeks to prepare for the Hearing and that the investigative file consisted of approximately eleven terabytes of data, which is equivalent to twenty-two million documents or the entire contents of the Library of Congress. (*See* General Prehearing Order (Nov. 18, 2013); RX 451-454.)

- Magnetar did not suggest a minimum number of ABX Index assets (ID at 78);
- Magnetar was not betting on Octans to fail because its short position was smaller than its long equity position 2 to 1, *i.e.*, Magnetar's interest were aligned with those of other long investors (ID at 75-77);
- there was no *quid pro quo* whereby Harding would get more business if it allowed certain assets into the CDO (*id.*);
- Harding's incentives were also aligned with those of the investors in Octans (ID at 75);
- the relevant parties believed at the relevant time that the ABX trade was beneficial to the Octans deal (ID at 77);
- according to one of Division's own experts, "the performance of Harding-managed CDOs was generally consistent with the performance of several other managers' deals in the market at the time," and that "with the recession beginning in 2008, everyone in the financial industry failed to predict the crash of non-agency bonds[;]" (ID at 56);
- there was no direct evidence that Respondents' conduct contributed to any CDO's failure, and there was insufficient evidence of harm to investors or the marketplace resulting from Respondents' conduct (ID at 92);
- "[t]he evidence is insufficient to conclude that Harding possessed a conflict of interest with respect to Octans" (ID at 73); and
- no one at Harding was ever asked to do anything unethical or anything that he or she was uncomfortable doing (ID at 8-10).

In sum, there was no deliberate fraud, the relevant assets were fine, and Harding deals, including Octans, performed in a manner consistent with the performance of deals managed by other comparable managers.

Despite these factual findings–all of which were consistent with the evidence and arguments marshalled by Respondents in their post-Hearing brief–the ALJ still found fraud, albeit *negligent* fraud. To get there, the ALJ accepted Division expert's opinion that a Harding analyst, Lieu, was negligent in selecting assets on the relevant day. (ID at 64-68.) Note that the ALJ found what Lieu did that day was not completely at odds with what she was supposed to do.

(ID at 66.) ("Nor was the disparity between the pitch book's [("PB")] representations and the reality of the process so clear and distinct that the representations rose to the level of an extreme departure from the standard of care. Lieu followed the [PB] represented review standards to some extent, albeit untidily and incompletely.") Nonetheless, the ALJ found that Lieu was negligent *in selecting assets* on that single day and, therefore, her conduct rendered PB representations about Harding's *asset-selection process*, as well as representations about comportment with a standard of care contained in the Collateral Management Agreement ("CMA") and described in the OC ("OC") materially misleading, resulting in *negligent* fraud. (ID at 66, 70, 72-73, 90.)

As discussed in more detail below, this finding erroneously conflates negligent fraud with simple negligence; mere negligence on a simple, random day cannot render false general descriptions of asset selection *processes* unless those processes were wholly abandoned. *See, e.g., Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 773 (1st Cir. 2011); *Genesee Cnty. Emps.' Ret. Sys. v. Thornburg Mortg. Secs. Trust 2006-3*, 825 F. Supp. 2d 1082, 1167-68, 1170 (D.N.M. 2011); *Emps.' Ret. Sys. of Gov't of the V.I. v. J.P. Morgan Chase & Co.,* 804 F. Supp. 2d 141, 154 (S.D.N.Y. 2011) (all cases cited by the ALJ in his ID). There is no such finding here.

In any event, the finding of negligent fraud here is inconsistent with and is outside of the scope of what is actually alleged in the OIP and must be reversed for that reason alone. (*Compare with* OIP ¶¶ 2-6, 54-59.) *See, e.g., In the Matter of Gordon B. Pierce*, Exchange Act Release No. 9555, 2014 SEC LEXIS 4544, at 62 (Mar. 7, 2014) ("In our administrative proceedings, in contrast, a law judge lacks the authority to amend an OIP to include matters outside its original scope; expanding the scope of the OIP requires action by the Commission.");

Russell W. Stein, Exchange Act Release No. 47504, 2003 SEC LEXIS 608, at *30 n.34 (Mar. 14, 2003) (rejecting Division's argument as outside the scope of the OIP where the allegations underlying it were not part of the OIP), *recons. granted on other grounds*, 2004 SEC LEXIS 1727 (Aug. 9, 2004).

The prejudice to Respondents from this departure from the OIP was incalculable. Division's submission of the Wagner expert report was the first hint that Division may try to prove that Lieu made a mistake and did not run the assumptions she intended to run, but even that report did not make clear that Division would try to prove that *Lieu's negligence* would be a predicate for fraud because the report addressed industry standards in the context of intentional departure from those standards in response to pressure from Magnetar. (Resps. Mtn. to Exclude Evidence of Uncharged Acts (Mar. 21, 2014); Division Exhibit ("DX") ¶ 8001.)[4]

Specifically, asset analysis entails running mathematical models by applying certain assumptions to see how assets would perform in response to changing economic conditions. In his report, Wagner asserted that, to accommodate Magnetar, Harding used non-standard, more relaxed assumptions in order to approve assets that might otherwise be kicked out. (*See, e.g.*, DX 8001 at ¶ 81.) He also asserted, and this was Respondents' very first hint of the ultimate negligence theory, that Lieu made a mistake in applying even the more relaxed assumptions she intended to use. (*See id.* at ¶¶ 83-84, 92-95)[5] However, given the entirety of his report, even if the Division were to prove negligent disclosure failures, the predicate for such failures would

4 ALJ refused to order Division to provide more information on its allegations. (Order Denying Resps. Mtn. for More Definite Stmt. (Feb. 12, 2014).)

5 These and many other allegations in the Wagner expert report were predicated on his review of the investigatory record given to him by Division. (*See* DX 8001.) Of course, Respondents made a motion to exclude his testimony, in large part because he was opining on the ultimate issues in the case and because, in a similar case in federal court, Wagner's testimony was precluded by a district court judge. (*See* Resps. Mtn. to Exclude the Expert Testimony of Wagner, (Mar. 21, 2014) (citing *SEC v. Tourre*, 950 F. Supp. 2d 666 (S.D.N.Y. 2013).)

have been a deliberate, purposeful departure from accepted norms and PB representations. (*See id.* at ¶¶ 88, 108, 166)

For these reasons, Respondents did not retain and proffer an expert on the standard of care by the due date of March 3, 2014; under the circumstances, there was no reason to hire an expert to opine on the standard of care when the relevant allegation was that the standard, whatever it may have been, was deliberately ignored. Only to rebut Wagner's specific assertion about relaxation of assumptions, Respondent hired an expert to show that had Lieu applied the assumptions Wagner claimed she intended to apply (and that were standard in the industry), all assets would have been found to be credit-worthy. (*See* Respondents Exhibit ("RX") 976 (finding that analysis based on what Wagner claimed to be Harding-intended, industry-standard assumptions would have resulted in approval of all relevant assets; also finding that Wagner appears not to have understood how to run a proper analysis).)[6]

Apparently in response, *after the start* of the Hearing, over Respondents' repeated objections,[7] Division began to assert a new theory of liability: that the departure from the standard of care was Lieu's alleged negligence on the day she selected the ABX Index assets.[8] The ALJ's finding of liability predicated on Lieu's negligence is inconsistent with and is at variance from the allegations in the OIP and was highly prejudicial. It must, therefore, be reversed. *In the Matter of John P. Flannery & James D. Hopkins*, File No. 3-14081, Opinion of Commission at 50 (hereinafter "Flannery") (Dec. 15, 2014) ("the standard for determining

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6 Given the short time frame and at the ALJ's invitation, Respondents also tailored their document review and preparation to demonstrating that Magnetar's interests were aligned, that none of the assets at issue were ever disfavored, and that there was no scheme. (*See* Order on Motion for Adjournment at 2 (Jan. 24, 2014).)

7 *See, e.g.*, Resps. Br. 25-32; Tr. 67:8-68:8-4903:14-4904:24.

8 Even in its pre-Hearing brief, Division still asserted that it intended to prove only deliberate conduct. (*See, e.g.*, Div. Pre-Hearing Br. at 1.)

whether notice is adequate is whether the respondent understood the issue was afforded full opportunity to justify [his] conduct during the course of the litigation" (internal citation marks omitted).)

Division's negligent selection case was predicated on two things primarily: a hearsay document prepared by a junior analyst, Brett Kaplan (DX 53), showing substantial write-downs in the relevant assets and Wagner's assertion that Lieu completely failed to review eleven assets (DX 8001 at ¶ 83). The ALJ found that she was negligent because: (1) there does not seem to be contemporaneous documentary evidence reflecting the exact analysis Lieu claims she had done; (2) that her testimony on the matter was confused and contradictory; and (3) that Wagner opined that her review (as evidenced by the documents given to him by Division) was substandard. (*See, e.g.* ID at 65-66). We discuss these findings in order.

DX 53 is a spreadsheet of certain cash flow analyses performed on May 31, 2006. DX 53 showed substantial write-downs on the eleven bonds at issue. However, DX 53 is so problematic on its face that even Wagner agreed that he would not have approved assets on the basis of that document without further analysis. (Tr. 4726:15-4727:15; 4738:19-4751:18.) As a basic reality check, suffice it to say that Lieu knew at the time that each of the bonds in the flawed analysis was trading at par, which would not have been possible if DX 53 reflected a correct analysis. (Tr. 3670:20-3671:3; 3959:23-3960:5; 4733:23-4734:6; 4726:15-4727:15.) (Division agrees: it alleged that DX 53 could not have supplied a good faith basis for approving those assets. (OIP ¶¶ 46-47).)

Lieu testified that she did not have a good recollection of the events of May 31, 2006. (Tr. at 4046:9-12) But she was confident that she would not have approved those assets based on Kaplan's analysis. (Tr. 3429:8-3432:11.) Her testimony, in a nutshell, is that she would not have approved assets for inclusion in any deal had she not done the requisite work and gotten comfortable that the assets were credit worthy. (Tr. 3659:10-14; 4330:2-25.) Her inability to remember precisely what she did on a random day eight years before she testified at the Hearing is not surprising. Given (a) the absence of proof that anything untoward had taken place on that day, (b) her testimony and the ALJ's specific finding that she was never asked to do anything unethical (Tr. 3930:9-3933:4; ID at 9-10), and (c) the ALJ's finding that she was very busy on the day she analyzed the ABX Index bonds (ID at 23), it would be surprising if she did remember in April 2014 exactly what she did on May 31, 2006.

