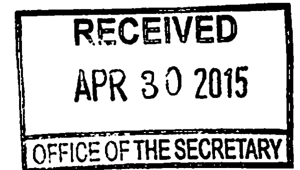
HARD COPY



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16462

In the Matter of **LYNN TILTON;** **PATRIARCH PARTNERS, LLC;** **PATRIARCH PARTNERS VIII, LLC;** **PATRIARCH PARTNERS XIV, LLC;** **AND** **PATRIARCH PARTNERS XV, LLC,** **Respondents.**	**DIVISION OF ENFORCEMENT'S BRIEF IN OPPOSITION TO RESPONDENTS' MOTION FOR A MORE DEFINITE STATEMENT**

The Division of Enforcement ("Division") opposes Respondents' motion for a more definite statement, and files the below brief in opposition.

INTRODUCTION

In their motion, Respondents essentially request the pre-hearing disclosure of witnesses and other evidence – a request that longstanding Commission precedent makes clear is improper at this stage. The Order Instituting Proceedings ("OIP"), which contains over 70 paragraphs detailing Respondents' alleged misconduct, is more than sufficient to allow Respondents to prepare a defense. In any event, in a spirit of compromise, and as detailed below, the Division has determined to provide Respondents with certain information that they are requesting through their motion. In all other respects, Respondents' motion should be denied.

LEGAL STANDARD

Under Rule 200(b) of the Commission's Rules of Practice, the OIP must "contain a short and plain statement of the matters of fact and law to be considered and determined" and where, as here, an answer is required, "set forth the factual and legal basis alleged therefor in such detail as will permit a specific response thereto." 17 C.F.R. § 201.200(b). In light of this pleading standard, it is well established that respondents are entitled to be sufficiently informed of the charges against them so they may adequately prepare their defense, but are not entitled to disclosure of evidence in advance of the hearing. *See, e.g., Orlando J. Jett*, Admin. Procedures Rulings Rel. No. 502, 1996 WL 220933, *2 (April 25, 1996) (citing cases). For that reason, "a motion for more definite statement is not a device to obtain discovery otherwise not provided for in the [Commission's] Rules ...." *Ernst & Whinney et al.*, Admin. Procedures Rulings Rel. No. 268, 1986 WL 175655, *2 (Feb. 12, 1986). Thus, motions for more definite statements seeking details on, for example, which precise investors were the recipients of a respondent's misrepresentations are historically disfavored and routinely denied. *See M.J. Reiter Co.*, 39 S.E.C. 484, 486 (1959); *Dempsey-Tegeler & Co., Inc.*, Admin. Procedures Rulings Rel. No. 50, 1970 WL 11234 (June 16, 1970).

ARGUMENT

The OIP details Respondents' misconduct, which centers on Tilton's failure to abide by the terms of the deals she made with investors in Patriarch's funds. Through the deal documents, Respondents told investors they would use an objective method to value and categorize the funds' assets. Instead, Tilton employed an undisclosed, subjective methodology that turned on whether Tilton personally felt the assets were still worth supporting. Respondents claim they do not have adequate information to prepare their defense without detailed identification of (1) the specific

assets that the Division alleges should have been downgraded and (2) the specific investors who were misled. As explained below, Respondents are wrong.

1. The Division's Allegations Regarding Defaulted and Impaired Assets are Sufficiently Detailed to Permit Respondents to Prepare a Defense.

Respondents first argue that they cannot adequately prepare their defense because the OIP does not specify which assets should have been classified as Category 1/Defaulted Investments, or which assets should have been impaired. In fact, Respondents have adequate notice of the claims against them – the OIP details the practices that form the basis of the Division's allegations, all of which are based on information that is entirely known to and under the control of Respondents.

The OIP describes in detail the manner in which Respondents improperly categorized assets using a subjective methodology rather than following objective standards prescribed by the deal documents, including whether a portfolio company was making timely interest payments (OIP ¶¶ 2-6, 29-42); the effect that improper categorization had on the Overcollateralization Ratio ("OC Ratio"), an important investor protection tool (OIP ¶¶ 43-44); the absolute control exercised by Respondents over the categorization and the interest payments made by portfolio companies (OIP ¶¶ 40-42, 46-48); and Respondents' failure to follow GAAP in preparation of the financial statements, including procedures relating to asset impairment (OIP ¶¶ 62-68). As described in the OIP, Respondents themselves categorized the investments, determined when and how much interest to collect form portfolio companies, provided the inputs for and monitored the OC Ratio, and decided when to impair an asset on the financial statements. These are the factual and legal bases that underlie the Division's allegations that certain assets should have been downgraded; by their very nature, Respondents have adequate notice of these facts.

Respondents also argue that they will need to present "factual circumstances underlying the judgments made as to the portfolio companies at issue" in presenting a defense to the breach of

fiduciary duty and contractual standard of care allegations. They go on to say that to prepare for trial on all companies would be "extraordinarily burdensome and inefficient." As a threshold matter, this argument shows that Respondents are attempting to use their motion for more definite statement to obtain information about the Division's specific evidence and trial strategy – a tactic that is not permitted at this early stage of the case.

