**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-16349**

**In the Matter of**

**BARBARA DUKA,**

**Respondent.**

**DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT BARBARA DUKA'S POST-HEARING BRIEF**

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## INTRODUCTION

Respondent's Post-Hearing Brief ("RPHB") mounts a scattershot defense that ranges from the meritless (*e.g.*, her *Janus* argument) to the internally inconsistent (*e.g.*, claiming no control over the content of the 2011 presales, on the one hand, while at the same time seeking credit for the inclusion of purportedly exculpatory language in the very same presales). Still other arguments are simply audacious—*e.g.*, Duka's argument that it is "irrelevant" to investors that S&P's presales contained scores of demonstrably false statements concerning the metrics used to derive credit enhancement levels. Her cramped view of materiality—that investors allegedly did not care whether a particular loan constant, viewed in isolation, was X versus Y—overlooks extensive, consistent evidence that investors cared that S&P's disclosures were accurate, that a change in methodology that caused CE to swing by as much as 750 basis points should be clearly disclosed, and that a ratings methodology should be consistently applied.

Duka's brief is also littered with hyperbole about how the Division allegedly failed to offer any proof in support of its claims. To the contrary, the evidence demonstrated that, among other things, Duka directed the switch to blended constants; she promised to disclose that dramatic change in methodology internally and externally; she had the opportunity to and in fact did exercise control over the inadequate disclosures in the presales; and she had powerful commercial incentives to engage in this conduct.[1]

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[1] Respondent's simultaneously filed a 153-page document containing 825 Proposed Findings of Fact and Conclusions of Law ("RFOF/COL"). The Division objects to the RFOF/COL listed in Exhibit A. At the Hearing Officer's request, the Division will file specific objections to any or all of these proposed FOF/COL. The lack of specific objection(s) to any of RFOF/COL is not an admission that the FOF/COL is undisputed.

## ARGUMENT

## POINT I

**The Division Proved that Duka Violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.**

Duka's defenses to the Division's fraud claims rest on flawed legal propositions and sweeping mischaracterizations of facts. Among other things, she is wrong on *Janus*, ignores well-settled law on what it means to obtain money or property within the meaning of Section 17(a)(2), and disregards binding Commission precedent that her conduct is actionable under the scheme liability provisions of the securities laws.

### A. Duka "Made" the Statements in the 2011 Presales.

Duka's *Janus* argument would require the Hearing Officer to disregard the weight of evidence showing Duka's ultimate authority over the 2011 presales. Duka herself manifested authority over the Presales when she promised Dr. Parisi that any change made to the loan constants used to issue ratings would be disclosed. *See* DFOF 42.

Duka acknowledged responsibility for certain aspects of the Presales. In her Pre-Hearing Brief, Duka admitted that she "approved inclusion" of the "considered both" language in the 2011 Presales "to describe the DSC calculations." Pre-Hearing Brief at 22. Duka also seeks to take credit for the inclusion in some Presales of DSC ranges that were proposed by analyst Brian Snow. *See id.* at 23. Putting aside that none of this language was helpful to the reader, and failed to heed Parisi's directive to disclose blended constants, Duka cannot both selectively take credit for such language (in hope of demonstrating her lack of scienter) and also claim that, under *Janus*, she did not have ultimate authority over the presales.

Duka's position as the senior most person in the CMBS ratings group and as managing director on the relevant rating committees, along with her admission that she reviewed and

commented on the 2011 Presales, also evidence her ultimate authority. *See* DFOF 47, 61, 97. Duka's review and approval of the presale language, even if that language is not directly attributed to her, is sufficient to show ultimate authority. *See In re Pfizer Inc. Sec. Litig.*, 819 F. 3d 642, 657-58 (2nd Cir. 2016) (finding senior management's review and approval of language disseminated by a public relations firm could show "ultimate authority"). The testimony of Duka's analysts removes any doubt that Duka had authority to dictate the contents of the presale. *See, e.g.*, Tr. 1799:19-21 (Snow testimony that he would have disclosed the use of blended constants if his supervisor directed it); DX 103 (Digney email to Fisher recounting Duka's directive not to include the blended constant in the GSMS presale). Duka's *Janus* argument is without merit.

**B. The Division's Section 17(a)(2) Claim is Supported by S&P's Receipt of Payments from Issuers in Connection with the 2011 Presales.**

Duka claims that "S&P's receipt of fees from issuers for rating the 2011 CF Transactions was not connected to the disclosures in the 2011 Presales," citing engagement letters. RPHB 3. Those engagement letters, however, show that S&P received fees for rating the issuer's CMBS transactions. Further, "[i]ssuers use Presales to help sell the bonds." DX 335 at 23, ¶ 52(d); *see also* Tr. at 428:15-429:15 (Digney testimony that S&P issued preliminary ratings and presales after providing final feedback to the issuer, which was followed by the final phase of "the issuer ... marketing the securities").

Privity of contract between the purchaser of securities and the supplier of false or misleading statements is not required to establish a case under Section 17(a). *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 381 (S.D.N.Y. 1998). As a result, there is no requirement in Section 17(a)(2) that the money or property obtained by the person charged with the violation come from the purchaser. *SEC v. Wolfson*, 539 F.3d 1249, 1263-64 (10th Cir. 2008). It is sufficient that the

respondent obtained money or property for her employer while acting as its agent. *SEC v. Stoker*, 865 F. Supp. 2d 457, 463 (S.D.N.Y. 2012).

