UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

HARD COPY

In the Matter of:

LYNN TILTON;

PATRIARCH PARTNERS, LLC;

PATRIARCH PARTNERS VIII, LLC;

PATRIARCH PARTNERS XIV, LLC; AND

PATRIARCH PARTNERS XV, LLC;

Respondents.

Administrative Proceeding
File No. 3-16462

MEMORANDUM AND POINTS OF AUTHORITIES IN SUPPORT OF RESPONDENTS' MOTION FOR A MORE DEFINITE STATEMENT

David M. Zornow
David.Zornow@Skadden.com
Christopher J. Gunther
Christopher.Gunther@Skadden.com
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, NY 10036
(212) 735-3000

Susan E. Brune
sbrune@bruneandrichard.com
MaryAnn Sung
msung@bruneandrichard.com
BRUNE & RICHARD LLP
One Battery Park Plaza
New York, NY 10004
(212) 668-1900

Dated: April 22, 2015
New York, New York

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

OTHER AUTHORITIES

RULES

Respondents Lynn Tilton ("Tilton") and Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC and Patriarch Partners XV (collectively, "Patriarch"), by and through their undersigned counsel, respectfully submit this memorandum and points of authorities in support of their motion for a more definite statement of fact pursuant to Rule 220(d) of the Securities and Exchange Commission's Rules of Practice.

PRELIMINARY STATEMENT

After over five years of investigating and collecting approximately 2.4 million pages of documents in its Investigative File, the Commission has issued an Order Instituting Proceedings ("OIP") that still leaves the Respondents uncertain as to the scope of critical factual allegations. The Respondents do not seek an early peek at the Division of Enforcement's ("Division") evidence or for the Division to try its case prematurely. Rather, they submit this motion solely for clarification regarding two essential categories of factual information so that they may adequately prepare their defense of a complicated case involving three investment funds (the "Zohar Funds"), numerous portfolio companies, and allegations that date back at least seven years. (*See* OIP ¶¶ 1 ("since 2003"), 43 ("beginning by at least 2008").)

The Zohar Funds are Collateral Loan Obligations ("CLOs") that invest in the debt and equity of distressed portfolio companies. (OIP ¶¶ 2, 20, 21.) Patriarch acts as the collateral manager for these Funds. (OIP ¶¶ 12-14, 25.) The strategy for the Zohar Funds is and has been to improve the operations of the portfolio companies so that the companies can pay off their debt, increase in value, and eventually be sold for additional profit. (OIP ¶ 22.) Ms. Tilton actively manages the business of the portfolio companies, including by providing input on their major operating decisions. (OIP ¶ 28.)

The gravamen of the OIP is that "many" of these distressed portfolio companies were underperforming and owed large sums of unpaid interest to the Zohar Funds, yet "[d]espite the poor performance of many of the Funds' assets," Respondents did not treat them accordingly in indenture reporting and financial statements. (OIP ¶¶ 3, 4.) Respondents supposedly hid the underperformance from investors by categorizing assets, depending on the particular indenture, as "Category 4" or "Collateral Investments" rather than as a "Category 1" or "Defaulted Investments" for purposes of the overcollateralization ratio test. (OIP ¶¶ 34-36, 43-45.) In addition, the OIP alleges that such assets should have been, but were not impaired on the Funds' quarterly financial statements. (OIP ¶ 68.) The OIP alleges that investors were misled. (OIP ¶¶ 45, 49, 51, 57.)

While the Division's overarching allegations can be inferred, the specifics are not so easily ascertained. Respondents managed hundreds of loans to dozens of companies through the three Zohar Funds over more than a decade, yet the OIP provides strikingly little notice about the Division's claims. Accordingly, two critical pieces of factual information need to be clarified so that the Respondents can adequately defend themselves. First, which assets does the Division allege should have been categorized as Category 1/Defaulted Investments but were not, and when. Similarly, which assets supposedly should have been impaired on the financial statements but were not, and when. Second, which of the investors in which of the three Zohar Funds were misled by the categorizations, including their impact on the overcollateralization ratio tests, and by the financial statements. Motions seeking these categories of information are regularly granted. Absent more reasonable particularity as to these factual allegations, Respondents are unfairly hampered in their ability to prepare for a hearing. In addition, such particularity would help avoid unnecessary inefficiency in these administrative proceedings.