In other words, the primary document offered as proof of Lieu's negligence by Division is unreliable hearsay (Division did not even call Kaplan) and her testimony directly contradicted the inference Division asked the ALJ to draw. Even if the ALJ disbelieved Lieu, Division failed to meets its burden of proof because there was no other, reliable evidence of what actually occurred on that day.[9] We note that, in the middle of the Hearing, Respondents did find an electronic file containing what appeared to have been a compilation of analyses for all Octans assets. (RX 966-67.) It is not clear based on some of the information in that file and its metadata exactly when it was created or updated. (*See* ID at 43 n.45.) However, there was uncontested testimony at the Hearing that Harding would not have approved an asset without analysis and

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[9] In an administrative proceeding, the government cannot rely solely on uncorroborated hearsay evidence to satisfy its burden in the face of contradicting evidence from the sworn testimony of the Respondent. *See Hoska v. U.S. Dept. of the Army*, 677 F.2d 131, 138-41 (D.C. Cir. 1982) (quoting *McKee v. United States*, 500 F.2d 525, 528 (Ct. Cl. 1974) ("mere hearsay lacking sufficient assurance of its truthfulness is not substantial evidence to overcome the sworn testimony of a claimant.").) Evidence that is as consistent with innocent conduct as they are with fraudulent conduct are never sufficient to establish liability under Sections 206(1) or (2). *United States v. Mulheren*, 938 F.2d 364, 372 (2d Cir. 1991) (evidence that is as consistent with innocent conduct as they are with fraudulent conduct is not sufficient to establish liability); *see also*, 4-73 Modern Fed. Jury Instructions-Civil, ¶ 73.01 (Matthew Bender) (stating that, when the standard for determination of liability is "preponderance of evidence," then the party bearing this burden must prove more than equality of evidence and if the testimony of both parties is "in balance or equally probable, then the plaintiff has failed to sustain his burden.").

would document that analysis as well as update it at some point following the credit decision. (ID at 42-44 (citing Tr. 3729-30, 3809-12, 3824-30, 3843, 3869, 4029-30).)

In short, the ALJ found, at most, that Lieu's documentation of her work on May 31, 2006 was "slapdash," "untid[y]," and "incomplete[e]." (ID at 65-66.) His critique is not that she did not fulfill all of the steps to review an asset or that she did not run cash flow analysis of the relevant bonds, but rather that there was "no *documentation* of Lieu running stress case runs." (ID at 65 (emphasis added)) The fact that the ALJ cannot determine exactly what happened that day does not establish negligent fraud, it establishes that Division failed to meet its burden of proof. At most, the ALJ's factual findings show that Division proved that Harding's record keeping was inadequate, rather than that Lieu was negligent in asset selection. To repeat, there was nothing wrong with the assets she selected and those same assets were selected by her and another analyst for other deals at other times. In any event, the ALJ's findings represent an improper burden shifting from Division to Respondents. In effect, he erroneously equated the absence of evidence of adequate review with evidence of the absence of review. (*See, e.g.*, ID at 65-67.)

Separately, the ALJ's decision to accept Wagner's opinion on the ultimate issue is inexplicable. To begin, Wagner's bald assertion that Harding failed to perform any analysis for eleven of the relevant assets was flat out false. Wagner was repeatedly forced to admit on cross-examination that documents he reviewed in connection with his report showed that cash flow analyses were performed for every single asset. (*See* Tr. 4768:11-4797:6). Ultimately, Wagner was reduced to taking the absurd position that the words he used repeatedly in his report, including in Appendix 7 to his report (DX 8001) entitled "Harding Decision on Bonds Not Previously Reviewed by Credit" did not mean what they said, *i.e.*, that when he said "no analysis" in the column entitled "Bond Analyzed and write downs (Test. Ex. 277)", he did not mean that no one at Harding did any analysis. (*See, e.g.*, Tr. 4776:6-24.) (Here, one has to wonder whether Division understood that Wagner's report was misleading. This may be why Division prevented Respondents from seeing its communications with its experts. (Tr. 92:5-95:24.)

Wagner's credibility aside, it is also not clear how the ALJ could rely on Wagner's opinion that Lieu's credit review did not meet the standard of care when the ALJ explicitly found that Wagner "did not identify exactly what 'industry standards' entail for collateral managers." (ID at 55.) *See Daubert v. Merrell Dow Pharmaceuticals Inc.*, 509 U.S. 579 (1993) (expert testimony must be the product reliable principles and methodology). Wagner also admitted that he had no personal knowledge about the Octans transaction and insufficient information on which to base a reasoned conclusion. (*See* Tr. 4766:17-4811:16.) For example, rather than basing his opinions about the ABX Index on personal experience with Intex (the analytical platform used in the industry), Wagner simply stated that he could "intuitively look at [cash flow run] models and understand them." (Tr. 4561:23-4563:6.) Wagner had to concede, however, that his intuition failed him, admitting that he had made an error in interpreting Harding's runs and retracted portions of his initial, inaccurate report pertaining to Harding's credit default rate. (*Compare* DX 8001 at ¶ 84 *with* DX 8003 at ¶¶ 17, 38). Nevertheless, the ALJ accepted Wagner's opinion that the analysis of ABX Index assets for Octans failed to meet industry standards of care and the asset review procedures described in the PB. (ID at 55, 65, 66, 70, 73.)

All of this is academic, however. The ALJ made specific findings that the ABX Index assets at issue had been analyzed, including having cash flow analysis runs, at various times both before and after May 31, 2006, including for deals not involving Merrill or Magnetar.[10] He also found that these reviews showed nothing wrong with the ABX Index assets that were selected for Octans. (*See* ID at 35-36; 42-47.)[11]

There is another independent reason that the ALJ's finding was in error: there was uncontroverted testimony that prior to the closing of Octans, Harding and Chau certified that the assets in the deal met all of the eligibility criteria for the deal and that Harding performed an analysis of deal assets in connection with this certification prior to closing. (Tr. 4252:15-4254:10.)[12] Therefore, even if there had been something wrong with the initial analysis performed on May 31, any problem had been remedied in connection with pre-closing review and certification. If this case is about negligence, that is a break in causation. Note too, that the ALJ found that a September 18, 2006 analysis of the same bonds showed no problems with any of the bonds; Octans closed six days later, on September 26. (ID at 56; *see also*, RX 429-432, 435.)

Even assuming that Lieu was negligent in her review of assets on a given day, her random negligence could not be the basis for a finding of negligent fraud. To begin, there are

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10 Specifically, he found: "Of the forty ABX Index bonds, at the Baa2 and Baa3 levels, Harding analysts analyzed cash flow for at least thirty-nine within the ten days leading to Lieu's decision on May 31, 2006, including the twenty-four that Lieu had Kaplan run on May 31, 2006. (ID at 66 (citing Tr. 4741; DX 52-54, 267-70; RX 773-74).) He found that: "The fortieth bond, for which no cash flow run records have been located, was approved by both Moy and Lieu on May 31, 2006, and had been approved several times before that." (ID at 36 (citing DX 65-66; RX 298-99, 371-72.).)

11 ALJ found that Lieu acted on her own without speaking to the other senior RMBS analyst at Harding. (ID at 64.) A more likely inference is that they did speak and reconcile their different opinions, given the ALJ's other finding that they sat in the same room at the same desk and both were present that day. (*See* ID at 5, 9 (citing Tr. 326-327, 511-13, 966, 970, 3259-60, 3269).) The other analyst was not called by the Division and did not testify.

12 Contrary to the ALJ's finding (*see* ID at 72 n.61), that review did involve credit quality review, as one of the eligibility criteria was that an asset could not be a **credit risk or a defaulted asset**. (*See* RX 2 at 138-144; Tr. 4252:15-4254:10.) That means the review did not show that an asset posed, "a significant risk of declining in credit quality or value (or, there has occurred, or is expected to occur, a deterioration in the quality of the underlying pool of assets) or, with a lapse of time, a significant risk of becoming a Defaulted Security" for each security. (RX 2 at 257 (OC); RX 4 at 19 (Indenture); Tr. 2991:5-2992:6.)

only eleven assets at issue here, representing approximately six percent of the Octans portfolio.[13] That is to say that all representations about asset selection *processes* and comportment with the relevant standard of care are true and correct in all *material* respects. The fact that one analyst's conduct may have been "slapdash" on one day as to one element of the credit review process for eleven assets is not wholesale abandonment and does not change the total mix of information.

Put differently, general compliance with review standards means that Lieu's aberrational failure to do cash flow runs on a small subset of the RMBS bonds, even if true, could not alter the "total mix of information" about Harding's processes available to investors. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). This was essentially the testimony of every investor in the deal, including the only investor called by Division. None said that it relied on the PB alone for ascertaining the CM's capabilities and processes. (Tr. 1942:21-1943:13, 2551:19-2552:4, 2609:17-24, 2873:15-20, 2875:21-2894:7; 4589:13-4594:21.) All said that they did their own asset analysis and spoke with Harding employees to satisfy themselves that Harding was capable and its employees knowledgeable. (*See, e.g.*, Tr. 4589:13-4594:21.) The only investor the Division called to testify at the Hearing, Doiron, testified that it would be "absurd" to base an investment decision on bullets in the PB about the CM. (Tr. 1943:20-1944:21; 1954:25-1955:20.) Again, to the extent the statements in the PB about Harding's process were relevant at

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13 Harding selected 185 assets with a total notional value of approximately $1.47 billion for the Octans portfolio during the warehouse period. (DX 6 (Trade Blotter).) Division's case only focuses on the selection of 28 ABX Index assets on May 31, 2006. (*See, e.g.*, OIP § 40; DX 6.) Even then, the OIP, the Division, and ultimately ALJ only take issue with 13 of those bonds. (*See, e.g.*, OIP §41-50, Div. Br. at 57, 113; ID at 44, 64.) That was because there was evidence that another Harding analyst, Jamie Moy, independently approved the other 15 on May 31, 2006. (ID at 44, 64.) There are, however, actually only eleven assets at issue. One of the assets, the MABS bonds at the Baa2 and Baa3 levels had been approved by both analysts on other occasions including on May 22 and May 30, 2006. (*See* DX 16, DX 6; RX 776-777; DX 34-35; Tr. 3712:13-3713:6.) The eleven assets represent approximately 7% of the value of the Octans portfolio at closing. (*See* DX 6; RX 874 (listing the thirteen3 bonds at issue, including the MABS bonds).) There is no allegation or suggestion that any of the $1 billion plus assets selected during the same time period as the ABX Index assets, by the same team at Harding, were acquired pursuant to anything less than a thorough, rigorous, and collaborative credit review. In fact, any notion that Harding's entire process was defective would plainly contradict the OIP allegation that Harding lowered its own standards to accommodate Magnetar and Merrill. (OIP ¶¶ 2, 8, 32-40, 54-59.)

all, the ALJ's findings show that they were materially true, given its entire contents and the role it played in the process. One investor even observed that: "[t]he description of an investment approach in a pitch book is an ideal. A manager sometimes falls short." (*See, e.g.*, RX 884 (Statement of Imran Khan, UOB (Khan was an investor in Octans), produced as *Brady*.)