## C. Duka's Analysis of Materiality is Flawed.

The switch to blended constants had a dramatic impact on credit enhancement levels. DFOF 45. The analysis performed by Dr. Rubinstein stands unrebutted,[2] and demonstrates that the switch to blended constants caused huge swings in CE and concomitantly inflated ratings. *Id.* Because certain investors are limited to investing only in CMBS at or above certain ratings (DFOF 8), these inflated ratings allowed investors to purchase bonds they would have otherwise been precluded from purchasing. Duka attempts to sweep this powerful evidence of materiality aside by inviting the Court to ignore controlling legal precedent and view materiality in an artificially narrow manner.

### 1. Duka's Unduly Narrow Focus on the Loan Constant Ignores the Impact the Change in Loan Constants Had on the Overall Rating.

Duka frames the materiality inquiry as: "whether disclosure of the [blended constant] to arrive at the disclosed [CE levels] would have "significantly altered" the total mix of information in the decision-making process of the reasonable investor[.]" RPHB 16. In other words, Duka seeks to narrow the materiality inquiry solely to the impact that the disclosure of a blended constant would have had on a reasonable CMBS investor's decision.

Duka has it backwards. The question is not, *hypothetically*, how would a reasonable investor have reacted if S&P *disclosed* its use of a blended constant to derive CE levels; the

[2] Duka's critique of Dr. Rubinstein for not "correcting for the model's flawed lost interest calculation" (RPHB at 20) assumes Dr. Rubinstein was opining about the appropriateness of S&P's model. He was not. He simply used the same models S&P used in forming his opinions. Moreover, Duka's argument that actual interest rates should have been used to calculate lost interest is beside-the-point—that is not what S&P did. Duka was in fact personally involved in S&P's decision to use the interest rate derived from the Table 1 constants (or the actual interest rate, if higher) to calculate lost interest resulting from defaults. DX 48 at 2, paragraph 3.

question is, *in reality*, how did a reasonable investor view S&P's *omission* of a critical change to its published methodology for rating CMBS? Duka seeks to focus the Court on a single number – *i.e.*, the loan constant – and whether investors placed weight on that number in isolation. But materiality cannot be analyzed in a vacuum. *See Omnicare v. Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1330 (2015) ("[W]hether an omission makes an expression of opinion misleading always depends on context.") Investors cared whether S&P used the same approach to rating CMBS consistently for purposes of comparing "apples to apples" – and they uniformly testified that if S&P changed its published methodology, by using a different loan constant or otherwise, they would have wanted to know. DFOF 77-80.[3] This is especially true where Duka's group at times – including with respect to the Goldman Sachs deal – gave the real loan constant and DSCR numbers to issuers. DFOF 64.

**a. Investors Cannot Be Faulted for Duka's Conduct.**

Duka attempts to shift responsibility for her conduct to investors, suggesting that the absence of certain questions from investors about S&P's misleading presales means that Duka's omissions were immaterial. *See* RPHB 8 (noting, *inter alia*, the lack of questions to S&P from investors about the "consider[ed] both" language). The fact that investors purportedly failed to raise questions about the opacity of S&P's disclosures means nothing about materiality, particularly given the efforts made by Duka's group to conceal the use of the blended constant from the investing public. *See* DX 103. And, ironically, it was only the questions raised by investors that prompted the revelation that S&P was using blended constants, and the subsequent withdrawal of the ratings. *See* DX 105, 106, 146. It was Duka's responsibility to publish

[3] Certainly S&P was not free to publish incorrect loan constant and DSCR numbers over 60 times in each of eight different presales, without disclosing the actual numbers used to reach the ratings assigned. *Compare* DFOF 110 with RPHB at 17 (claiming that "[i]t is also irrelevant that investors expected presales to be 'accurate and truthful," or to be provided the same metrics as issuers") (citation omitted).

truthful presales; it was not the burden of CMBS investors to parse through S&P's disclosures to divine clues that they were being misled.

Duka also seizes on the absence of a targeted question to investor-witnesses about "whether any investment-related mix of information would be significantly altered had S&P published different DSC figures in the Presales." RPHB 1. This misses the point – witnesses would necessarily have had to speculate about how they would have weighed the disclosure of the blended constant as the basis for the DSC, because Duka and S&P *did not disclose* the blended constant. The investors testified uniformly that they would have wanted to know how S&P arrived at its ratings. But they did not know, because Duka failed to tell investors that S&P had dramatically changed the way it was rating CMBS transactions.

**b. Events Postdating Duka's Fraud Are Irrelevant.**

Finally, Duka attempts to use developments after the publication of the presales to argue that the misrepresentations and omissions were immaterial – including S&P's so-called "affirmation" of the CMBS ratings in August 2011,[4] or the absence of proof that investors changed the marks on their books. *See* RPHB 9, 11. However, post-hoc developments are irrelevant, as such events have no probative value as to what "would have been important to a reasonable investor *at the time*." *U.S. v. Martoma*, 993 F.Supp.2d 452, 459 (S.D.N.Y. 2014) (emphasis added). "The determination of materiality is to be made upon all the facts as of the time of the transaction and not upon a 20-20 hindsight view long after the event." *Spielman v. Gen. Host Corp.*, 402 F. Supp. 190, 192-94 (S.D.N.Y. 1975), aff'd, 538 F.2d 39 (2d Cir. 1976).

