UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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 Hon. Carol Fox Foelak

NON-PARTY VÄRDE PARTNERS, INC.'S REPLY TO RESPONDENTS' OPPOSITION TO MOTION TO QUASH SUBPOENA

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Administration Decisions

Statutes, Rules and Regulations

TABLE OF AUTHORITIES
(continued)

Page(s)

Other Authorities

Värde Partners, Inc. (together with its affiliated management companies, "Värde"), which is not a party to this proceeding, respectfully submits this memorandum replying to the Memorandum of Law In Opposition to the Motion of Non-Party Värde Partners, Inc. to Quash the Subpoena Served by Respondents (the "Opposition") submitted by Lynn Tilton; Patriarch Partners, LLC; Patriarch Partners VIII, LLC; Patriarch Partners XIV, LLC; and Patriarch Partners XV, LLC (collectively "Respondents" or "Patriarch").

INTRODUCTION

Respondents' subpoena to Värde (the "Subpoena") should be quashed because it attempts to force Värde to disclose confidential and proprietary business information to a direct competitor, seeks information irrelevant to this administrative proceeding, and is unduly burdensome to Värde – a nonparty to this proceeding. Moreover, in their Opposition, Respondents do not dispute that, notwithstanding the irrelevancy of the information sought by the Subpoena, Värde produced over 16,000 pages of documents to them on September 11, 2015. Yet nowhere in their Opposition do Respondents explain why this substantial production fails to satisfy their alleged needs in preparing a defense to the Division of Enforcement's (the "Division") case. They similarly fail to specify what parts, if any, of their Subpoena – containing twenty separate document requests, including subparts, and six pages of instructions and definitions – are supposedly "imperative" for their defense beyond what has already been produced. Respondents also do not dispute in the Opposition, that their counsel has thus far not even reviewed the 16,000 pages of documents that Värde provided almost a year ago.[1]

The burden falls on Respondents to show that their Subpoena seeks "relevant and non-privileged" information "crucial to the preparation of the case." However, virtually all of the

[1] See Memorandum of Non-Party Värde Partners, Inc. In Support of Its Motion to Quash Subpoena Served by Respondents ("Motion to Quash") at 13.

information sought by the Subpoena is irrelevant. The Enforcement Division's allegations in this case focus on whether *Respondents* made misrepresentations to investors in three CDO funds previously managed by Respondents, Zohar CDO 2003-1, Limited ("Zohar I"), Zohar II 2005-1, Limited ("Zohar II"), and Zohar III ("Zohar III") (collectively the "Zohar Funds"). Respondents' Subpoena on the other hand seeks information concerning *Värde's* valuation and analysis of its own investment in Zohar III which has nothing to do with this proceeding. Respondents' concede the irrelevancy of this information by stating in their Opposition that they "intend to challenge the admissibility of evidence regarding the subjective views of investors as irrelevant to the charges . . ."[2] Significantly, the ALJ quashed at least one very similar subpoena in this proceeding on the grounds that it was "unreasonable and burdensome and the documents sought do not appear to be related to the allegations that *Respondents* reported misleading values." *In the Matter of Lynn Tilton et al.*, Release No. 3144 (Sept. 17, 2015).

Finally, Respondents' overly burdensome Subpoena also seeks to require Värde to search for and produce documents relating to all three Zohar Funds from as far back as November 1, 2004, even though Värde did not invest in Zohar III until September 24, 2013, and never invested in Zohar I and Zohar II at all. Even worse, Respondents are direct competitors of Värde and their Subpoena is calculated to obtain Värde's confidential and proprietary information that goes to the core of its business including the prices at which it makes investments, the values it assigns to actual and potential investments, and its methods for pricing, valuing, analyzing, and monitoring those investments.

The potential injury to Värde far outweighs any legitimate benefit that Respondents might obtain from production of the remaining documents sought in their Subpoena.

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[2] Opposition at 5, fn 2.

Accordingly, the Subpoena should be quashed with respect to all documents requested other than those already produced.