ARGUMENT

I. THE OIP DOES NOT PERMIT RESPONDENTS TO PREPARE A DEFENSE ADEQUATELY

Rule 200(b) of the SEC Rules of Practice requires the Division to provide in its OIP a "plain statement of the matters of fact and law to be considered and determined." 17 C.F.R. § 201.200(b)(3) (2014). It is bedrock principle that, through the OIP, Respondents "are entitled to be sufficiently informed of the charges against them so that they may adequately prepare their defense." *David F. Bandimere*, Admin. Proceeding File No. 3-15124, Order (ALJ Feb. 11, 2013) (hereinafter "*Bandimere*"). While Respondents are not entitled to receive the Division's evidence at this time, Your Honor has stated that allegations that are "vague, ambiguous, and generalized" will not suffice. *Alfred M. Bauer*, Admin. Proceeding File No. 3-9034, 62 SEC Docket 2273, Order (ALJ Aug. 27, 1996) (CFF) (hereinafter "*Bauer*").

In applying this standard, Judges consider the need for clarity in the context of the "magnitude" of the particular case. *Donald T. Sheldon*, Admin. Proceeding File No. 3-6626, 52 SEC Docket 427, Order (ALJ June 9, 1986) (hereinafter "*Sheldon*"). In cases like this one involving numerous transactions over an extended period of time and voluminous discovery, "the boundaries of the allegations need to be reasonably precise in order to give respondents a reasonable opportunity to prepare their defense." *Id.* at *2 (granting motion, in part, and ordering Division to provide, among other things, a list of securities and individuals involved in the alleged misconduct); *see also J.W. Barclay & Co., Inc.*, Admin. Proceeding File No. 3-10765, Order (ALJ June 13, 2002) (hereinafter "*J.W. Barclay & Co.*") (granting motion, in part, because "[t]his case has the prospect of becoming unmanageable because of the number of actively-defending Respondents (nine), the size of the Division's investigative file (more than

thirty boxes of non-privileged materials), and the Division's stated intent to present evidence of fraudulent activity that took place more than five years before the OIP was issued").

Considering the extremely wide scope of this case—in parties, transactions, and time—the Division's OIP does not provide the "reasonably precise" boundaries required. Providing the Respondents with the requested basic information will allow them to prepare their defense adequately and greatly expedite the matter.

A. THE OIP DOES NOT PERMIT RESPONDENTS TO KNOW WHICH ASSETS WERE ALLEGEDLY REPORTED IMPROPERLY

The Division has frequently been required to specify which assets or securities it refers to in an OIP. For instance, in *Bauer*, the OIP referred vaguely only to "certain securities" involved in fraudulent sales. On a motion for a more definite statement, Your Honor required the Division to identify what the "certain securities" were. *See Bauer*. Similarly, in *James L. Copley*, Admin. Proceeding File No. 3-7912, 55 SEC Docket 2770, Order (ALJ Feb. 2, 1994), the Judge required the Division to provide "names of the securities" because such details were not "evidence [the Division] intends to present" but part of the information necessary to the preparation of a defense. *Id.*; *see also Stuart-James Co., Inc.*, Admin. Proceeding File No. 3-7164, 52 SEC Docket 479, Order (ALJ May 19, 1989) (holding "that the Division had to identify those securities involved in the allegations of paragraphs V and VI which it had not already identified").

The specificity that has been required of the Division is missing here. The OIP does not contain sufficient factual allegations to permit Respondents to determine which assets the Division contends were improperly categorized for indenture reporting purposes, and which assets were not impaired under the financial statements but allegedly should have been. Instead, the OIP is riddled with vague allusions to the Zohar Funds' distressed assets underperforming.

For example, the OIP states that "*many* of the distressed companies have performed poorly and have not made interest payments, or have made only partial payments." (OIP ¶ 2 (emphasis added).) Similarly, the OIP alleges that "*many* of Portfolio Companies had large sums of unpaid interest, beginning by at least 2008." (OIP ¶ 43 (emphasis added).)

Since their inception over a decade ago, the Zohar Funds have made loans to well more than 100 distressed companies. It is the Division's theory of the case that "many" of these investments should have been categorized as Category 1/Defaulted Investments, which purportedly would have led to a failure of the overcollateralization ratio test in two of the investment funds by the summer of 2009.[1] (OIP ¶ 44.) Likewise, according to the OIP, those same loans should have been impaired in the Funds' quarterly financial statements. (OIP ¶¶ 64, 68.) But Respondents should not have to guess which of the assets supposedly should have been categorized as Category 1/Defaulted Investments (as of the summer of 2009 and otherwise) and/or impaired based on their poor performance and unpaid interest. That information is core to the Division's contention that Respondents defrauded the Funds and certain of the Funds' investors by allegedly failing to disclose the fact that, in an exercise of the collateral managers' discretion, the Zohar Funds accepted less than the full contractual rate of interest from distressed portfolio companies in the effort to turn those companies around.