[4] There is ample reason to view S&P's reaffirmation of the ratings with skepticism. Among other things, Dr. Parisi's *ad hoc* committee first concluded that the ratings were *not* consistent with S&P's ratings definitions—only when his supervisor asked Parisi to reconsider did the committee (just hours later) reach a different conclusion. *See* Tr. at 1526:13-1537:8 (Parisi). This conclusion allowed S&P to limit damage to the still-recovering CMBS market and its own reputation by leaving the ratings on the other six rated transactions in place. *See* Tr. at 314:10-321:9 (Adelson); 547:22-548:4 (Jacob).

### 2. S&P's 2011 Presales Were Misleading.

Duka attempts to dodge responsibility for the misstatements and omissions in the 2011 presales by arguing that they were simply "opinions" that were not misleading in the first place. RPHB at 3.

But the fact that a rating is an "opinion" does not insulate Duka from liability where the underlying facts were misrepresented to (and/or simply hidden from) investors. As the Supreme Court observed in the *Omnicare* decision:

> A reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion – or, otherwise put, about the speaker's basis for holding that view. And if the real facts are otherwise, but not provided, the opinion statement will mislead its audience.

*Omnicare*, 135 S. Ct. at 1328. Here, the switch to blended constants—which dramatically impacted CE levels—was not disclosed and, further obfuscating the changed methodology, the context here is that the presales were replete with references to stressed loan constants and DSCs that S&P did not use to rate the transactions. DFOF 53-54. Moreover, the switch to blended constants was at odds with prior practice and the 2009 Criteria. *See* DFOF 28-30. Nonetheless, Duka contends that the presales were not misleading because i "investors believed that Actual DSCs were considered, in addition to Table 1 DSCs, in S&P's determination of CE levels." RPHB 4. While investor Douglas Weih testified that the actual constants - may have been used, "in some fashion, to arrive at the disclosed CE levels" (RFOF 708), Duka's attempt to transform such testimony into a finding that investors understood that a blended constant was applied is disingenuous. No investor could have understood from reviewing the presales that the ratings were based on 50/50 blended constants that were not disclosed in the presales. DFOF 55.

Accordingly, investors were misled as to how S&P formulated the rating "opinion" for the newly issued CMBS.

**D. The Division Proved That Duka Acted With Scienter and Possessed the Requisite Mental State for Aiding and Abetting or Causing Liability and Acted Negligently.**

Duka argues that the misstatements and omissions at issue were not all that important, so a heightened showing of scienter is required. RPHB 20. But when Duka's surreptitious change to S&P's methodology is viewed in context, the materiality of that change is manifest. Thus the Division's burden of proving scienter is in fact lessened.

**1. Duka Acted With Scienter.**

As discussed in the Division's Post-Hearing Brief, the hearing evidence showed that Duka had a commercial motivation to switch to blended constants; reviewed the eight presales that were riddled with misstated loan constants and DSCRs; obfuscated the change in methodology internally; and failed to follow established S&P procedures. *See [also]* Div. Pre-Hearing Brief at 34-41. Duka's attempt to overcome this evidence fails.

**a. Duka's Vague "Disclosures" in the Presales and Within S&P Do Not Diminish the Evidence of Intentional and/or Negligent Conduct.**

Duka seeks to defeat the evidence of her mental state with a litany of misleading arguments about the 2011 presales. As outlined above in Section I.A., Duka exercised authority over the presales. Nonetheless, having previously disclaimed responsibility for the presales in her *Janus* argument, Duka then argues that the Division failed to prove scienter by highlighting her *involvement in drafting the presales*. Duka's effort to "have it both ways" should be rejected. Among other things, Duka acknowledged during the hearing that she reviewed all presales and would at times comment on them. DFOF 47. Further, while she claimed that she did "not [ ] review specific S&P metrics" (RPHB 22), she testified that she paid close attention to the "Top

10 Loans" section of the Presales – a section that comprised two-thirds of the document.[5] Duka further acknowledged that the Presales "should reflect the numbers that were actually used," but did not. DFOF 55. Duka's suggestion that her "sloppiness" resulted from analysts' use of prior templates for presales (RFOF 649) is no defense. *See SEC v. Stoker*, 865 F. Supp. 2d 457, 466-467 (S.D.N.Y. 2012) (finding that "although Stoker used an offering circular from a previous transaction as a template," he could not "evade liability by copying and pasting inapplicable or inaccurate information from other documents into sections of a document that he is responsible for, editing some parts of the old language, and leaving other inaccurate language in place").

Undeterred by these admissions, Duka claims that the "consider both" disclosure buried in the "Conduit/fusion methodology" section of the Presales reflected her intent to "alert[] the reader that S&P was not calculating DSCs solely using Table 1 Constants." RPHB 23. However, even putting aside that this claim tacitly affirms Duka's role in drafting the presales, Duka's "consider both" language reflects an effort to use opaque language to conceal the use of the blended constant. Duka herself acknowledges that "[a] presale was not the appropriate document to disclose differences between NI and Surveillance." RFOF 697 ("That's a type of disclosure that would be made in, say, a criteria document.").