There is also no fraud because all investors received the benefit of their bargain. Octans was a Rule 144A private offering to extremely sophisticated investors – other investment managers and CMs. (RX 2 at 221-225; Tr. 2938:11-2939:3; 2970:16-2971:6.). There is no allegation or proof that any of them did not get the exact securities they expected at the price they expected to pay. There is no allegation or proof that any of the assets in the Octans portfolio did not comport with all eligibility and investment criteria. There is no dispute that all these sophisticated investors were given the entire portfolio before they invested and that they all reviewed and re-analyzed that portfolio before investing. (*See, e.g.*, Tr. 1875:11-14, 1944:3-21, 1955:21-1956:21, 2521:15-23, 2821:2-2825:13.)

The ALJ gives short shrift to the fact that both the PB[14] and the OC explicitly stated that neither was making any representations about the quality of the collateral in the deal. (RX 2 at 18, 52; DX 2 at 2, 30.) To say, as the ALJ does, that this disclaimer is irrelevant because the representations he found wanting relate to the process of selecting the collateral rather than the collateral itself stands logic on its head. (*See* ID at 65.) It is the equivalent of saying that the

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[14] Note that the PB explicitly disclaimed that it is an offering document and was also replete with warnings that it was subject to change. (DX 2 at 2, 3, 6, 16, 18, 19, 20, 22, 27-34). It also directed the reader not to make any investment decisions based on the information contained therein. (*Id.* at 3, 27). This is another independent reason the ALJ's finding of liability premised on the PB was in error. Fraud in connection with an offer or sale of securities under Section 17(a) cannot be predicated on a document that expressly stated that it was not an offering document and was subject to change. *See, e.g.*, *Independent Order of Foresters v. Donald, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 939 (2d Cir. 1998); *see also Banco Espirito Santo de Investimento, S.A. v. Citibank N.A.*, No. 03 Civ. 1537 (MBM), 2003 U.S. Dist. LEXIS 23062, at *13-15 (S.D.N.Y. Dec. 29, 2003), *aff'd*, 110 F. App'x 191 (2d Cir. 2004).

investors in Octans would care more about how Harding selected assets than about the assets Harding selected.

On the contrary, the description of Harding's process and the disclaimer of the quality of the assets must be read together, not in conflict. Read together, these two provisions make clear that Harding's asset selection process was relevant only in very general terms primarily because Octans was a managed deal with a six-year life expectancy, *i.e.*, Harding's capabilities were relevant *after* the deal closed, when investors would be dependent on Harding's skill to maximize deal performance. (*See* RX 2 at 13; Tr. 2582:2-21; 1980:11-16.)

The implications of the ALJ's decision, should it be allowed to stand, are as profound as they are frightening. In effect, any employer can find itself liable for fraud if one of its employees has a bad day at the office, even if (1) there is no evidence of collusion or bad faith; (2) no investors were hurt as a result; (3) the assets selected were no worse than any other assets; and (4) the conduct in question is an aberration. This is not fraud.[15]

NORMA

The second set of claims relates to Harding's role as CM for two other Merrill-created CDOs, Neo CDO 2007-1 ("Neo") and Lexington Capital Funding V Ltd. CDO ("Lexington"). In January 2007, Chau negotiated a discount to purchase the BBB-rated tranches of a CDO named Norma CDO I, Ltd ("Norma") for Neo and Lexington. Harding was not involved in the structuring, marketing, or asset selection for Norma. The ALJ concluded that Respondents operated under an undisclosed conflict of interest with respect to the purchase of these Norma

[15] ALJ also erred in finding liability for statements that were not made or used by Respondents. Merrill drafted, prepared, and circulated the Octans PB and OC. In fact, the Engagement Letter explicitly stated that Merrill was the only authorized party to distribute materials about Octans and to solicit offers and sales. (RX 118 at 4.) Harding's role was expressly limited to providing information to Merrill. (*Id.* at 2.) Such a limited role does not establish a securities fraud violation. *See SEC v. PIMCO Advisers Fund Mgmt LLC*, 341 F. Supp. 2d 454 (S.D.N.Y. 2004); *SEC v. KPMG LLP*, 412 F. Supp. 2d 349 (S.D.N.Y. 2006.)

bonds and materially misrepresented and failed to follow a standard of care in selecting the Norma BBB bonds for these two transactions, in violation of Section 17(a)(1) of the Securities Act and Section 206(1) of the Advisers Act. The purported victims were the special purpose vehicles ("SPVs") created by Merrill for these transactions, in other words, their Issuers. These findings were in error as a matter of both fact and law.

A. There Was Nothing Wrong the Asset Selection Process for 98.4% of the Collateral.

The role of the CM is, in part, to check the influence of the underwriter on the portfolio. Therefore, ALJ's finding that the Norma bonds constituted approximately 1.6% of each of Neo and Lexington (ID at 52) suggests that Harding's process worked. Put differently, the ALJ found that the asset selection process followed by Harding resulted in Neo and Lexington deals being 98.4% free of any conflict or taint. (*See* ID at 48-54; 81-86.) Put yet another way, he found that all representations about asset selection and processes were true and correct in all material respects.

As mentioned, minor departures from the credit review standards fail the materiality test. For a misstatement or omission to qualify as material, there must be a substantial likelihood that a complete and truthful disclosure "would have been viewed by [a] reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus.,* 426 U.S. at 449. If investors understood that pressure from the deal underwriter about asset selection -- which is common and unremarkable according to the only investor witness called by Division (*see supra* at section D(4)) -- resulted in the inclusion of only one asset representing 1.6% of the portfolio, investors would be reassured, rather than concerned. The very fact that these deals were found by the ALJ to be (at worst) 98.4% conflict free belies the entire notion that Harding or Chau was conflicted at all. One would expect more problems in these Merrill deals if Harding were laboring under a conflict, yet none other was proved and none other was even alleged.

Regardless of the manner of their selection, Norma bonds did not cause any harm. (ID at 92 (There was "no direct evidence that Respondents' failure to follow the appropriate standard of care contributed to any CDO's failure, particularly as to the Norma-related violations").) Norma's performance was, in fact, consistent with that of other similar deals of the same vintage, as was clearly reflected in a document submitted by Wagner in another Commission CDO litigation. (RX 858 at ¶¶ 41-42; RX 856 at 5; Tr. 4886:13-4890:8.)

B. <u>The ALJ's Findings Rested on False Premises.</u>

The primary allegation here is that Harding did not like the Norma portfolio but caved in to pressure and bought Norma bonds anyway. (OIP at ¶¶ 60-69.) The first problem with that allegation is that not a single witness to the relevant events testified that there was any accommodation to Merrill or Magnetar or that he or she thought at the time that Norma bonds were bad investments at the price and spread at which they were purchased.

The next problem is that Harding agreed to buy certain A-rated Norma bonds *before* there was any pressure from anyone. (ID at 82 ("Harding committed to purchasing A-rated Norma bonds prior to any emails of conversations with Magnetar, and without any palpable pressure from either Magnetar or Merrill"); *see also* Exhibit A (Timeline of Events Related to Norma) (also demonstrative exhibit at Hearing, RX 975); Tr. 4184:14-4185:18; DX 196.) Harding inquired about Norma before anyone from Merrill or Magnetar reached out to Harding. (DX 193.) Here again, no one really remembers what was done by whom and when six years ago (*see generally* Tr. 4167:16-4480:21, 1578:5-19, 2636:23-2637:8), but Harding received the Norma collateral, PB, and the term sheet and, after enough time to review all those, *volunteered* to buy the single-A Norma bonds. (Exhibit A; Tr. 4184:14-4185:18; DX 196.)

The significance of this fact cannot be overstated. The portfolio analysis is the same for the single-A's as for the other Norma bonds, like the BBBs. If Harding understood the portfolio well enough to buy the single-As, *a fortiori* it understood it well enough to buy the BBBs.[16] It is, therefore, very significant that Division *did not charge* the purchase of the single-A Norma bonds, as the ALJ found. (ID at 86.) This could not have been an oversight, and Division did not even contest the point at the Hearing when Respondents brought it up. (Tr. 4237:5-19.) In the absence of any evidence of pressure, there was no possible nefarious explanation for that purchase. The ALJ seems to have missed the import of this fundamental truth.[17]

But the primary reason the ALJ came to the wrong conclusion about Norma is that Division mislead the ALJ with rank, unreliable hearsay into believing that Harding's internal analysis showed that Harding bought Norma BBB bonds knowing that they were already substantially impaired. Specifically, one of the hearsay documents offered by Division was a Norma analysis by the same junior analyst who prepared DX 53, the analysis of Octans bonds that was wrong on its face. (DX 217.) DX 217 too was on its face riddled with indicia of unreliability. Among other things, it misidentified Norma's CM. (Tr. 4222-4223:12.)[18] Division argued that DX 217 showed that the BBB Norma bonds were impaired at the time of purchase because a figure of 10.17% appeared in a column titled "write-down %". (DX 217). Without

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16 The ALJ points out only one difference: the turbo structure. (ID at 82.) The ALJ, however, mistook the import of an email in which Chau complained about the turbo structure in Norma being weak. (ID at 82; DX 189.) In that email, shortly after Merrill's pricing announcement for Norma, Chau complained about Norma's turbo feature in order to create a wedge with which to later negotiate. (DX 189; Tr. 4169:5-11.) Moreover, a "turbo" feature is a CDO feature that diverts a percentage of the CDO's income from the equity tranche to other debt tranches to pay down the principal of that particular tranche. (Tr. 4133:13-4138:20.) In the main, the turbo feature *does not* affect the credit of a particular debt tranche, nor does it serve as credit enhancement. (*Id.*) It only optimizes the Weighted Average Life ("WAL") of the security. (*Id.*)

17 ALJ found both that Harding did not analyze the portfolio (before agreeing to buy the BBBs) and also that Harding's analysis showed that Norma was a bad investment. (*Compare* ID at 84 *with* 86.) Both cannot be true. And neither is consistent with a voluntary, pressure-free purchase of the single-As.