The need for the Division to provide these facts and inform Respondents meaningfully of the allegations against them is particularly acute because the Division also alleges breach of fiduciary duty and a contractual duty of care. To show at the hearing that Respondents' management of the Zohar Funds met the applicable standards, Respondents will present the

---

[1] The Division has already made its determinations as to which assets should have been differently categorized and it would not be a burden on the Division to provide the information to Respondents.

factual circumstances underlying the judgments made as to the portfolio companies at issue. To prepare to do so for all companies would be extraordinarily burdensome and inefficient.

"Many" simply is not enough to put appropriate boundaries on the allegations. The Division should specify the assets it alleges to have been improperly categorized or misreported, and when. At a minimum, the Division should be ordered to identify the portfolio companies referenced in paragraphs 2, 4, 43, and 68 of the OIP whose loans, in whole or in part, allegedly should have been categorized as a Category 1 or Defaulted Investment under the indentures and impaired for purposes of the financial statements because of their underperformance.

B. THE OIP DOES NOT PERMIT RESPONDENTS TO KNOW WHICH INVESTORS WERE ALLEGEDLY MISLED

Motions like this one seeking specific information about allegedly misled investors are granted regularly. For instance, recently in *Bandimere*, a scheme liability case alleging violations of Section 10(b) of the Exchange Act and 17(a) of the Securities and Exchange Act, among other things, the Respondents sought an order requiring the Division to provide more detailed information about the identity of investors who were allegedly misled. The OIP alleged, among other things, that Bandimere "made misrepresentations or omissions to 'investors' and 'potential investors,' and that he 'raised at least $9.3 million from over 60 investors.'" *Id.* at 2 (citation omitted). The Judge granted the motion: "In light of the number of investors involved, the variety of misrepresentations and omissions potentially at issue, and the fact that the alleged conduct occurred over a period of five years, the investors and potential investors must be identified." *Id.*

Similar relief was granted in *J.W. Barclay & Co.*, a case against six registered representatives who allegedly engaged "in a pattern of sales practice abuses that defrauded customers" over an 18-month period. *Id.* at 1. The misconduct alleged in the OIP included

"'among other things' purchases and sales of securities on margin in the accounts of 'at least' eleven customers, churning the accounts of 'at least' twelve customers, making materially misleading statements or omissions to 'at least' two customers, making unsuitable purchases and sales in the accounts of 'at least' thirteen customers, and failing to execute sell orders for 'at least' four customers." While the Division gave the respondents a partial list of the allegedly defrauded customers by name in response to the motion for a more definite statement, the Judge held that only a full list would allow the respondents to prepare their defense and that "[t]his is really no more than the Division has routinely provided in other recent OIPs." *J.W. Barclay & Co.* at 2; *see also Bauer* at 2 (requiring Division to identify the customers listed in certain paragraphs of the OIP); *W. Pac. Capital Mgmt.*, Admin. Proceeding File No. 3-14619, 102 SEC Docket 3633, at *3, Order (ALJ Feb. 7, 2012) ("[T]he identities of such clients are necessary to sufficiently inform Respondents of the charges against them and to prepare for hearing, and are not evidence.").

Here, the OIP provides no particularity as to which of the Zohar Funds' investors were misled regarding the performance of the Zohar Funds and the underlying assets by the asset categorization and the financial statements. The OIP repeatedly alleges that the investors "were not informed" or "do not know" or "have not been told" about the decline in value of the Funds' assets and Respondents' approach to categorization. (*See* OIP ¶¶ 45, 49.) It further alleges that Respondents' approach to categorization, and the resulting impact on the OC Ratio test, were "important to investors" (OIP ¶ 51), and that "[i]nformation in the financial statements about the value of the Funds' assets was important to investors." (OIP ¶ 57.)

Notice as to which investors in which Zohar Fund were allegedly misled is critical to Respondents' defense against alleged violations of Section 206(4) and Rule 206(4)-8 thereunder.