Moreover, this language meant nothing to the investors. *See, e.g.*, DFOF 108 (investor-witness testimony that "considered both" language did not reveal that S&P had changed its existing methodology for rating CMBS); *see also* DFOF 108 (expert testimony that the "consider both" language "didn't mean anything to me. And the reference that it made to the criteria didn't

[5] Notably, the Presales repeatedly presented tables for each top ten loan stating that the S&P DSC was "Calculated based on a Standard & Poor's stressed constant of [*e.g.* 8.25]% and a 30-year amortization schedule." DFOF 49, 54.

help me at all.") Even Brian Snow, the Primary Credit Analyst on several presales, did not understand the disclosure to mean what Duka claims it means. *See* Tr. at 1745:7-21.

Duka also argues that references to actual constants in the presales are evidence that she had no intent to conceal, but then argues there is "no evidence of her intervention or involvement or comment one way or the other" as to these additions. RPHB 25. In short, Duka again asks for credit and no blame. And, scattered references to actual constants were more misleading than explanatory, as they were not used in rating the transactions, and certainly did not fulfill Duka's responsibility to disclose the blend.

Duka also argues that because "the Table 1 Constants were not required by the express terms of the Criteria – and were analytically indefensible because they imposed random, variable stress regardless of the scheduled interest rates associated with the collateral pools – NI had no reason not to disclose repeatedly the use of a Blended Constant." RPHB 26. But there is substantial evidence that the 2009 Criteria called for the use of Table 1 constants, and that both Surveillance and NI used them until the time Duka switched to blended constants. DFOF 28-30. Duka admits as much. RFOF 443 ("Opting to use both the 2009 Criteria [in rating JPMCC 2010-C2 with Table 1 constants] and the criteria for large loan/single borrower transactions had the effect of increasing credit enhancement levels relative to the credit enhancements that would have resulted had the transaction been evaluated using the 2009 Criteria exclusively.") Further, Duka's after-the-fact argument that the Table 1 constants applied random, unnecessary stress applies with equal force to her blended constants.

The April 2011 communications between Duka's group and Criteria do not support Duka's scienter argument either. *Cf.* RPHB 24. While Criteria Officer Majid Geramian – who did not testify – received an e-mail in late April 2011 stating that Duka's group was "currently

using a 50/50 blend,"[6] no evidence was presented of his or any other senior S&P manager's awareness that Duka and her team failed entirely to disclose the use of the 50/50 blend to investors. None of this shows that Duka acted reasonably or without the intent to deceive when she changed S&P's methodology months earlier in December 2010. More importantly, whether others internal to S&P became aware of the use of the blended constants over time does not obviate Duka's responsibility for disclosure to the investing public.

Critically, Duka's brief is silent as to the most significant evidence of her responsibility for the presales – her acknowledged responsibility for such disclosure. Duka promised Dr. Parisi that any change in loan constant would be disclosed internally and to investors, and in assuming that duty to speak she also assumed a duty to make full and accurate disclosures. *See Caiola v. Citibank, N.A., New York*, 295 F.3d 312, 331 (2d Cir. 2002) ("[U]pon choosing to speak, one must speak truthfully about material issues.").

Duka's remaining arguments are trivial. While Duka herself did not mechanically run the models (RPHB 23), that is beside the point. Duka directed the change to blended constants, which, coupled with the Table 1 constants cited throughout the presales, necessitated running the models two or three times. *See* DFOF 44, 65. In addition, the absence of adverse feedback from investors concerning the "considered both" language is probative of nothing. As noted above at Section C.I., the responsibility for truthful and accurate disclosures belonged to S&P – it was not

[6] While Duka seeks to take credit for this statement in a memo authored by a subordinate there is no evidence that Duka had anything to do with Digney including that language in his memo, or that she even saw it.

the investors' burden to parse Duka's vagaries in the Presales, nor is the fact that they did not any defense to her mental state.[7]

#### b. Duka Attempts to Downplay Her Mental State by Minimizing and Making Assertions Contrary to the Evidence.

Duka attempts to downplay the significance of Division Exhibit 103, which demonstrated that she was explicitly asked if she wanted to disclose DSCs based on the blended constant and said no, by speculating that it was late and she was "otherwise occupied." RPHB 25. But this e-mail exchange unequivocally shows that Duka both exercised control over the content of the presales and did not want to disclose the use of blended constants. This finding is further bolstered by Duka's statements – which incredibly, and tellingly, she now denies (*see* RFOF 696) – that "she hadn't published the blended constant or explained the blended constant, so she didn't want to have to explain why new issue was different from surveillance[.]" DFOF 72.

### 2. Duka Was At Least Negligent in Failing to Disclose the Switch to Blended Constants.

Under Section 17(a)(2) and (3), Duka's liability may be premised upon negligent conduct, *i.e.* a failure to act with reasonable care. Duka first claims that the Division cannot pursue negligence based claims, at all, and then incorrectly posits that proof of a particular standard of care is required. Both arguments fall flat.