18 While DX 217 is evidence of an analysis of Norma, it was not the basis for Harding's investment decision, as it post-dates that decision. (*See* Exhibit A.)

calling the author of the document, Division asserted that the 10.17% figure referred to the degradation of the RMBS bonds in the Norma portfolio and because it was higher than the 6.79% subordination below the BBB tranche of Norma, the BBB bonds had been impaired. (*See, e.g.*, Div. Br. at 95.)

As Chau testified and Respondents argued post-Hearing, the analysis shows no such thing, nor could it because the BBB bonds at issue could not have been investment grade had they been impaired when they were issued and bought. Chau testified DX 217 referred to losses in the *underlying pools of loans*, which did not translate directly into losses by the RMBS backed by those pools of loans because of the various credit enhancements imbedded in the securitization of those RMBS. (Tr. 4382:5-4386:23.) His testimony is fully corroborated: It is undisputed that, employing a similar analysis, the rating agencies gave the bonds an investment-grade rating. (RX 890 (Fitch Rating of Norma on March 1, 2007).) Fitch could not have done so if the RMBS collateralizing Norma were already impaired to the tune of 10%. (Tr. 4223:21-4230:21; RX 890 at 2.)[19]

Unfortunately, this legerdemain succeeded. The ALJ found that a mezzanine CDO was backed by bonds that were *not* investment grade. (ID at 4.) In other words, he disbelieved Respondents when they said that the relevant Norma bonds could not have had a BBB rating – meaning they were investment grade by definition – had they been impaired when issued. (Tr. 1559:25-1562:10; 4100:09-4112:05; 4147:6-4150:20.) In sum, the ALJ rejected the un-contradicted testimony of the only witness with any understanding of the document in favor of

[19] As previously explained, the government cannot rely solely on uncorroborated hearsay evidence contradicted by Respondents' uncontested testimony to satisfy its burden. *See supra* note 10.

Division's false explanation because he was misled by the Division about the nature of these assets and their relevant metrics.[20]

Unsurprisingly, the ALJ's erroneous understanding of the quality of the BBB bonds infected his interpretation of the other rank hearsay Division offered. And, because there was no non-hearsay evidence supporting Division's theory, the ALJ found Respondents liable (and found scienter) relying almost exclusively on his jaundiced interpretation of this hearsay. (ID at 48-54.)

For example, Division introduced, as its main evidence of scienter, an internal Merrill email purportedly reflecting Chau's agreement to buy Norma BBBs. (DX 204.) This email is subject to multiple interpretations and none of the people on the email testified at the Hearing.[21]

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[20] This was not the only instance of ALJ being misled by Division. Among other things, the ALJ was initially misled into believing that the fraud here was that the RMBS underlying the CDOs in question were supposed to be AAA and that Harding placed lower-rated securities into these deals unbeknownst to investors and others. It was not until Chau was testifying in Respondents' case that the ALJ understood that the AAA-rated tranches of CDO's were not backed by AAA-rated RMBS. At that point, the ALJ noted that he had to rethink many things about this case, given his new, correct understanding. (Tr. 4080:11-4081:18; 4161:12-4161:15.) By then the damage was done, he had made numerous credibility findings on the record before he developed a correct understanding.

[21] On January 24, 2007, Kenneth Margolis and Andrew Phelps exchanged emails with a subject line, "Wing is in for $20mm." In the body, Margolis wrote: "I told [Chau] we would try and sell him down to $15mm if we could ... He wants to talk about the spread but he will be in ...." (DX 204.) Nobody at Harding received a copy of this email.

The lines "Wing is in for $20mm" and "He wants to talk about the spread but he will be in," could mean several things. They could be an expression of Margolis': (1) *hope* that Chau *would* "be in;" (2) *expectation* that Chau *will* "be in;" or (3) *assessment* of Chau's *intention* based on the conversation they had. Moreover, "is in" is not the same thing as "will be in." Most fundamentally, it is clear from the face of the email that these was no agreement on a trade because Chau apparently still wanted to agree on both price (spread) and quantity ("we would try to sell him down to $15mm"). (*Id.*) At the Hearing, Chau offered this interpretation of this sentence: "Harding, would like to talk about the price of the security-spread is equivalent to price-of the Norma transaction and if his price is met, he will probably be in." (Tr. 4199:2-4200:14.) This interpretation is as consistent with the words in the email as any other.

As for the line, "I told [Chau] we would try and sell him down to $15mm if we could," the ALJ speculated that Margolis meant that he would reduce Harding's allocation as an accommodation to Chau. There is no testimony from anyone to support this speculation. As Margolis and Phelps knew at the time, Harding was ramping deals for which it needed BBB securities. (DX 201 (internal Merrill email identifying Harding as a party with BBB needs); DX 205 (email from Phelps noting that Harding had BBB list out in the market).) They also knew that Chau had earlier expressed an interest in the Norma BBBs at the right spread. (DX 198.) They also knew that Harding had already done an analysis of Norma in connection with placing its single-As order. (RX 275-76.) They also appeared to have known that if he could get the right spread, Chau would be interested in a $20 million allocation. It is

(Footnote continued on next page)

Nonetheless, at the Hearing, Chau was subjected to the spectacle of having to testify about its meaning. (*See, e.g.*, Tr. 1623:21-1627:13.) In the ID, the ALJ found Chau's explanations of the meaning of this and other similar emails to be wanting. (*See, e.g.*, ID at 6, 51, 83-84.) The ALJ's finding of willfulness is predicated almost entirely on Chau's testimony about these hearsay emails. (ID at 81-87.) Essentially, Chau's inability to decipher hearsay authored by others was held against him both substantively and in assessing his credibility.

The "candle in the wind" email, which figures prominently in the ID as evidence that Harding "did not like" the BBB Norma bonds is similarly problematic. (ID at 84.) Its author did not testify about its meaning either. As a parody written in verse, it amuses, but there is no reason to think that its contents were meant to be taken seriously. (DX 226.) For example, the parody mentions that Norma was too long Long Beach, when Norma's exposure to Long Beach was actually relatively modest. (*See* RX 270.) There was no other evidence - zero - that hedge funds were shorting Norma or why.

It is worth remembering that by the date of this email, late May 2007, the RMBS market began softening. (*See* DX 509 (OC for Neo (4/4/07) (disclosing as a risk factor recent increases in losses in the mortgage market).) The author's complaints about Norma, therefore, may not have been particular to Norma. Had the original song been about Betty Lynn or Norma been called Marilyn, the same parodist may have chosen a different rhyming theme. (As in: "Good-bye Marilyn".) Chau testified that he was engaged in price discovery when he offered Norma to the author of that email, which makes sense in a softening market. (Tr. 1692:21-1693:23.)

reasonable to conclude then that the "I told him we could try and sell him down to $15mm if we could," was indeed a threat that if Chau wanted $20 million, he would not get it, unless he stopped negotiating and agreed to their price. All these interpretations are plausible from the face of the email, or it could be as simple as Margolis indicating that Chau would want $20 million at a certain price but only $15 million if he could not get the price he wanted. Doubtless, Margolis did not agonize about the wording of his email. However, the only witness who testified about it and who has any relevant knowledge read the email in a way not helpful to Division. His reading controls. *See supra* note 10.

In the absence of reliable, non-hearsay evidence, the ALJ should have found that Division failed to meet its burden of proof. Instead, he again converted absence of evidence into evidence of absence.

C. The ALJ Erred in Finding a Conflict of Interest

And if none of that obtained, as a matter of law, even as their Investment Adviser, Harding did not have a conflict that had to be disclosed to the Issuers. Investment advisers owe certain fiduciary duties to their clients and they must disclose conflicts that may affect fealty to those clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963). These conflicts fall into two general categories: (1) conflicts arising from the adviser's economic interest in a specific transaction that he recommends (self-dealing), and (2) conflicts that arise from the adviser's relationships that may influence his advice given on an on-going basis (divided loyalty). 2 Tamar Frankel & Ann Taylor Schwing, *The Regulation of Money Managers: Mutual Funds & Advisers*, §14.01, at 8-9 (2d ed. 2011).

The relevant conflict analysis here relates to divided loyalties with respect to prospective clients.[22] When a prospective client seeks to engage an adviser, that adviser must disclose any relationships or interests that may present a conflict. In these cases, an investment adviser does not have to disclose all of his or her relationships and interests, only the ones that may have some bearing on the relationship with the prospective client and the nature of the services the investment adviser would be performing. *Id.* § 13.01(B)(2)(c), at 18-19 ("[T]he information is provided to allow prospective clients to determine the fidelity of the prospective adviser. Prospective clients cannot prohibit the conflict, only reject the services."). An investment advisor

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22 The self-dealing analysis is irrelevant here because that deals with an adviser secretly profiting from a recommendation made to the client. *Id.* § 13.01(B)(2)(c), at 19. That is not the issue here. The issue here is the ALJ's finding that Respondents were conflicted, *i.e.*, had divided loyalties. There is also no allegation or proof that Respondents had divided loyalties after Neo and Lexington closed.