ARGUMENT

A. Legal Standard

"If compliance with the subpoena would be unreasonable, oppressive or unduly burdensome, the hearing officer or the Commission shall quash or modify the subpoena, or may order return of the subpoena only upon specified conditions."[3] Discovery in Commission administrative proceedings is limited. *In the Matter of Bandimere and Young*, Release No. 746 (Feb. 5, 2013) at 4. Even a subpoena seeking relevant information may be quashed if it is "unreasonable, oppressive or unduly burdensome." *Id.* Typically, once the recipient of a subpoena makes an initial showing that the subpoena is unreasonable, oppressive, or unduly burdensome, the party seeking discovery bears the burden of establishing that the information sought is "relevant and non-privileged" and "crucial to the needs of the case." *See generally, In re Clean Energy Capital, LLC,* Administrative Proceedings Rulings Release No. 1963, SEC Docket 2285 (ALJ July 25, 2014). However, when a subpoena to a non-party seeks confidential commercial information the demanding party bears the burden to show a substantial need for the information that cannot otherwise be met without undue hardship. *Fort James Corp. v. Sweetheart Cup Co.*, 1998 U.S. Dist. LEXIS 15908 (S.D.N.Y. Oct. 8, 1998).

B. Respondents' Subpoena Seeks Irrelevant Information

The documents Respondents seek by their Subpoena are irrelevant to this proceeding. The Division alleges in this case that Respondents engaged in securities fraud by failing to use an objective methodology required by fund indenture agreements to categorize the value of loans

[3] 17 C.F.R. § 201.232(e).

held by the Zohar Funds.[4] According to the Division, by applying a subjective categorization methodology, Respondents improperly maintained control of the Zohar Funds, accrued millions of dollars in subordinated management fees and preference shares to which Respondents were not entitled, and created conflicts of interest that they never disclosed to investors.[5] The Division further alleges that Respondents misrepresented that financial statements they prepared were GAAP-compliant and included information based on a fair value analysis of loans owned by the Zohar Funds.[6] Thus, this proceeding focuses on whether *Respondents* (a) followed the valuation categorization methodology mandated in indenture agreements, (b) prepared financial statements that complied with GAAP, and (c) conducted the fair value analysis referenced in financial statements. Yet, the documents Respondents seek from Värde in the Subpoena focus instead on Värde's valuation and analysis of its own investment in Zohar III which is not at issue in this proceeding.

Respondents' attempt to establish the relevance of the document requests in their Subpoena by pointing to a few snippets in filings made by the Division and its proposed experts indicating that investors generally were not aware of the true facts concerning Respondents misrepresentations.[7] However, Respondents do not need Värde's documents to respond to these tangential statements in the case. Respondents already know perfectly well what disclosures they made to investors and must have evidence of those disclosures in their possession. Furthermore, it is undisputed that Värde already produced over 16,000 pages of documents to Respondents including all information it received from the trustee of Zohar III, the only one of

[4] *See* Order Instituting Administrative Proceedings, In the Matter of Lynn Tilton et al., Admin. Proc. No. 3-16462 (Mar. 30, 2015) at ¶ 3-6, 29-39,
[5] *Id.* at 6, 9, 43–44, 49, and 54–56.
[6] *Id.* at ¶ 57-73.
[7] Opposition at 5.

the Zohar Funds in which Värde invested.[8] Nowhere in their Opposition do Respondents explain why this production is insufficient for their needs or identify specifically what additional material they allegedly require from Värde.

Respondents also point to two sentences in the thirteen page OIP which make the unremarkable statement that the subject matter of Respondents' misrepresentations were important to investors.[9] Yet, Respondents neither need, nor are entitled to, Värde's documents to respond to these statements because the standard for determining materiality is objective and not subjective. "The reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective." *ZPR Investment Mgmt., and Max E. Zavanelli*, SEC Release No. 4249, 2015 WL 6575683, at *14 (Oct. 26, 2015)*Id.* at * 5. "An omitted [or misrepresented] fact is material 'if there is a substantial likelihood that a reasonable [investor] would consider it important' in making an investment decision." *Id.* at *13.