The Division alleges that the categories and the overcollateralization ratio test were "valuations" that materially misled investors. Whether investors understood these categories and tests to be valuations will be hotly contested. Respondents will need to seek third-party discovery on how investors valued their investments, and whether the overcollateralization ratio test had any role in such valuations. More generally, the question of what investors were told or understood and what was important to them is a highly fact-specific inquiry and requires adequate discovery into their communications with Respondents and other third parties, as well as their internal communications, all of which reflect the investors' knowledge of the very issues about which the Division alleges they were deceived.

Without greater particularity, Respondents would be required to assume that any investor who invested in the Zohar Funds over the course of twelve years could provide the factual basis for the charged violations. That would amount to no notice at all. The case would become unmanageable. In order to prepare a defense, Respondents would need to seek permission to issue scores of subpoenas for document discovery to investors whose knowledge the Division may not be putting at issue. Notably, not even the universe of investors the Division may call is readily known to Respondents.[2]

The Division should be ordered to provide a more definite statement concerning the investors in paragraphs 45, 49, 51 and 57 of the OIP.

---

[2] This is because the notes are often custodied or held in the name of third parties, and while Respondents have some information regarding the identities of the investors at particular points in time, they do not have a complete record of all of the investors who originally or subsequently invested in the Zohar Funds over more than twelve years of operations. Moreover, an initial review of the Investigative File suggests that that information cannot be easily culled from the SEC's document collection, nor should it have to be. *See Sheldon*, at 2 (ordering Division to provide additional information about transactions despite Division's contention that Respondents should have personal copies of relevant files where, given the size of the investigatory file, and multiplicity of allegations and respondents, the "boundaries of the allegations" still needed to be made "reasonably precise" to allow the respondents a reasonable opportunity to prepare a defense).

II. AN EXERCISE OF DISCRETION WOULD SIGNIFICANTLY EXPEDITE THIS MATTER

This matter is ripe to be narrowed down. This is a complex, multi-year case. Simply to get to this point, over the last five years the Respondents alone have produced almost 1.7 million pages of discovery. The Division's investigatory file, inclusive of the Respondents' productions, totals about 2.4 million pages of documents and sheds little light on which companies or investors are the focus of its case. Even if the Judge concludes that the Respondents are not entitled to a list of assets that were improperly categorized or misreported (or even to know the names of the companies), or to learn the identity of the allegedly misled investors, an exercise of discretion requiring the Division to furnish the information anyway would benefit all, by expediting matters and focusing the hearing on the Division's actual allegations.

The Judge has the discretion to order such relief. In *Robert M. Winston*, Admin. Proceeding File No. 3-6986, 52 SEC Docket 456, Order (ALJ Apr. 28, 1988), the Judge denied a motion for a more definite statement yet still directed the Division to produce some details sought by the respondents in that matter. The Judge recognized that "in appropriate cases, discretion may be exercised to direct that information be given to respondents if doing so will have the effect of expediting the proceedings" and where there is no claim doing so will "prejudice" the Division's case. *Id.* at *1; *see also Fin. Programs, Inc.*, Admin. Proceeding File No. 3-2564, 52 SEC Docket 94, Order (Sept. 25, 1970); *Dempsey-Tegeler & Co., Inc.*, Admin. Proceeding File No. 3-2393, 52 SEC Docket 85, Order (June 16, 1970).

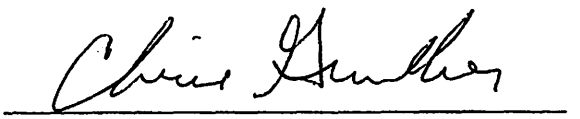
There is no concern for prejudice to the Division here. Respondents are requesting information that the Division regularly provides in OIPs. *See, e.g., J.W. Barclay & Co.* (recognizing that OIPs regularly include the identities of wronged investors).

CONCLUSION

For the foregoing reasons, Respondents respectfully request an order for a more definite statement pursuant to Rule 220(d) of the SEC Rules of Practice concerning paragraphs 2, 4, 43, 44, 45, 49, 51, 57, and 68.

Dated: April 22, 2015
New York, New York

Respectfully Submitted,

By: 

David M. Zornow
David.Zornow@Skadden.com
Christopher J. Gunther
Christopher.Gunther@Skadden.com
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, NY 10036
(212) 735-3000

Susan E. Brune
sbrune@bruneandrichard.com
MaryAnn Sung
msung@bruneandrichard.com
BRUNE & RICHARD LLP
One Battery Park Plaza
New York, NY 10004
(212) 668-1900