"must disclose conflicts of interests to prospective clients before they accept an offer of services," and they must do so "regarding specific transaction[s] involving a conflict of interest." *Id.* § 13.01(B)(2)(a), at 17. Similarly, the investment adviser has to disclose only conflicts existing at the time when a prospective client can contemplate entering into the relationship; past conflicts, once extinguished, are no longer conflicts by definition.

1. ***There was no conflict to disclose when Harding was hired by the Issuers.***

Harding selected the Norma bonds in late January/early February. (*See* Exhibit A.) By the time the Issuers were capitalized, there was no longer anything to disclose because (1) Harding's selections were made pursuant to warehouse agreements with Merrill that expired at closing; (2) Harding engaged in a pre-closing certification, which served as an independent check on the quality of assets; and (3) at close, Harding recommended the portfolio as a whole based on the defined Eligibility Criteria and Investment Guidelines. Thus, any conflict that existed extinguished or was superseded by subsequent events.

2. ***The findings do not support a conclusion that Harding had a conflict.***

Even if Harding did have an obligation to disclose an extinguished conflict to the Issuers, there was no conflict to disclose. First, the ALJ's finding that a conflict existed as to Norma contradicts his earlier finding regarding Octans. With Octans, the ALJ correctly found that Harding was not acting under a conflict of interest because it wanted to build goodwill with and please Magnetar and Merrill. Specifically, he found that "[o]rdinary business incentives, absent other factors, are not indicative of a conflict of interest." (ID at 74 (citing, for example, *Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 544 (5th Cir. 2008) ('"incentive compensation can hardly be the basis on which an allegation of fraud is predicated"' . . . only in an extraordinary case is it probative") (internal citations omitted).) The ALJ also correctly noted that, "it was not in Respondents' interest to collude with other parties to create a CDO that would fail. Harding only received fees as CDOs produced income. If a deal failed, Harding stopped receiving payment." (ID at 75 (citing Tr. 1475).) We agree. Harding's desire to build goodwill or please Merrill and Magnetar by selecting the Norma does not, by itself, establish a conflict of interest. (*cf.* ID at 50, 81.)

Second, although the ALJ found that Harding was acting under a conflict because it sought to please Magnetar with its purchase of BBBs, there is no evidence whatsoever that Magnetar ever pressured Harding to purchase BBBs. After Prusko of Magnetar inquired whether Harding would purchase BBB bonds, Chau informed him that he had already bought the single-As. (DX 200.) No one from Magnetar ever followed up or ever asked Harding again to purchase BBB bonds. In fact, Chau never told Magnetar that he purchased the BBBs. (Tr. 4235:20-4236:14.)

Third, to please Merrill or garner goodwill, Harding would have given Merrill a lead order or an early order at the original price that Merrill offered for the Norma BBB bonds. As Chau testified, an early lead order would have been extremely valuable to Merrill because it would have allowed Merrill to inform the market that it had interest at its original price. (Tr. 4196:9-4198:6.) Had Chau eschewed price negotiations and simply said "yes" to the Norma BBB bonds at the original price when it was first offered, he would have given Merrill its lead order. (Tr. 4194:11-4198:6.) Instead, Harding agreed to purchase these securities much later, in late January/early February, and at a discounted price. (*See* Tr. 4213:24-4215:5; DX 212.) This price was the full coupon rate, or the maximum return offered on this tranche of Norma. (Tr. 4213:24-4215:5.)

The wider spread Harding secured also represented a benefit for the investors of Neo and Lexington, at the expense of Merrill and Magnetar.[23] Wider spread in the context of CDOs refers to a higher interest payment for that tranche of the CDO. (*See* Tr. 2636:3-2636:22.) A wider spread means that less money for Magnetar; as Norma's equity owner, it received residual payments after all other investors were paid though the waterfall. (*Id.*; *see also*, Tr. 2638:2-20; 4234:13-4235:13.) Similarly, when Merrill sold bonds at discount, "every dollar price below par [was] a loss to Merrill Lynch." (Tr. 4231:4-4233:11, 2659:18-2660:3.) (Tr. 4233:15-20.)

D. **<u>The ALJ Misunderstood the Relevant Deal Documents and Misapplied the Relevant Law.</u>**[24]

Even if, contrary to the proof at the Hearing, one were to assume that Harding succumbed to pressure from Merrill, there would still be no violation. The only question in connection with Norma is whether the Issuers had been defrauded. Yet, there is no evidence of any specific representations of any kind made to them about asset selection. The PBs for Neo and Lexington are not even in evidence. No director of these Issuers testified at the Hearing.

1. ***The Standard of Care provision applied to prospective conduct only.***

In the absence of any specific evidence of representations about asset selection, the ALJ hangs his hat on the standard of care provision in the relevant CMAs. Those provisions became effective when Neo and Lexington closed on March 29, 2007 and April 5, 2007, respectively.

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23 The ALJ misunderstood what a "lead order" was, finding that Chau did not learn of a lead order and enhanced spreads until later in the negotiation. (ID at 85.) This does not make sense. Industry participants know of the importance of lead order, and Chau knew the original price offered by Merrill on January 9, 2007.

24 The same problems and errors outlined in this section apply equally to the Octans transaction.

(DXs 506, 510; Tr. 3121:21-3122:11; 3051:4-3052:16.)[25] The reason is simple and also self-evident: one is not bound by the terms of the agreement until one enters into that agreement. (Tr. 3042:11-3044:20.)[26]

2. *Harding had no obligation to the Issuers during the warehouse period.*

Before then, Harding had no obligations to the Issuers. None. As was the case with Octans, Merrill, as the underwriter, could have capitalized those Issuers with whatever assets it chose because it created the Issuers to receive whatever assets it decided to place there. (*See, e.g.*, DX 507 at 103-4.) In fact, Merrill could have fired or bought out Harding and replaced Harding with another manager to manage the Harding-selected portfolio post-closing. The Issuers could not have prevented that action.

3. *The Issuers had all relevant information about Norma.*

Merrill was both the creator and a fiduciary of the Issuer of Neo and Lexington. *See In re Parmalat*, 684 F. Supp. 2d 453, 475-76 (S.D.N.Y. 2010), *aff'd sub nom. Food Holdings, Ltd. v. Bank of Am. Corp.*, 423 F. App'x 73 (2d Cir. 2011) Merrill knew all about Norma, another Merrill-structured CDO. (RX 280.) Harding did not know anything that Merrill did not know about the quality of the Norma bonds.

Not a single witness testified about what Neo and Lexington Issuers were told or not told about asset selection. This is a fundamental failure of proof by itself. Regardless, Harding could reasonably be deemed to have made all relevant disclosures to the Issuers because it did not hide

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25 (*See, e.g.*, DX. 506 at 1 (The CMA, "dated as of March 29, 2007 . . . is entered into . . . ."), 3 ("The Issuer hereby appoints the Collateral Manager as its investment advisor and manager with respect to the Collateral on the terms set forth herein and authorizes the Collateral Manager to perform such services and take such actions on its behalf as are contemplated . . . .")

26 The Standard of Care provision also was not meant to impose an affirmative obligation; it was a defensive provision. It protected Harding from liability if a bad security made it into the portfolio despite an asset selection process that comported with the standard of care. (*See, e.g.*, DX 506 at 7.)

anything from their fiduciary and creator. (In fact, the ALJ found as much in another part of the ID relating to Octans. (ID at 80-81.) Disclosure to a fiduciary is disclosure to the principal. *See* Restatement (Third) of Agency § 5.03 (2006) ("[f]or purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is imputed to the principal if knowledge of the fact is material to the agent's duties to the principal. . ."). ***And the directors of the Norma Issuer were the exact same three directors for the Issuers of Neo and Lexington.*** (RX 280 at 136; DX 507 at 103, 509 at 110.) There is no evidence in this case that the Norma Directors were not fully aware of Norma's quality, its structural features, or its asset composition. ***They were the ones who offered the Norma bonds for sale to the Neo and Lexington warehouses.*** (RX 280 at Cover, iv-v.) One would hope that if these directors thought that Norma BBBs were good enough to offer for sale, they would agree that they were good enough to buy. As to these specific assets, in other words, they did not need a recommendation from their CM.[27]

4. *The Issuers were aware of Merrill's influence pre-closing.*

Issuers knew that assets were selected and warehoused subject to agreements between Merrill and Harding to which the Issuers were not parties. (*See* DX 507 at 58, 509 at 59.) Warehouse agreements typically gave the structuring bank, which warehoused the assets until the CDOs closed and assumed liability for certain losses during that period, "rights to approve or veto assets selected by the collateral manager." (ID at 4 (citing Tr. 115-16, 389, 395-96, 727-33, 1894-95, 3616, 4205, 4263).) In fact, it was basic industry knowledge and standard protocol that

[27] Again, Division cannot have it both ways: One cannot take the position that SPV directors can be deceived if one also takes the position that they are unaware of their own conduct. They are legally responsible for the disclosures made in the Norma OC, including, as Division would argue, the disclosures that the selection of Norma's collateral comported with the relevant standard of care. (RX 280 at iv-v, 175-76.) Harding can fairly rely on those representations in selecting Norma BBB bonds.

anyone taking warehousing risk would exercise control over the assets during the warehouse period. (*See, e.g.*, ID at 16, 29; *see also*, Tr. 727:19-728:19; 2536:5-2539:3; 2544:6-16; 2832:6-22; 2849:2-2850:15; 4634:3-8; 4640:17-4641:11.)

Division's sole investor witness Doiron explained that in the Wadsworth CDO, for which he and his HIMCO team served as CM, he felt no need to disclose anything to investors about his interactions with Morgan Stanley, the underwriter in that CDO, even though: (a) Morgan Stanley exercised control during the warehouse, including suggesting and getting certain assets into the portfolio, and (b) Morgan Stanley had different interests than the investors, including wanting to use the CDO to move certain assets off its books. (Tr. 1988:15-2002:18; 2009:21-2010:21; 2056:3-24; 1865:8-1867:23.) Likewise, Harding did not need to disclose—and was not acting under a conflict—simply because Merrill suggested and succeeded in getting one bond into two other deals that it structured.