#### a. Duka's Claim That the Division Did Not Allege or Disclaimed a Negligence Theory is Meritless.

Respondent's argument that because the OIP alleged intentional conduct, in support of its Section 10(b) and 17(a)(1) claims, it "may not cite a negligence theory to support its claims

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[7] For example, investor Douglas Weih testified that he did not recall reviewing the "Conduit/fusion methodology section" because he viewed it as boilerplate, understood S&P's methodology from the 2009 Criteria, and would have expected any change in that methodology to be published. Tr. at 886:19-887:20 (explaining that if such a change in methodology were made, S&P "would have made an announcement and highlighted to the investment community that they're making a [change] in their methodology").

under Section 17(a)(2) and (a)(3)" (RPHB 21) is frivolous. *See* October 12, 2016, Order in *In the Matter of Lynn Tilton*, Release No. 4245 at 3 (copy attached as Exhibit B) (holding that Respondent's argument "that only 'intentional misconduct' – and not 'evidence relating to, or in support of recklessness or negligence standards of liability' – is within the scope of the OIP" is "not well taken and is, in fact, frivolous"). As in *Tilton*, the Division brought claims that may be proven by a showing of negligence. Thus, Respondent was on notice of those claims and the Division's intent to rely on a negligence standard. Moreover, the OIP alleged five times that Duka violated a reasonable standard of care (*see* ¶¶ 30, 39, 42, 43, and 48) and the Division's Pre-Hearing Brief explicitly argued that "Duka acted with scienter or negligently" (p. 8). Further, the Division introduced evidence at the hearing of S&P's Code of Conduct, CPG, and RAMP guidelines, as well as Duka's failure to meet the standards of care set forth therein.

*Rodale Press, Inc. v. F.T.C.*, is readily distinguishable in that there a new theory that had not been charged or argued at the hearing was raised for the first time on appeal. 407 F.2d 1252, 1256-57 (D.C. Cir. 1968). The other cases cited by Duka are similarly unavailing. In *SEC v. Ginder*, the appeals court found that the SEC had not put on any evidence of negligence or standard of care and thus the "jury's findings [of negligence] could only have been the result of sheer surmise and conjecture." 752 F.3d 569, 576 (2d Cir. 2014). *In the Matter of David J. Montanino*, the Court ruled that having "failed to argue negligence or present evidence about the appropriate standard of care for someone in Montanino's position, the Division is foreclosed from doing so now," in its post-hearing brief. Release No. 773, 2015 WL 1732106, at *27 (Apr. 16, 2015). Here, in contrast, the Division has alleged and argued negligence in its OIP, Pre-Hearing Brief, and at the hearing.

### b. S&P's Code of Conduct, CPG, and RAMP Guidelines Set Forth a Standard of Care that Duka Breached.

Duka further argues that the Division cannot succeed on its negligence claims because it did not adduce evidence establishing a standard of care or showing that Duka breached that standard. RPHB 29. But, in fact, S&P's Code of Conduct established a standard of disclosure that Duka breached. *See* DPHB 11, n.14 and 12. As did the CPG and RAMP guidelines. *Id.* at 16-18 and 27. In any event, the Division need not offer proof of a particular standard of care, but must rather show that Duka's conduct was unreasonable in light of the facts and circumstances known to her. *Ira Weiss*, Release No. 34-52875, 2005 WL 3273381, at *12 (Dec. 2, 2005); *SEC v. Goldsworthy*, 2008 WL 8901272, at *12 (D. Mass. June 11, 2008) ("the SEC [is] not required to present evidence of an alternative standard of care in order to support its claim of negligence").

Duka argues that surveillance's purported lack of disclosure regarding Table 1 constants – which were disclosed in the 2009 Criteria and drew investor focus on the term default test on multiple occasions – and S&P's lack of publication of the July 2009 decision to continue using the Table 1 constants, somehow absolves her failure to disclose her switch to blended constants. But the fact that S&P may have committed other acts of negligence, or worse – *see* RX 782 – does not make Duka's unreasonable failure to follow multiple S&P guidelines and procedures reasonable. *See In the Matter of Dennis J. Malouf*, Release No. 34-78429, 2016 WL 4035575, at *2, *3 n.9 (Comm'n Dec. July 27, 2016) (finding investment advisor violated Section 17(a)(3), inter alia, after company had settled enforcement action based on its own violations, because his "conduct was plainly unreasonable as it violated well-established professional and fiduciary standards").

Duka's final argument, that all she did was fail to supervise (RPHB 27), is specious at best. Duka promised Dr. Parisi that she would disclose any switch in the Presales and RAMPs. Her failure to ensure that her change in methodology was adequately disclosed in those documents, either by herself or through her subordinates, is not about "inattention to supervisory responsibilities" (RPHB 28), it was part of her fraudulent scheme to decrease CE levels.

**E. The Division Alleged and Proved Scheme Liability.**

Duka's claim that scheme liability "'hinges on the performance of an inherently deceptive act that is distinct from an alleged misstatement'" (RPHB 28), is directly contrary to recent Commission guidance on this issue. *See Malouf*, 2016 WL 4035575, at *6. Moreover, the Division alleged, and proved, not only actionable misstatements and omissions, but also independent conduct, including the change in methodology itself, along with Duka's failure to follow S&P's internal policies and procedures and efforts to shield her conduct from scrutiny. Indeed, as explained in the Division's Post-Hearing Brief, "Duka's conduct in switching to blended loan constants across multiple CMBS transactions without following mandated S&P procedures and without adequately disclosing the change in methodology and the resulting dramatic decrease in credit enhancement levels violated Exchange Act Section 10(b) and Rules 10b-5(a) and (c), and Securities Act Section 17(a)(1) and (3)." DPHB 30-31. This conduct – separate and distinct from the actionable misstatements and omissions – was both alleged in the OIP and proved at the hearing.