In addition, and more importantly, this argument ignores the Division's actual claims relating to fiduciary and contractual standards of care. The Division argues that Respondents' undisclosed approach to categorization of the fund assets created a conflict of interest: it allowed Respondents to categorize assets in a way that benefitted them by allowing Respondents to obtain fees to which they were not entitled and to retain control over the management of the funds. (OIP ¶¶ 54-55.) The Division does not make any allegation that Respondents' subjective judgments relating to the portfolio companies were incorrect – and in fact, asserts that such evidence is irrelevant. Instead, the Division alleges that investors were not aware that Respondents were using subjective judgment, rather than disclosed, objective criteria, to categorize assets. As a result, investors were not aware of this underlying conflict and were not given the opportunity to consent or opt out.

Despite the fact that the OIP provides Respondents with information that is more than sufficient to prepare a defense, in the spirit of cooperation and in the interest of advancing the proceeding, the Division is willing to provide Respondents with a list of the portfolio companies it has focused on as a basis for the allegations in the OIP. This list is contained in the Appendix to this brief.[1]

[1] The Division reserves the right to present evidence at trial relating to additional portfolio companies.

2. The Division's Allegations Regarding Defrauded Investors are Sufficiently Detailed to Permit Respondents to Prepare a Defense.

Respondents also seek the identity of the investors that Respondents misled. Respondents' arguments again ignore the nature of the misrepresentations and omissions at issue in this case. This is not a case where different statements were made to different investors and the OIP is unclear as to what was said (or not said) to whom. Rather, Respondents made the same core misrepresentations/omissions to every investor in the Zohar Funds. Thus, asking for the identity of specific investors is little more than a request to ascertain which investors the Division intends to rely on to prove its case at trial – an impermissible request for early disclosure of evidence.

As alleged in the OIP, the terms of the deal between Respondents and the investors in the funds were outlined in deal documents, including an indenture agreement. (OIP ¶¶ 17-18.) The relevant portions of the indentures for each of the three funds at issue were functionally the same, and included the promise that Respondents would employ objective standards to categorize the funds' assets and calculate the OC ratio. (OIP ¶¶ 29-39). The indentures also promised investors that they would receive financial statements that complied with GAAP each quarter; those financial statements were supposed to reflect whether loans to distressed companies were "impaired." (OIP ¶¶ 57-62.) However, rather than follow the terms of the indentures – terms that were disclosed to each and every investor – Tilton employed her own subjective discretion to categorize the loans, downgrading them only once she decided she would no longer "support" the distressed company (OIP ¶¶ 40-42; 63-68.)

In short, Respondents made the same core misrepresentations/omissions to all of the investors: despite promising in the indenture to use an objective categorization methodology and GAAP-compliant impairment analysis, Respondents in fact used an undisclosed, subjective, discretionary methodology to categorize assets. There is nothing vague about these allegations, or

which investors were misled. Put simply, each and every investor was misled in the same way. (*See, e.g.*, OIP ¶ 1 (noting that Respondents "have defrauded three Collateralized Loan Obligation ('CLO') funds they manage and these funds' investors ....").

For this reason, the handful of cases cited by Respondents – all of which involve respondents charged with making varied misrepresentations or employing varied fraudulent practices – are inapposite.[2] In *Bandimere*, the law judge granted respondents' motion for a more definite statement and required the Division to identify the investors allegedly misled in light of fact that the Division alleged a "variety of misrepresentations and omissions" to individual investors in an offering fraud. *See David F. Bandimere*, Admin. Procedures Rulings Rel. No. 749 (Feb. 11, 2013). As the law judge made clear, the order was based on the "specific facts of [that] case." *Id.* Similarly, in *J.W. Barclay*, the law judge granted a motion for more definite statement where the OIP alleged that numerous brokerage firm employees engaged in five different types of fraudulent practices, each of which was perpetrated on "at least" a specified (but unnamed) number of customers. *J.W. Barclay & Co., Inc.*, Admin. Proc. File No. 3-10765, 77 S.E.C. Docket 2819 (June 13, 2002). In *Bauer*, the OIP alleged that respondent engaged in "numerous fraudulent sales practices" that defrauded certain specific (but again unnamed) customers; this Court found that, in those circumstances, the respondents were entitled to know which customers the OIP was referring to. *See Alfred M. Bauer*, Admin. Proceedings Rulings Rel. No. 517, 1996 WL 529025 (Aug. 27, 1996); *see also John J. Aesoph*, Admin. Proceedings Rulings Rel. No. 762 (April 2, 2013)

---

[2] *See generally Miguel A. Ferrer*, Admin. Proceedings Rulings Rel. No. 706 (June 13, 2012) (denying motion for more definite statement and distinguishing *Bauer, J.W. Barclay*, and *Western Pacific*); *Houston Am. Energy Corp.*, Admin. Proceedings Rulings Rel. No. 1867 (Sept. 30, 2014) (noting that *Bauer* and *Western Pacific* are "exceptions to established precedent).