In *Worlds of Wonder Securities Litig.*, 1992 WL 330411 (N.D. Cal. July 9, 1992), the federal magistrate judge quashed a document subpoena served on institutional investors by defendants in a securities class action. Defendants claimed the documents requested "will show that the sophisticated institutional investors and the market as a whole were aware of all the risks that plaintiffs contend were concealed," and that "[s]uch evidence would bear directly on whether any misstatements or omissions by [defendants] in the prospectus were material." *Id.* Plaintiffs argued that the subpoenas should be quashed because "Under the federal securities laws, materiality is determined by a objective standard: the hypothetical 'reasonable investor' is the yardstick . . . Consequently, no useful evidence relating to materiality could be gained through discovery of these individual investors." *Id.* at *5. The Court agreed with the plaintiffs,

[8] Motion to Quash at 3 and 12-13.
[9] Opposition at 5-6.

stating that "the evidence sought from the institutional investors would not be relevant to the . . . [issue] of materiality . . . ." *Id.* at *6.

This clear precedent is not lost on the Respondents in this administrative proceeding because they admit that the "subjective views of investors are irrelevant to the charges."[10]

Respondents further complain that the Division noted in a single sentence on a witness list that it may call a Värde employee to testify in this case.[11] They then claim that their extraordinarily broad subpoena to Värde is somehow justified because the Division did not provide a lengthier statement of the possible testimony it may hope to elicit from Värde and there were not any transcripts or documents concerning Värde in the investigative record the Division produced to Respondents. [12] However, the paucity of information the Division apparently has regarding Värde merely reflects Värde's irrelevance to these proceedings. Furthermore, if Respondents really need additional information concerning the Division's views on Värde, it can petition the ALJ to compel the Division to provide whatever information Respondents believe they need.

Finally, and as noted above, Respondents do not dispute that Värde produced over 16,000 pages of documents to Respondents almost a year ago in response to the Subpoena.[13] It is undisputed that these documents included, among other things: (a) the timing, size, and counterparty for Värde's purchases of Zohar III notes; (b) Värde's communications with the Commission concerning Zohar III notes; (c) information Värde received from the Zohar III trustee, (d) Värde's pre-acquisition due diligence memoranda that do not reveal confidential pricing, valuation, recovery value, or proprietary model information, and (e) marks Värde

[10] Opposition at 5, fn2.
[11] Opposition at 1, 2, and 7.
[12] *Id.* at 1.
[13] Motion to Quash at 3, 12-13.

received from third party pricing services such as IHS Markit.[14] However, Respondents have completely failed to explain why this production is insufficient for their needs. They do not even mention in their Opposition any document or request that has not been complied with and that would supply relevant information to its defense. Instead, Respondents spend much of their Opposition repeating arguments as to why it is the Division that made them serve such a broad Subpoena on a non-party, and the illegality or unfairness of Commission administrative proceedings, a refrain they unsuccessfully took all the way to the Second Circuit. All the while, Respondents fail to make the required legal showing that their Subpoena calls for the production of relevant, non-privileged documents that are crucial to their preparation. Despite Värde delineating each request to which it objected and the reasons for each objection, Respondents have not stated what further information they need, or which of their requests specifically, if any, is "crucial to their preparation."

C. Respondents Are Using A Commission Subpoena to Obtain a Competitive Advantage by Forcing Värde to Disclose Confidential Business Information Irrelevant to This Proceeding

Värde explained in its motion that the Subpoena should be quashed because Respondents are direct business competitors of Värde and are using the Commission Subpoena to obtain Värde's confidential and proprietary business information including the prices and values Värde places on its investments as well as the methods it employs to identify, price, value, analyze, and monitor those investments, even though none of that information is relevant to this proceeding.[15] The disclosure of this information would cause enormous competitive harm to Värde because it would allow Respondents to use Värde's own confidential information and methods to take

[14] *Id.*

[15] Motion to Quash at 1, 2, 7-9, 17-19. Mach Declaration, Motion to Quash Exhibit A at ¶¶11-16.