While conceding that materiality "'is not an express element'" of a scheme liability claim, Duka also contends that "proof of materiality is required." RPHB. 5 (quotation omitted). However, unlike Section 17(a)(2) and Rule 10b-5(b), the scheme liability provisions of the securities laws do not expressly reference materiality (*see* 15 U.S.C. § 77q(a) and 17 CFR

§ 240.10b-5), and there is "no requirement that conduct underlying a Section 17(a) claim must itself be 'manipulative or deceptive.'" *Malouf*, 2016 WL 4035575, at *10. The Division is aware of no Commission precedent holding that it must satisfy a formal "materiality" element in connection with a scheme liability claim. *See, e.g.*, *Malouf*, 2016 WL 4035575, at *17 (no mention of materiality element in discussion of scheme liability claims). Further, even if some form of materiality was an element of a scheme claim (which it is not), the evidence adduced at the hearing demonstrated that Duka's conduct was material for all the reasons set forth above.

## POINT II

## The Evidence Adduced at the Hearing Proves that Duka Aided and Abetted, or Caused S&P's Violation of Rule 17g-6(a)(2).

### A. The Division Proved That Duka's Switch in Loan Constants Did Not Follow S&P's Established Procedures and Methodologies.

Duka argues that the 2009 Criteria required the use of actual loan constants (RPHB 30-31), but fails to address the undisputed evidence that: (1) surveillance read the criteria to require Table 1 constants and used Table 1 constants in rating CMBS transactions from the time the 2009 Criteria was published; (2) S&P's senior management met on July 31, 2009 and decided that the criteria called for the use of Table 1 constants; (3) in March 2010, criteria committee members met and in a memorandum signed by Duka determined that NI would use the higher of the Table 1 constant or the actual constant; and (4) the 50/50 blended constants Duka did use – but cannot explain – are nowhere to be found in the 2009 Criteria.[8] Thus Duka's use of blended constants was "not determined in accordance with [S&P's] established procedures and methodologies for determining credit ratings." 17 CFR § 240.17g-6(a)(2).

[8] While it is not necessary for the Division to prove that the 2009 Criteria required the use of Table 1 Constants, for all these reasons, and as explained in the DPHB, it did.

Duka's claim that she and others viewed the use of blended constants as consistent with the 2009 Criteria is irreconcilable with her claim that the 2009 Criteria required the use of actual constants. RFOF 180. Moreover, the evidence Duka cites does not support this claim. The fact that Digney, Pollem and Snow signed RAMPs is not supportive because the RAMPs did not disclose the use of blended constants. Jacob's initial comment about blended constants being a reasonable interpretation was made based upon what he heard from Duka; but changed when he learned more. Tr. at 658:7-660:11 (testifying that it would be "[d]ifficult to imagine that [a change in loan constants] could be" a consistent application of methodology). Duka's citation to various non-testifying witnesses' purported opinions (RPHB 33-34) is hearsay and, in any event, not supported by the documentary record. And, Henschke's testimony as to why he viewed blended constants as consistent with criteria is indecipherable. *See* RFOF 363 ("Because we viewed it as the constant to be used to not necessarily be – have been addressed in the criteria."). The "weak gruel" here is thus Duka's claim that while Table 1 constants are "random" and "analytically indefensible," her 50/50 blended constants are somehow consistent with the 2009 Criteria.

Duka's argument that the switch to a 50/50 blended loan constant was a criteria "interpretation" and thus not subject to the escalation provisions of the CPG is supported by only one witness – Duka. *See* RPHB 35. Adelson testified as to the switch in loan constants: "That's a change ... because it affects how you are assigning ratings to all the CMBS. It is a very big deal." DFOF 90. Parisi testified that an "interpretation really applied to a unique circumstance" and that the CPG "would apply to changes or introduction of criteria that were intended to apply to, across-the-board sector or the entire class of securities or debt in that sector." *Id.* And Jacob testified that the switch was "humongous in terms of the value to the transaction." Tr. at 659:21-

660:8. Tellingly, even Duka, who described the use of a 50/50 blend as "policy" (DX 338 at 625:1-9), could not explain how an across-the-board change in loan constants could be considered an interpretation.

**B. If Actual Constants Were Called for by the 2009 Criteria, Analytically Correct, and the Switch Was an Authorized Interpretation, Why Didn't Duka Use Them?**

Duka claims that the switch to the blended constant was motivated by analytical, not commercial, considerations. RPHB 35. But when asked to explain why she switched to the blend Duka testified: "I don't know what the discussion was. I recall we had a discussion. And I recall arriving at a decision to use a 50/50 blend. I can't tell you why. I don't know." DFOF 68. And when asked if she could point to any documents supporting the blend she testified: "I don't recall any analysis that would help me recall that, no." *Id.* Duka does not, and cannot explain why, if she truly believed that the Table 1 constants were imposing unjustified stresses, she did not simply switch to the actual constants she claims the 2009 Criteria called for in the first place.[9]

The most logical reason she did not go all the way is that she knew that if she did S&P's CE levels would be unreasonably low. While lower CE levels would get Duka's group hired to rate more CMBS deals, S&P had gone to great lengths to try to rehabilitate it reputation by, among other things, strengthening its criteria. DFOF 10, 15. It is reasonable to infer that Duka knew that if she switched all the way down to actual constants instead of a 50/50 blend – or announced to investors who looked for ratings consistency (DFOF 77-79) that she was loosening criteria – investors would react negatively, much as they did with when S&P assigned a 14.5%

[9] Duka's claim that Thompson and Parisi agreed with her view that Table 1 Constants is based solely on her own testimony (RFOF 345), and is contradicted by Parisi and Thompson. *See* DFOF 37-41.