(describing *Bauer*'s allegations).[3] Finally, in *Western Pacific Capital Management*, the law judge granted a motion for more definite statement where the OIP was ambiguous as to whether respondents failed to disclose material facts to all, or merely a portion, of their clients. *W. Pac. Capital Mgmt.*, Admin. Proceedings Rulings Rel. No. 691 (Feb. 7, 2012). Notably, the OIP here does precisely what the law judge found lacking in *Western Pacific*: it alleges that Respondents' misrepresentations and omissions affected all of the funds' investors.

Where, as here, the nature of the misrepresentations/omissions is the same to all investors, any request that the Division identify specific investors is essentially a request that the Division outline which investors it may use to prove its case at trial. Such a request is improper at this stage of the case. *See, e.g.*, *Orlando J. Jett*, Admin. Procedures Rulings Rel. No. 502, 1996 WL 220933, *2 (April 25, 1996).

Finally, the Division notes that it has produced to Respondents transcripts of all investigative testimony, which includes testimony from five investor representatives. In addition, although not required by Rules of Practice 230 or 231, the Division has also determined to produce to Respondents handwritten notes of any additional interviews with investors the Division conducted during the investigation, which it will do in short order. Thus, Respondents have significant insight into what investors old the Division during its investigation. Additional disclosure of the specific investors the Division intends to present at trial will occur at the time the Court sets for disclosure of witness lists.

---

[3] In addition, the OIPs in *J.W. Barclay* and *Bauer* contained only brief descriptions of the alleged misconduct. As this Court has previously noted, in *Bauer*, the entirety of the factual allegations were contained in one paragraph and three sub-paragraphs. *See John J. Aesoph*, Admin. Proceedings Rulings Rel. No. 762 (April 2, 2013). Similarly, in *J.W. Barclay*, the alleged misconduct was described over the space of two pages. *See Trautman Wasserman & Co., Inc.*, Order on Motions for More Definite Statement and Due Date for Respondents' Answers, Admin. Proc. File No. 3-12559 (July 30, 2007) (describing allegations). Here, by contrast, the OIP contains more than 70 paragraphs detailing Respondents' misconduct.

CONCLUSION

For the reasons stated above, Respondents' motion for a more definite statement should be denied.

Dated: April 29, 2015

Respectfully Submitted,

Dugan Bliss, Esq.
Nicholas Heinke, Esq.
Amy Sumner, Esq.
Division of Enforcement
Securities and Exchange Commission
Denver Regional Office
1961 Stout Street, Ste. 1700
Denver, CO 80294

APPENDIX

The Division has analyzed loan agreements, written loan amendments, schedules of payments due, and schedules of payments made by the following portfolio companies in support of its allegations relating to categorization and impairment. The Bates numbers below identify schedules produced by Respondents of loan payments due and loan payments actually made by the identified portfolio companies.

ALF
PP127581.xls
PP127580.xls

Amweld
PP 127585.xls
PP 127586.xls

Galey
PP127620.xls
PP127621.xls

Global Automotive
PP127624.xls
PP127625.xls

Hartwell
PP127639.xls
PP127638.xls
PP 127637.xls

Heritage
PP127642.xls
PP127643.xls

Intera
PP127647.xls
PP127648.xls

LVD
PP 127657.xls
PP 127658.xls

MAV-PVI
PP127667.xls
PP127668.xls

MD Helicopters
PP127662.xls
PP127663.xls

Natura
PP127672.xls
PP127673.xls

Netversant
PP127677.xls
PP127678.xls

Petry
PP127682.xls
PP127683.xls

Scan Optics-SO Acquisition
PP127691.xls
PP127692.xls

CERTIFICATE OF SERVICE

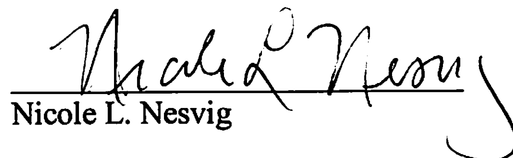
I hereby certify that a true copy of the foregoing was served on the following on this 29th day of April, 2015, in the manner indicated below:

Securities and Exchange Commission
Brent Fields, Secretary
100 F Street, N.E.
Mail Stop 1090
Washington, D.C. 20549
(By Facsimile and original and three copies by UPS)

Hon. Judge Carol Fox Foelak
100 F Street, N.E.
Mail Stop 2557
Washington, D.C. 20549
(By Email and UPS)

Christopher J. Gunther
David M. Zornow
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
Four Times Square
New York, NY 10036
(By email pursuant to the parties' agreement)

Susan E. Brune
MaryAnn Sung
BRUNE & RICHARD LLP
One Battery Park Plaza
New York, NY 10004
(By email pursuant to the parties' agreement)



Nicole L. Nesvig