advantage of investment opportunities for themselves at the expense of Värde and its investors.[16] The harm would be particularly severe in this case because Respondents are adverse counterparties to Värde in a proposed restructuring of the Zohar Funds that Respondents managed until February 2016.[17] The information Respondents seek would allow them to unfairly calibrate negotiating positions based on knowledge – gained by using a Commission subpoena in this proceeding – of Värde's confidential valuation estimates and prices paid for notes issued by Zohar III.[18] In addition, should the information Respondents seek become public in an administrative proceeding or otherwise, it would cause substantial harm to Värde's competitive position vis-à-vis other investment advisers because that information goes to the core of Värde's business model.[19]

Respondents disingenuously argue in their Opposition that they are not business competitors of Värde because they are no longer registered investment advisers.[20] In fact, even though Patriarch withdrew its registration with the Commission on or about March 31, 2016, it continues to compete with Värde as an investment adviser. Respondents have publicly stated that they "will operate as a family office and private equity company for . . . [their] portfolio of businesses."[21] Indeed, in their Opposition Respondents implicitly acknowledge their intention to continue in the investment adviser industry because they express grave concern about being barred from the industry as a result of this administrative proceeding.[22]

Moreover, Respondents never addressed in their Opposition that, in addition to being a market competitor, Patriarch is also an adverse counterparty in connection with the proposed

[16] Mach Declaration at ¶4.
[17] Mach Declaration at ¶12; Motion to Quash at 18-19.
[18] Motion to Quash at 8-9, 18-19.
[19] Id. at 18-19.
[20] Opposition at 3 and 11.
[21] Press release issued by Patriarch, dated February 5, 2016 ("Press Release"), Exhibit 3 to Mach Declaration, Motion to Quash Exhibit A.
[22] Opposition at 3.

restructuring of the Zohar Funds.[23] For example, while it was still acting as the Collateral Manager of the Zohar Funds, a Patriarch affiliate, Patriarch Partners, LLC, sent a letter to Värde and other noteholders of Zohar Funds asking to discuss with Patriarch and others a restructuring of the funds.[24] In the letter Patriarch Partners LLC, states that "[W]e are providing notice of the late 2015 maturity of the Zohar I Class A Notes, the potential effect on all the Zohar Funds and requesting that all interested parties come together for the purpose of discussing a restructuring of the Zohar Funds."[25] Patriarch Partners, LLC also states in the letter that, "The Zohar Class A Notes will mature on November 20, 2015.[26] As there is an overlap among the obligors of the collateral held by all three Zohar Funds, this maturity may impact the noteholders of Zohar II and Zohar III."[27] Patriarch Partners, LLC further advised noteholders in the same letter that "we believe it is time for, and in the best interest of, all Noteholders and other interested parties to come together to more formally discuss a restructuring of the three Zohar Funds."[28] Finally, Patriarch stated that it had retained an investment banker that would be reaching out to noteholders of the Zohar Funds shortly regarding the restructuring.[29]

More recently, Ms. Tilton and Patriarch issued a press release on February 5, 2016 the (the "Press Release") announcing that Patriarch was stepping down as the Collateral Manager of the Zohar Funds.[30] This resignation, however, does not alter the fact that Ms. Tilton and Patriarch remain active adverse counterparties of Värde and any noteholders in the Zohar

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[23] Mach Declaration, Motion to Quash Exhibit A at ¶ 12; Motion to Quash at 8-9, 18-19.
[24] Letter from Patriarch Partners, LLC to noteholders of the Zohar Funds, February 6, 2015, Exhibit 2 to Mach Declaration, Motion to Quash Exhibit A.
[25] *Id.* at 1.
[26] *Id.* at 3.
[27] *Id.*
[28] *Id.*
[29] *Id.* at 4.
[30] Press Release, Exhibit 3 to Mach Declaration, Motion to Quash Exhibit A.