CE level to the AAA bonds in GSMS 2011-GC4.[10] She thus implemented a compromise position in the hopes of satisfying both issuers and investors – a commercial motivation – and succeeded, at least for a while.[11]

Duka argues that the Division's commercial motivation claim is "absurd" because "S&P rated a substantial number of non-CF transactions in 2010." RPHB 35-36. But CF transactions comprised 85% of the CMBS market before it went dormant in 2009 (DFOF 14), and as the CMBS market came back on line in the latter half of 2010, Duka, looking ahead to 2011, noted that "[w]e expect to see more pooled [CF] transactions." RFOF 299-302 (*see also* RFOF 303, where Duka sought more resources because of "the shift from single-borrower to multi-borrower deals"). Thus CF transactions were clearly the focus in December 2010 and looking forward.

Duka also sweepingly claims that the "Division presented no evidence that she was concerned about a salary reduction, losing her job, or a possible downsizing of the CMBS staff" if her group were not hired to rate CMBS deals. RPHB 36. But this ignores Duka's own testimony, and that of David Jacob. *See* DFOF 27.

Duka further claims that the Division's commercial motivation evidence consists of "a few smattered statements in emails and required monthly activity reports," when in fact the Division introduced and elicited testimony about six separate documents wherein Duka noted the loss of business due to the 2009 Criteria. Compare RPHB 36 and DFOF 36. Duka's commercial motivation is further evidenced by the fact that of the seven CF transactions in 2010 (RPHB 36), Duka's group was hired to rate only one (Tr. at 1456:6-8 (Duka)). And Duka's argument that

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[10] *See, e.g.*, Div. 112 (July 15, 2011 e-mail from Penner to Jacob noting the "[s]eemingly incongruous[]" rating S&P assigned to GSMS 2011-C4 and commenting upon LTV, the only metric visible to investors given that the switch in loan constants was undisclosed).

[11] The need to maintain credibility also explains passing on a "standalone deal secured by hotels concentrated in Hawaii" where "estimated 2011 net cash flow could not cover the actual loan constant." RPHB 36.

criteria only lost it two of those deals is based on misleading claims that RBS 2010-MB1 was not a CF deal, when it was classified as a CF deal at the time (RX 369), and that S&P did not consider JPMCC 2010-C1 a CF deal, despite the fact that it was analyzed with CF criteria, including Table 1 constants. Duka herself acknowledges that CMA "attributed S&P being 'left off the bulk of' CF transactions in 2010 [due] to 'conservative criteria.'" RFOF 311.

For these reasons, Duka's switch to blended constants was a commercially motivated deviation from established S&P procedures.[12]

## POINT III

Citing no authority, Duka claims that she cannot be found to have caused S&P's internal controls violations because she claims she was "not responsible" for those controls. RPHB 37. This argument confuses primary and secondary liability; the Division need not show that Duka was responsible for S&P's internal controls (although Judge Elliot previously found that she was, at least in part, as discussed below). It is enough that Duka "knew, or should have known, that . . . her conduct would contribute to the violation." *See Robert M. Fuller*, Release No. 34-48406, 2003 WL 22016309, at *4 (Aug. 25, 2003) (footnote omitted).

While Duka characterizes her conduct as "circumvention" of internal controls (RPHB 37), she ignores Judge Elliot's prior observation that her conduct may have undermined S&P's internal controls because she was in a position to "influence the determination of the same criteria she was tasked with implementing." (July 2, 2015 Order at 5.) This was not mere circumvention—Duka's conduct and unique position contributed to S&P's failure to maintain and enforce effective internal controls.

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[12] Duka does not cite any authority for reading a scienter requirement into Rule 17g-6(a)(2). The rule imposes no such requirement and neither *Village of Hoffman Estates* nor *Brandt* (*see* DCOL 809) hold that a regulation prohibiting an act undertaken for a particular purpose necessarily requires a showing of scienter.