5. ***Harding complied with the CMA.***

But setting all that aside, even if one were to agree with the ALJ that the Issuers' purchase of the collateral at closing was covered by the CMA (ID at 72), that "selection" was made long after late January/early February 2007 (the time during which Harding selected the Norma bonds). To accept the ALJ's reading of the CMA -- which is based the provision in the CMA that "the Collateral Manager will undertake to select all Collateral Debt Securities to be purchased by the Issuer on the Closing Date" (*see, e.g.,* DX 506 at 4; DX 507 at 155) -- one must also give effect to how the CMA defines "selection." The "selection" provision expressly directed Harding to select collateral to be acquired by the Issuer in accordance with the eligibility and investment criteria set forth in the transaction documents, and nothing more. (*See, e.g.*, DX 506 at 4.) Harding did that; it met its obligations.

But even if one were to broaden Harding's obligations beyond the clear, unambiguous language of the CMA and infer some representation about the quality of the collateral, there is undisputed testimony that Harding performed a pre-closing analysis in connection with its pre-closing *certification*, and that this analysis included making sure that none of the assets presented a credit or default risk. (*See, e.g.*, Tr. 4252:15-4254:10.)

6. *Harding was not the Issuers' fiduciary.*

The ALJ also erred in finding that Harding was the Issuers' fiduciary.[28] Harding was not, nor could it have been, a fiduciary of Neo and Lexington because (a) the relevant CMAs specifically said so and (b) because that would have put Harding in immediate conflict with the actual investors in those deals. Here is the relevant language from the CMA: "Limited Duties and Obligations; No Partnership or Joint Venture. . . . the Collateral Manager shall not be subject to any fiduciary or other implied duties. . . ." (DX 506 at 7-8, 510 at 8-9 (CMA); *see also* Tr. 1510:19-24; 1511:3-14; 1513:9-15 (Issuers were not "advisory client[s]" because there was no investment advisor agreement).)[29]

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[28] The ALJ made no specific finding that Harding was fiduciary of either the Lexington Issuer or the Neo Issuer; however, to the degree he rested on his earlier finding that Harding was the Octans Issuer's fiduciary, he committed clear error.

[29] The ALJ points to other provisions that refer to the Advisers Act (ID at 71); however, those provisions expressly limit Harding's role as a "Collateral Manager." (*See, e.g.*, DX 506 at 6 ("The Collateral Manager shall take all action required, ***as Collateral Manager for the Issuer***, to be taken by it under the Advisers Act."), 3 ("The Issuer hereby appoints the Collateral Manager as its investment advisor and manager ***with respect to the Collateral on the terms set forth herein***.").) In sum, the provisions are subject to Harding acting as the "collateral manager" and the other terms of the agreement, which includes the disclaimer that Harding will not be subject to any fiduciary or other implied duties.

In any event, Chau is not a lawyer, and Harding's lawyers acted in good faith. Even if the CMA is not effective in disclaiming fiduciary obligations because of the IAA, Chau and Harding relied in good faith on their counsel's review and analysis of the CMA and liability here cannot be predicated on any ambiguity in its meaning. Chau and Harding, in other words, believed in good faith that they were not the Issuers' fiduciaries. (*See* Tr. 1512:6-23.)

This provision reflects the reality that the interests of the different tranches of the CDO were never perfectly aligned. Joseph Suh, Harding's lawyer who negotiated, edited, and advised Harding on CMAs, specifically explained:

> This provision reflects the reality of a CDO transaction, which is that, . . . the collateral manager [does not have] unfettered rights with respect to the management of the issuer's portfolio. It's subject to a number of eligibility criteria for the assets that it can have the trustee purchase on behalf of the issuer. It also has very strict provisions regarding disposition of the assets. So it's reflecting that reality, that because the collateral manager is subject to a number of restrictions set forth in the transaction documents, that the collateral manager does not have duties or obligations other than those that are set forth in the transaction documents. And so the collateral manager is not subject to any fiduciary or other implied duties, because it would be unfair for the manager to be subject to duties when they are also subject to these restrictions in the transaction documents. So that's what this is trying to get at, the fact that there are -- these are asset-backed deals, the issuer is not permitted to do, in certain investments, not permitted to even dispose of certain investments in certain circumstances. And because of that, those limitations also apply to the manager's ability to act on behalf of the issuer.

(Tr. 3053:13-3054:21; *see also* 3048:2-3049:6.) This testimony is uncontested.

The issuers did not care. Given their own economic interests, the directors would not care how assets were selected pre-closing, so long as the assets were appropriately described in the OC and met all relevant eligibility requirements. The SPV does not profit from the returns on the bonds. The only representations the SPVs make are those in the OC. The OC disclosure for Neo and Lexington also disclaimed any representations about the quality of the collateral. (DX 507 at 49, 509 at 49-50.) Again, the assertion that the Issuers cared how the initial portfolio was selected stands logic on its head, given that they were making no promises about its quality and, as in Octans, specifically told potential investors to rely on their own analyses of the initial portfolio. (DX 507 at iii, 11, 509 at iv-v, 49-50; Tr. 3039:9-3040:20.)[30]

[30] Other errors include, but are not limited to erroneous findings that: (a) the conduct at issue operated as a fraud for both Norma and Octans; (b) the same conduct for Octans violated both subsections (a)(2) and (3) of Section 17 of the Securities Act; (c) Lieu's isolated conduct on one day was sufficient to establish a violation of subsection 17(a)(3) for Octans; (d) there were disclosure obligations under the Advisers Act and Section 17(a) of the Securities Act for Octans and Norma; and (e) the remedies the ALJ were imposed for Octans and Norma were
(Footnote continued on next page)

STATUTORY AND CONSTITUTIONAL ISSUES

The ID cannot be affirmed by the Commission for another independent reason: it is void because the ALJ was not a properly appointed officer of the Commission for purposes of the Hearing. The statutory provisions governing Cease-and-Desist hearings relating to federal securities laws uniformly require that those hearings must be conducted by the Commission or "an officer or officers of the Commission designated by it." *See* Securities Act of 1933, 15 U.S.C. § 77u ("All hearings shall be public and may be held before the Commission or an officer or officers of the Commission designated by it, and appropriate records thereof shall be kept."); Securities Exchange Act of 1934, 15 U.S.C. § 78v ("Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designated by it, and appropriate records thereof shall be kept."); Investment Advisers Act of 1940, 15 U.S.C. § 80b-12 (same); Investment Company Act of 1940, 15 U.S.C. § 80a-40 (same). On its face, this statutory language suggests that only someone who is already an officer of the Commission may be designated to hold these hearings. In addition, the fact that the Hearing may be held only by the Commission itself or an officer designated by it suggests that these must be constitutional officers, *i.e.*, officers empowered to exercise significant authority pursuant to the laws of the United States. *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 486 (2010) (citing *Buckley v. Valeo*, 424 U.S. 1, 125–26 (1976)). As the Commission is aware, similar statutory provisions with similar language are invoked when the Commission specifically and formally designates "officers" for purposes of conducting its investigations, which is what empowers them to exercise significant authority they need to

appropriate given the factual findings. In addition, the ALJ erred in his conclusions regarding the statute of limitations. Among other things, the ALJ acknowledges that he does not even know when or how the alleged violations occurred meaning there is no proof that the relevant acts took place within the statute of limitation period. (ID at 67, 70, 88.)

conduct investigations. *See* Securities Act of 1933, 15 U.S.C. § 77s(c) ("For the purpose of any investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of this title, any member of the Commission or any officer or officers designated by it are empowered to administer oaths and affirmations, subpoena witnesses, take evidence. . . ."); Securities Exchange Act of 1934, 15 U.S.C. § 78u(b) (similar); Investment Advisers Act of 1940, 15 U.S.C. 80b-9(b) (similar); Investment Company Act of 1940 (15 U.S.C. 80a-41(b) (similar).

It is clear, however, that the Hearing held here did not comply with the statutory command that it be heard before "an officer of the Commission." Indeed, as the Commission and the Division have unequivocally stated (in litigation relating to whether SEC ALJs were properly appointed under Article II of the United States Constitution) that SEC ALJs are mere employees of the Commission, not officers. *See* Mem. of Law in Opp'n to Pl.'s Mot. for TRO and a Prelim. Inj. at 11-19, *Duka v. SEC*, No. 15-357 (S.D.N.Y. Jan. 28, 2015), ECF No. 13 (". . . SEC ALJs are not constitutional officers. SEC ALJs are employees and thus their removal does not implicate Article II."); Div. of Enforcement's Mem. of Law in Resp. to the Commission's Order Req. Supp. Briefing at 4-13, *In re Timbervest, LLC*, File No. 3-15519 (Feb. 12, 2015) ("SEC ALJs, however, are employees, not constitutional officers, and thus the President's alleged lack of power to remove them does not implicate Article II.") Notably, neither of the Commission briefs filed in connection with the Article II litigation makes mention of any such appointment, even if to explain it away. Indeed, an exhaustive search of publicly available information revealed no evidence that any ALJ, including the ALJ in this matter, has been appropriately appointed or designated as a Commission officer under the relevant statutory provisions for purposes of conducting hearings.[31] An improperly constituted hearing is void and cannot be ratified. *Ryder v. United States*, 515 U.S. 177, 182-83, 187-88 (1995).

ALJs' status as mere employees infects the Hearings they conduct and violates due process. Because they are mere employees, just as the Division employees who litigate on behalf of the Division -- -- there is a substantial question of bias and a substantial danger that the Division does not see ALJs as sufficiently removed and independent to conduct itself appropriately. *See Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 883-84 (2009) (explaining that the Due Process Clause does not require "proof of actual bias," and instead, the Court asks "whether, 'under a realistic appraisal of psychological tendencies and human weakness,' the interest 'poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented.'").

Separately, unconstitutional potential for bias exists simply because the Commission chooses the judge in its own case and from among its employees. *See id.* at 870 ("Just as no man is allowed to be a judge in his own cause, similar fears of bias can arise when . . . a man chooses the judge in his own cause."). The due process problem becomes even more severe when one

31 Of course, if they had been officers of the Commission, ALJs would be inferior officers for Constitutional purposes and their appointments would violate the Appointments Clause of Article II of the Constitution because they would then be separated from the President by at least two layers of "for cause" tenure protection. *See Free Enter. Fund*, 561 U.S. at 484 (explaining that if an inferior Officer can only be removed for good cause, then that removal decision cannot be vested in another official who enjoys good-cause tenure because officers may not be separated from Presidential supervision and removal by more than one layer of tenure protection).