Funds.[31] As Ms. Tilton and Patriarch note in their own Press Release, they remain focused "on managing the more than 70 operating companies" held by the Zohar Funds.[32] The press release also notes that "Patriarch's resignation will have no effect on Ms. Tilton's role as CEO of Patriarch Partners or her roles as manager, and in some cases CEO, of the portfolio companies..."[33] In addition to continuing to be CEO and manager (and often sole/controlling board members) of the Zohar Fund portfolio companies, Ms. Tilton and/or Patriarch also take the position that they continue to hold the role of "agent" on the loans extended by the Zohar Funds to the underlying portfolio companies.[34] Based on the foregoing, it is clear that Ms. Tilton and Patriarch remain key active participants in the Zohar Funds and adverse to Värde and other noteholders in any potential restructuring.[35]

Respondents also inaccurately argue that entry of a protective order will address Värde's concerns about the confidentiality of its business information.[36] Courts have repeatedly declined to require the production of confidential and proprietary information even under a protective order – particularly when, as is the case here, the party seeking discovery fails to establish a concrete and compelling need for the information that cannot otherwise be met without undue hardship.

In *Viacom Int'l Inc. v. Youtube Inc.*, the court denied discovery of Google's search and video codes even under a protective order because the consequences of inadvertent disclosure could be severe, and the plaintiff presented nothing more than speculation about the possible relevance of the code. *Viacom Int'l Inc. v. Youtube Inc.*, 253 F.R.D. 256 (S.D.N.Y. 2008). The

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[31] Mach Declaration, Motion to Quash Exhibit A at ¶ 13; Motion to Quash at 8-9.
[32] Press Release, Exhibit 3 to Mach Declaration, Motion to Quash Exhibit A.
[33] *Id.*
[34] Mach Declaration, Motion to Quash Exhibit A at ¶ 13.
[35] *Id.*; Motion to Quash at 8-9.
[36] Opposition at 11.

court explained that although "the protections set forth in the stipulated confidentiality order [were] careful and extensive," they were "nevertheless not as safe as nondisclosure." *Id.* at 260. The court held that such sensitive information could not be disclosed "without a preliminary proper showing justifying production." *Id.* The court concluded that the plaintiffs' justification for the discovery sought was "speculative" and "considered against its value and secrecy, plaintiffs have not made a sufficient showing of need for its disclosure." *Id. at 261.* Significantly, in *Viacom* the court also denied plaintiff's motion to compel discovery of Google's advertising scheme for similar reasons and because its disclosure would have permitted others to profit from Google's advertising programs without an equivalent investment of time and expense. *Id.* at 263. *See also telSPACE, LLC v. Coast to Coast Cellular, Inc.*, No. 2:13-CV-01477 RSM, 2014 WL 4364851, at *5 (W.D. Wash. Sept. 3, 2014) ("The Court further finds that reliance on the parties' protective order is insufficient to warrant disclosure in light of Plaintiff's inadequate showing of relevance and the burden that disclosure of the source code would place on Defendant."); *Abarca Health, LLC v. PharmPix Corp.*, 806 F. Supp. 2d 483, 488, 493 (D.P.R. 2011) (denying request for production of information under a protective order that was ""the heart of [a party's] business and most valuable asset" because plaintiffs did not demonstrate that the information was relevant and that "the benefits of disclosure...outweigh[ed] the considerable detriment invoked by defendants").

Värde's and its investors would suffer significant harm if the confidential and proprietary information sought by the Subpoena is disclosed to Respondents or becomes public in a judicial proceeding, administrative hearing, or otherwise.[37] The manner in which an investment adviser identifies, analyzes, prices, values and manages its investments goes to the core of any

[37] Mach Declaration, Motion to Quash Exhibit A. at ¶ 16.

investment adviser's business model.[38] Disclosure of this type of information – even if limited to one or a handful of investments - can be readily deciphered by sophisticated market competitors to reveal underlying procedures and strategies.[39] Once deciphered, these procedures and strategies can be extrapolated across broad portions of an investment adviser's overall business and portfolio.[40] Therefore, disclosing even subject to a protective order, the type of information requested by Respondents would be highly detrimental to Värde and its investors.[41]