On the merits, Duka contends that the Division "failed to present any evidence" that S&P's internal controls were ineffective. RPHB 38. This claim ignores facts that are not reasonably in dispute, including that Duka's scheme exposed the ineffectiveness of S&P's internal MQR, Quality, and Criteria controls that failed to detect her conduct, and caused S&P to issue ratings that were not consistent with the 2009 Criteria, leading to the withdrawal of two preliminary ratings.[13]

**POINT IV**

Duka contends that the Divisions' claim under Rule 17g-2(a)(6) cannot be based on her failure to ensure that the switch to blended constants was documented in the RAMPs. RPHB 41. This argument misses the mark for two reasons. First, the Division's claim is also based on Duka's failure to follow the CPG, which resulted in the switch to blended constants not being documented as a criteria change. Second, with respect to the RAMPs, having failed to follow the CPG, the switch to blended constants should have been documented in the RAMPs, which were the "official record" of the rating methodology. DFOF 106. Duka claims that RAMP documentation was not required in this case, citing a 2007 Exchange Act Release. RPHB 41. However, the focus of that Release was whether Commission examination staff needed methodology documents for each rating to discern the methodology employed. Obviously, if S&P had followed the 2009 Criteria, the examination staff could look at that document and see the methodology. However, when, as here, Duka caused S&P to deviate from the Criteria, there would be no way for the examination staff (or any internal S&P control group) to determine that without an accurate RAMP. Under these circumstances, it cannot be the case that Duka's efforts to conceal her conduct are beyond the reach of the NRSRO books-and-records requirements.

[13] Duka's quibbles with the Division's proof with respect to the internal control failures she caused with respect to MQR, the CPG, and RAMPs (RPHB 38-40) reflect her one-sided view of the record and are addressed in the DPHB 15-19.

## POINT V

The Commission has rejected Duka's argument that ALJs are not properly appointed. *See, e.g.*, *Raymond J. Lucia Cos., Inc., et al.*, Rel. No. 34-75837, 2015 WL 5172953, at *21 (Sept. 3, 2015), *aff'd*, *Raymond J. Lucia Cos. v. SEC*, --- F.3d ---, 2016, 40 WL 4191191 (D.C. Cir. Aug. 9, 2016) *pet. for reh'g en banc filed*, No. 15-1345 (Sept. 23, 2016).

## CONCLUSION

For these reasons, Duka should be found liable for the violations alleged.

Rule 450(d) Certification: Undersigned counsel certifies that the above brief contains 6,960 words, exclusive of the table of contents, table of authorities, and this certification, as calculated by Word.

Respectfully submitted this 15th day of March, 2017.

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CERTIFICATE OF SERVICE

On March 15, 2017, the foregoing Division of Enforcement's Response to Respondent Barbara Duka's Post Hearing Brief was sent to the following parties and other persons entitled to notice as follows:

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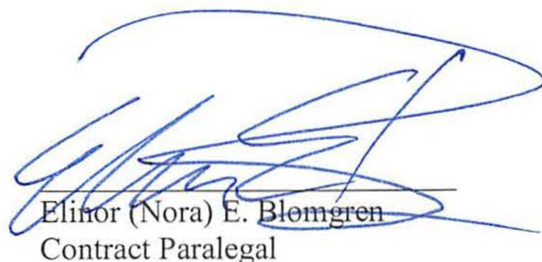

Elinor (Nora) E. Blomgren
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## EXHIBIT A: DIVISION OF ENFORCEMENT OBJECTIONS TO RESPONDENT'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Division of Enforcement ("Division") objects to the following of Respondent's Proposed Findings of Fact and Conclusions of Law on the grounds that the Proposed FOF/COL fail to comply with the Hearing Officer's January 9, 2017 Post-Hearing Order directing that "[e]ach citation shall be accompanied by a quotation of the language that supports the proposed finding" and prohibiting argument; are not supported by the evidence cited to, which is often simply the testimony of a single witness, often Duka, asserted as fact; or are contradicted by other evidence admitted at the hearing. At the Hearing Officer's request, the Division will provide specific objections to any or all of these PFOF/COL.

| | | | | |
|---|---|---|---|---|
| 47 | 224 | 348 | 457 | 680 |
| 63 | 227 | 351-354 | 474 | 683 |
| 64 | 236 | 356-358 | 477 | 688 |
| 76 | 237 | 360 | 481 | 695-697 |
| 93 | 247 | 363-365 | 487 | 698 |
| 98 | 248 | 369 | 492 | 704 |
| 111 | 256 | 372 | 498 | 705 |
| 127 | 258-260 | 375-377 | 512 | 708 |
| 143 | 272 | 379 | 531 | 710 |
| 144 | 279 | 380 | 552 | 711 |
| 148 | 293 | 381 | 572 | 717 |
| 160 | 295 | 383-385 | 592 | 721 |
| 180 | 304-307 | 389 | 613 | 724 |
| 181 | 309-311 | 391 | 617 | 729 |
| 187 | 317 | 395 | 637 | 739 |
| 193 | 318 | 398 | 649 | 745 |
| 200 | 324 | 409 | 651 | 753 |
| 204 | 337 | 415 | 653-659 | 774 |
| 205 | 338 | 427 | 661-664 | 781-783 |
| 213 | 341 | 434-437 | 666 | 794-807 |
| 222 | 343-346 | 440 | 674 | 809-825 |

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

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

ADMINISTRATIVE PROCEEDING
File No. 3-16462

| In the Matter of | | |
|---|---|---|
| LYNN TILTON;<br>PATRIARCH PARTNERS, LLC;<br>PATRIARCH PARTNERS VIII, LLC;<br>PATRIARCH PARTNERS XIV, LLC; and<br>PATRIARCH PARTNERS XV, LLC | :<br>:<br>:<br>:<br>:<br>: | ORDER |

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

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

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

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

**General Considerations**

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

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

**Specific Motions**

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

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

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

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

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

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

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

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

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

IT IS SO ORDERED.

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