In addition, it is not clear from publicly available information exactly how ALJs are appointed and hired. If for example, it turns out that the appointment of ALJs for purposes of conducting Hearings has been improperly delegated to the Chief ALJ, as may be the case based on the authority the Commission purports to have delegated to her, their appointments may be defective for reasons of improper delegation as well. Similarly, the delegation of authority to the Director of Enforcement to appoint officers for purposes of conducting investigation appears improper both under the securities laws because they vest that appointment power in the Commission itself and under Article II. There may be other problems with ALJ appointments; however, the opacity of the process makes it difficult to ascertain their precise legal status.

considers the *Chevron* deference; if *Chevron* deference is given, the Commission, directly and through its employees, performs the functions of the legislature, the prosecutor, and the judge.

With this as background it is not surprising that the ALJ precluded Respondents from developing the record on their constitutional claims. Respondents claim that the Commission's choice of the AP in this case resulted primarily from undisclosed conflict during the investigation, fear of judicial estoppel based on inconsistent assertions made in another litigation involving the same subject matter, a desire to deny them a jury trial, and an improper desire to improve its chances of success by burying Responders in documents while also putting them under impossible and inflexible deadlines.

The ALJ gave Respondents' constitutional claims the short shrift, essentially deferring to the opinion issued by other Commission employees in the general counsel's office to whom the Commission delegated responding to Respondents' pre-Hearing motion for relief from the shackles of the AP process.[32] *See* ID at 89-90 (relying on *Order Denying Pet. for Interlocutory Review and Emergency Mot. to Stay the Hearing and Prehearing Deadlines,* Securities Act Release No. 9561 (Mar. 14, 2014.). This is not surprising, as employees of the Commission, ALJs are duty bound to do its bidding. They could be subject to being fired for insubordination if they did not. (*See, e.g.*, Pre-Hearing Tr. Nov. 18 at 20 ("[t]he chief ALJ will not, except in emergencies, will not authorize the hearing in the New York Regional Office"), 30-31 ("I don't have the authority to ask them to extend it. I have to go through the chief ALJ to do that and she won't do it -- she won't file a motion with them until we get to within about 30 days of the due date of the initial decision"); *Order Denying Respondents' Mot. for Adjournment*, Release No. 1195 (Jan. 24, 2014) ("I must consult with the Chief Administrative Law Judge, and she has the

32 Query whether those employees were properly appointed to rule on constitutional challenges to Commission's processes.

discretion to file a motion for extension with the Commission, which makes the final determination. 17 C.F.R. § 201.360(a)(3)"). The Commission had spoken, albeit through ALJ's colleagues in the general counsel's office, it would be futile and insubordinate for the ALJ to come to a different conclusion.

To sum up: Respondents raised Constitutional equal protection and due process claims with the ALJ. (*Resps.' Emer. Mot. for Recons.* at 2-11 (Feb. 14, 2014).) He rejected them out of hand. (*Order on Resps. Emer. Mot. for Recons.*, Release No. 1252 (Feb. 19, 2014).) Respondents then raised those same claims with the Commission. (*Resps.' Pet. for Interlocutory Review and Emer. Mot. to Stay the Hearing* at 5-18 (Feb. 27, 2014).) ALJ's colleagues in the general counsel's officeruled on behalf of the Commission that the Commission did not violate Respondents' constitutional rights. (*Order Denying Resps.' Pet. for Interlocutory Review and Emer. Mot. to Stay the Hearing* at 2-14, Release No. 9561 (Mar. 14, 2014).) Respondents brought a district court action raising the same issues and seeking an injunction on that basis. *Chau & Harding Advisory v. SEC*, 14-cv-01903, *Complaint* [ECF No. 2] (Mar. 18, 2014). ALJ's colleagues in the general counsel's office responded that the Commission and the ALJ are fully capable of adjudicating those claims. *SEC's Mem. of Law in Opp. to Pls.' Mot. for PI and Mot. to Dismiss* at 21-22 [ECF No. 16] (May 12, 2014). Respondents tried to develop their record of constitutional abuse in the AP.[33] The ALJ effectively denied them that opportunity based

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[33] Contrary to established law and precedent, the ALJ refused Respondents' request for testimony and documents, making a blanket ruling that all of the information sought was covered by the deliberative process, attorney work product, and the attorney-client privileges. (Tr. 3193:14-3221:10.) First, in order for the SEC to sustain a law enforcement or deliberative process privilege, "three requirements must be met: (1) there must be a formal claim of privilege by the head of the department having control over the requested information; (2) assertion of the privilege must be based on actual personal consideration by that official; and (3) the information for which the privilege is claimed must be specified, with an explanation why it properly falls within the scope of the privilege." *See In re Sealed Case*, 856 F.2d 268, 271-73 (D.C. Cir. 1988); *Northrop Corp. v. McDonnell Douglas Corp.*, 751 F.2d 395, 405 (D.C. Cir. 1984). The Division was silent on all three requirements, and thus the ALJ erred. Moreover, "[t]he privilege is not absolute. Thus, even if the proponent of the privilege makes the requisite showing, the court is nonetheless required to determine whether it should be overridden." *Burke v. New York City Police*
(Footnote continued on next page)

primarily on his Division colleagues' claim that all relevant discovery was shielded by executive and attorney-client privileges, as well as work-product protection. (Tr. 3193:14-3221:10.) In his ID, the ALJ stated that he was not sure that he had jurisdiction over the constitutional claims, but found no violation anyway based on the limited record he reviewed and the earlier opinion of his colleagues in the general counsel's office writing for the Commission. (*See* ID at 89-90.) And now, in this appeal to the Commission, Respondents are raising those same constitutional issues but without the benefit of the relevant record. To make matters worse, Respondents asked for relief from the page limitations for this brief because of the number and complexity of issues, but their request was denied. (*See Order Granting in Part Motion for Extension of Time and Denying Motion to Exceed Word Limit*, Release No. 9736 (Mar. 9, 2015).) In its opposition to *that* motion, Commission employees at Division stated that Respondents did not need more pages because their appeal raises only two legal issues: did the Respondents violate Section 17(a) of the Securities Act and did they violate Section 206 of the Investment Advisers Act. (*Division's Opposition to Resps.' Request for Extended Briefing Schedule and Permission to File Oversize Briefs* at 1 (Mar. 3, 2015).)

Due process, according to the Supreme Court, requires fairness and the appearance of fairness. *See In re Murchison,* 349 U.S. 133, 136 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases . . . . "justice must satisfy the appearance of justice.") (internal citations and quotations omitted); *see also Amos Treat & Co. v. SEC*, 306 F.2d 260 (D.C. Cir. 1962) ("[A]n administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness. Only thus

Dep't, 115 F.R.D. 220, 231-32 (S.D.N.Y.1987). The ALJ, however, failed to consider Respondents' arguments that they had substantial need of the documents. (*See* Tr. 3193:14-3221:10; 4445:6-4467:10.)

can the tribunal conducting a quasi-adjudicatory proceeding meet the basic requirement of due process.") For the reason set forth above and in Respondents' various constitutional challenges, in this AP, Respondents received neither.[34]

CONCLUSION

For the reasons set forth above, the ALJ's findings of liability (and the corresponding remedies) should be reversed.