Moreover, all of the aforementioned harm to Värde would be caused by the disclosure of documents that, as explained above, have no relevance at all to this proceeding. Furthermore, Respondents have not offered any explanation as to why they need any documents from Värde beyond the more than 16,000 pages of documents that Värde already produced. As demonstrated by the cases cited above, courts have frequently declined to order production of confidential and proprietary information even subject to a protective order, particularly when, as here, the party serving the document requests failed to specify the documents that are relevant and crucial to their defense. Accordingly, a protective order is not warranted in this matter and the Subpoena should be quashed.

D. Respondents' Subpoena is Unduly Burdensome and Oppressive to Värde

Värde argued in its motion that the Respondents' Subpoena should also be quashed because requiring production of additional documents beyond the 16,000 pages already produced would be unduly burdensome and oppressive.[42]

The Subpoena seeks information that is not only irrelevant but also burdensome to search for and provide. For example, the Subpoena requires Värde to search for documents from a time

[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.*; Motion to Quash at 18-19.
[42] Motion to Quash at 19 – 22.

period covering November 1, 2004, to the present even though Värde first purchased Zohar III Notes in September 2013, and never purchased any notes at all in Zohar I and Zohar II. In their Opposition, Respondents continue to insist on their Subpoena being responded to in its entirety, including the date range of 2004 to the present, because they believe "the review of documents prior to that date should impose little, if any, burden."[43] Yet, searching for documents over a period stretching back to nine years before Värde purchased any notes of the Zohar Funds will consume an extraordinary amount of effort, time and expense while Respondents have not explained how such documents could possibly be relevant to this proceeding.

The Subpoena would also require Värde to incur the time and expense of preparing a privilege log of privileged documents that are irrelevant to this proceeding. Respondents argue in their Opposition that Värde should provide a "detailed index of the responsive documents for which it is claiming privilege."[44] However, the review and preparation of a "detailed index" listing large numbers of documents that although potentially responsive to the Subpoena are completely irrelevant to this proceeding would be unduly burdensome and oppressive to Värde. *See, e.g., Longport Ocean Plaza Condominium, Inc. v. Robert Cato & Associates, Inc.*, 2002 U.S. Dist. LEXIS 12929, *9 (E.D. Pa. Mar. 6, 2002) (burden of implementing redactions not justified where requested materials irrelevant).

In addition, the ALJ has already quashed at least one similar subpoena that Respondents served on another non-party investor in the Zohar Funds. In its order quashing the subpoena, the ALJ noted that, "the subpoena requests a wide variety of documents related to . . . [the investor's] purported monitoring of the funds' assets, including computations, modeling runs, identification of individuals responsible for the monitoring, and capital reserves or provisions

[43] Opposition at 9.
[44] Id. at 10.

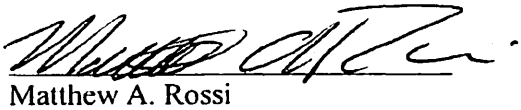
taken on the notes. The documents sought date back as far as November 2004." *In the Matter of Lynn Tilton et al.*, Release No. 3144 (Sept. 17, 2015). The ALJ quashed the subpoena because, *inter alia*, "on its face, the subpoena appears unreasonable and burdensome and the documents sought do not appear to be related to the allegations that Respondents reported misleading values." *Id.* Respondents Subpoena to Värde seeks all of the same information as the subpoena previously quashed by the ALJ.[45] Accordingly, Respondents' Subpoena to Värde should be quashed as well.

CONCLUSION

For the foregoing reasons, Värde respectfully requests that the Subpoena be quashed except for those documents already produced.

Dated: August 19, 2016

Respectfully submitted,



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[45] *See* Subpoena, Motion to Quash Exhibit B at 8-10.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Non-Party Värde Partners, Inc.'s Reply To Respondents' Opposition to Motion to Quash Subpoena was served August 19, 2016, on the following in the manner indicated below:

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