Dated: April 1, 2015

Respectfully submitted,

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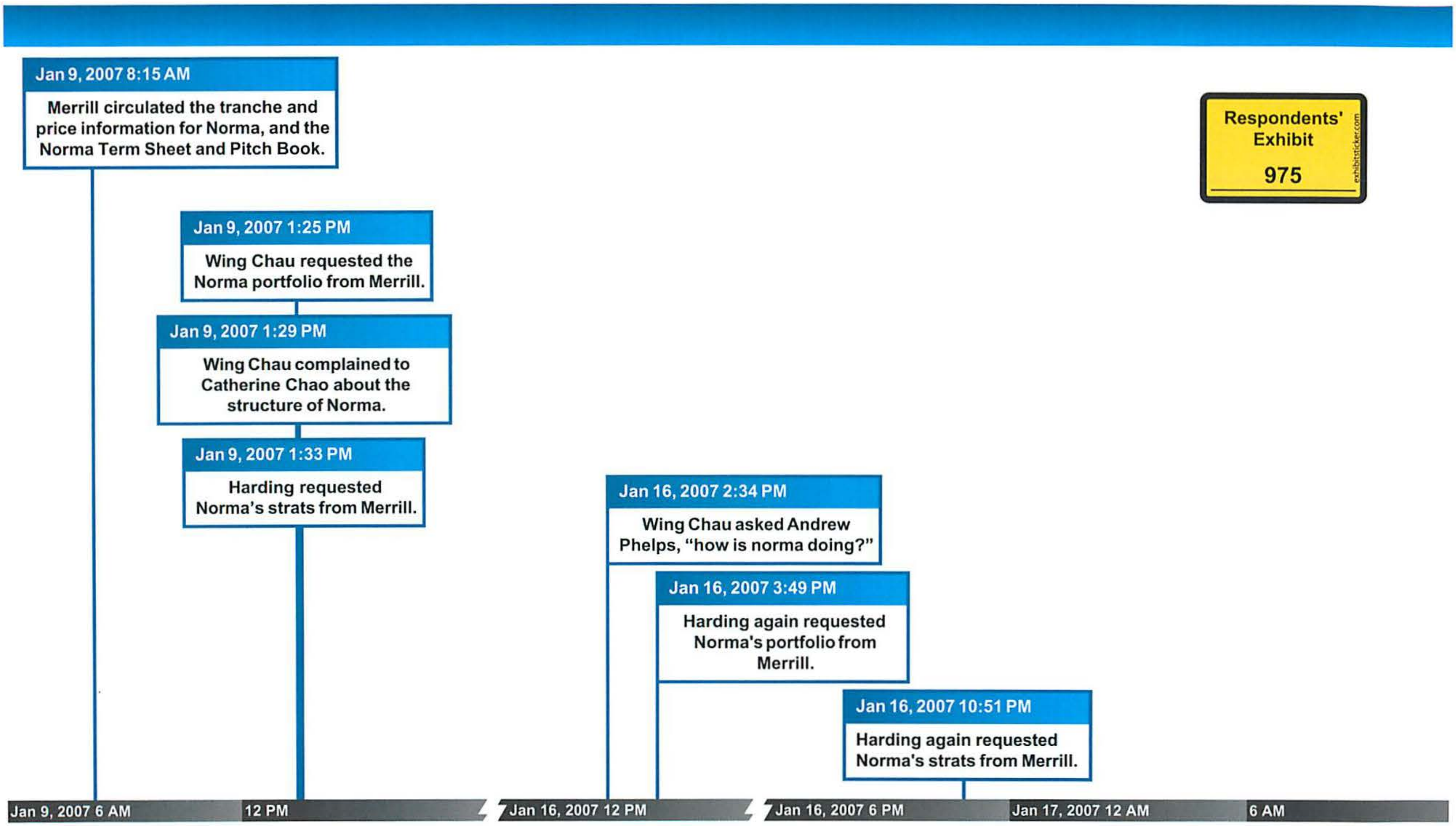
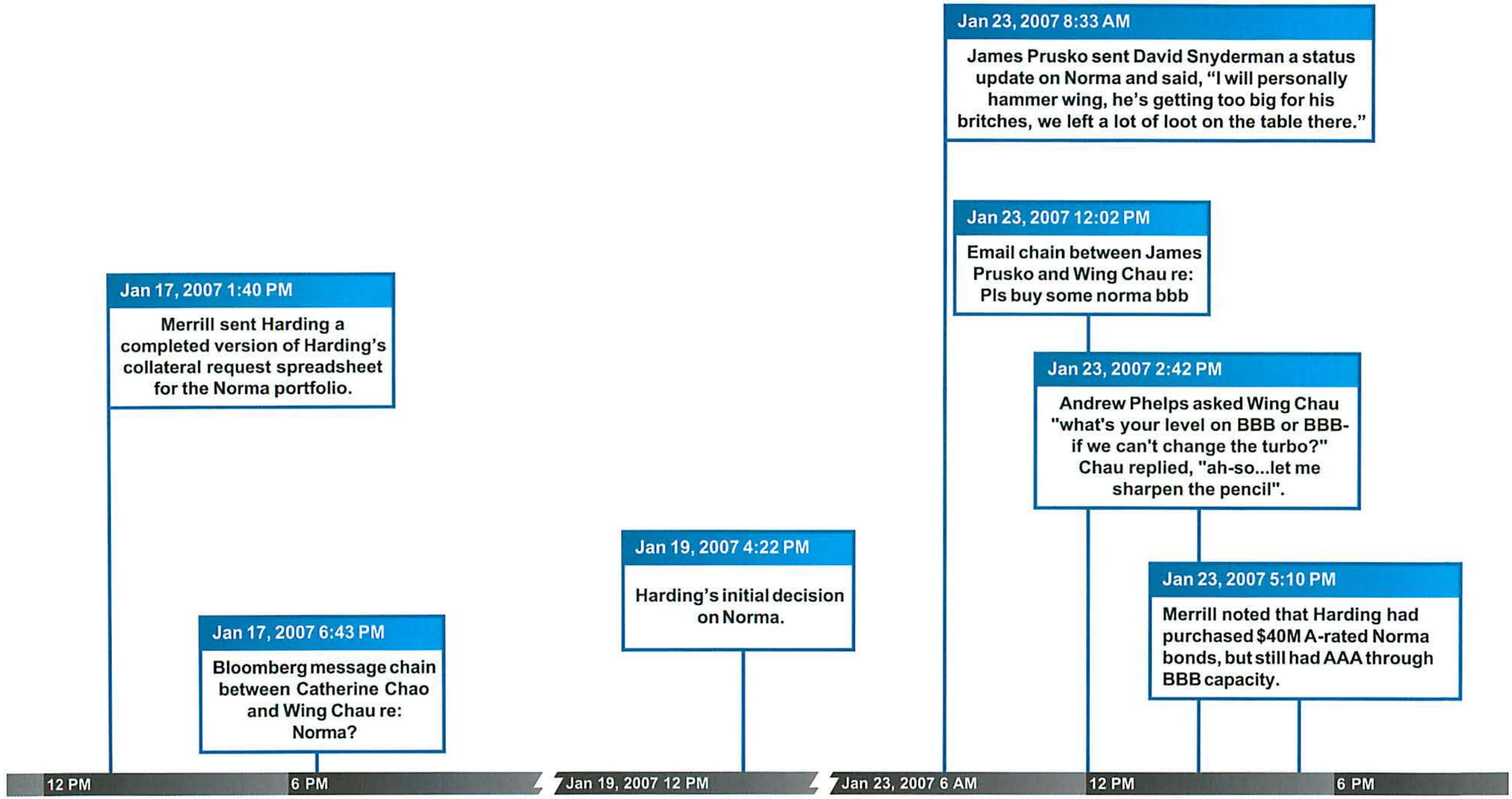
[34] Because of space limitations, Respondents cannot now detail all of the due process violations to which they were subjected in connection with the Hearing. Many of these abuses were detailed in Respondent's filings in the related district court actions. *See Pls.' Mem. of Law in Further Support of Mot. for PI and In Opp. to the [SEC]'s Mot. to Dismiss* at 2-21[ECF No. 20] (Jun. 5, 2014). It is worth pointing out, however, that after repeat denials by the ALJ and the Commission of Respondents' numerous requests for more time to prepare for the Hearing, the Commission granted the Chief ALJ's application to allow the ALJ to take an extra four months to issue his ID because of the complexity of the issues and the size of the record. *Order Granting Extension*, Release No. 9632 (Aug. 21, 2014.)

EXHIBIT A

Timeline of Events Related to Norma (Demonstrative Exhibit, RX 975)

Respondents' Exhibit
975




Jan 17, 2007 1:40 PM
Merrill sent Harding a completed version of Harding's collateral request spreadsheet for the Norma portfolio.
Jan 17, 2007 6:43 PM
Bloomberg message chain between Catherine Chao and Wing Chau re: Norma?
Jan 19, 2007 4:22 PM
Harding's initial decision on Norma.
Jan 23, 2007 8:33 AM
James Prusko sent David Snyderman a status update on Norma and said, "I will personally hammer wing, he's getting too big for his britches, we left a lot of loot on the table there."
Jan 23, 2007 12:02 PM
Email chain between James Prusko and Wing Chau re: Pls buy some norma bbb
Jan 23, 2007 2:42 PM
Andrew Phelps asked Wing Chau "what's your level on BBB or BBB- if we can't change the turbo?" Chau replied, "ah-so...let me sharpen the pencil".
Jan 23, 2007 5:10 PM
Merrill noted that Harding had purchased $40M A-rated Norma bonds, but still had AAA through BBB capacity.
12 PM
6 PM
Jan 19, 2007 12 PM
Jan 23, 2007 6 AM
12 PM
6 PM

Norma Ch

Jan 24, 2007 6:18 PM

Andrew Phelps (Merrill) emailed Wing Chau "so, have you 'sharpened your pencil' on norma BBBs yet? or has your citi mezz deal and bbb lists in the street taken up too much of your time? bbb- is done now fyi at 480"

Jan 24, 2007 9:30 PM

Kenneth Margolis emailed Andrew Phelps and others at Merrill that Wing Chau "wants to talk about the spread" of certain Norma notes.

Jan 24, 2007 10:28 PM

Harding had possession of the preliminary offering circular for Norma.

Jan 24, 2007 12 AM | 6 AM | 12 PM | 6 PM | Jan 25, 2007 12 AM | 6 AM

ronology

Jan 25, 2007 8:46 PM

Wing Chau emailed Andrew Phelps, "may have an issue with the Normas, we are subject at this time, warehouse issues ... will b back to you".

Jan 26, 2007 4:44 PM

Harding purchased BBB rated notes of Norma at full coupon.

Feb 1, 2007 12:12 PM

Harding learned that Merrill had cut its Norma BBB allocation.

12 PM | 6 PM | Jan 26, 2007 12 PM | Feb 1, 2007 12 PM | 6 PM | Feb 2, 2007 12 AM

Feb 2, 2007 10:18 AM

Merrill confirmed Harding's purchase of Norma securities: 40mm Class D @ 99.00 (+240DM) / 15mm Class E @ 97.00 (+505dm).

Feb 27, 2007 10:26 PM

Brett Kaplan circulated his write-up on Norma internally at Harding.

6 AM | Feb 27, 2007 6 PM | Feb 28, 2007 12 AM | 6 AM | 12 PM | 6 PM

Mar 1, 2007

Norma closed.

Mar 1, 2007 12 AM

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of HARDING ADVISORY LLC and WING F. CHAU, Respondents.	Administrative Proceeding File No. 3-15574 **CERTIFICATE OF COMPLIANCE**

Pursuant to Commission Rule of Practice Rule 450(d), I hereby certify that the Respondents' Opening Brief in Support of their Petition for Review complies with the length limitation set forth in Commission Rule of Practice 450(c). According to the Word Count function of Microsoft Word, this brief contains 13,982 words, exclusive of table of contents, table of authorities and cover page.

Dated: April 1, 2015

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of HARDING ADVISORY LLC and WING F. CHAU, Respondents.	Administrative Proceeding File No. 3-15574 **CERTIFICATE OF SERVICE**

Pursuant to Commission Rule of Practice 150, I hereby certify that on April 1, 2015, a true and correct copy of the RESPONDENTS' OPENING BRIEF IN SUPPORT OF THEIR PETITION FOR REVIEW was served via electronic mail on:

Howard A. Fischer
Securities and Exchange Commission
New York Regional Office
Brookfield Place, 200 Vesey Street, Suite 400
New York, NY 10281
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Dated: April 1, 2015

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Facsimile Cover Sheet

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April 1, 2015

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DELIVER TO	COMPANY/FIRM	FAX NUMBER	PHONE NUMBER
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RE: **In the Matter of Harding Advisory LLC, et al, Administrative Proceeding File No. 3-15574**

FROM Ashley Baynham

DIRECT DIAL (212) 209-4991

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C/M/A # 032392 / 0001/ 3722

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