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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 Judge Carol Fox Foelak

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' MOTION *IN LIMINE* 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

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Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Patriarch" or "Respondents"), respectfully submit this memorandum of law in support of their motion *in limine* to preclude the Security and Exchange Commission ("SEC") Division of Enforcement (the "Division") from introducing into evidence exhibits, or portions of exhibits, comprising unreliable hearsay, including (but not limited to) the Division's Exhibits 129, 140, 142, 174, 184, and 190.

INTRODUCTION

The Division's August 22, 2016 amended exhibit list is rife with documents containing unreliable hearsay statements, including numerous email communications containing multiple levels of hearsay. *See, e.g.*, Division's Amended Exhibit List, Exs. 129, 140, 142, 174, 184, and 190 (Aug. 22, 2016). These documents are problematic on their face, and their inadmissibility is further underscored by the fact that the Division has in many instances chosen not to designate the hearsay declarants as hearing witnesses, as a result of which Respondents will not have an opportunity to cross-examine, or otherwise verify or challenge, the out of court (and in the case of emails, unsworn) statements. *Compare id.*, *with* Division's Amended Witness List (Aug. 22, 2016). The admission of such untestable hearsay would jeopardize critical procedural safeguards and due process rights, including the right to confront adverse witnesses, which applies in administrative proceedings and is protected by Rule 326 of the SEC's Rules of Practice, 17 C.F.R. pt. 201. Admitting unreliable hearsay evidence denies Respondents the fundamental right to cross-examination necessary for a fair trial. Accordingly, Respondents move to preclude the Division from introducing hearsay as evidence.

LEGAL STANDARD

Pursuant to 5 U.S.C. § 556(d), evidence in administrative proceedings must be "reliable," "probative," and "substantial." Amended Rule 320[1] of the Rules of Practice states that the hearing officer "*shall exclude* all evidence that is irrelevant, immaterial or unduly repetitious." Additionally, Amended Rule 320 states that "[s]ubject to [Rule 235], evidence that constitutes hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair." Rule 235(a), in turn, provides that prior sworn statements of witnesses who are available to testify are generally inadmissible. Rule 300 states that the hearing "shall be conducted in a fair, impartial, expeditious and orderly manner."

Although the Federal Rules of Evidence do not govern the Commission's administrative proceedings, ALJs have acknowledged that they "may serve as a guide in determining the admissibility of evidence in administrative proceedings" and often provide helpful instruction on issues not directly addressed by the Rules. *In re Sky Sci., Inc.*, Release No. 137, 1999 WL 114405, at *2 (ALJ Mar. 5, 1999) (applying Federal Rules of Evidence in administrative proceeding); *see also, e.g.*, *Yanopoulos v. Dep't of Navy*, 796 F.2d 468, 471 (Fed. Cir. 1986). Indeed, the Federal Rules of Evidence provide a roadmap for ensuring that the evidence admitted during an administrative proceeding complies with the requirements of 5 U.S.C. § 556(d) and Rule 320, and is "reliable," "relevant," and "probative." Federal Rule of Evidence 802, "The Rule Against Hearsay," states that hearsay is inadmissible at trial, subject to limited exceptions.

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[1] Rule 320, as it applies to this matter, was recently amended by the Commission. *See* Final Rule, Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,230 (July 29, 2016) ("Amendments to Rules").

ARGUMENT

I. Exhibits Containing Unreliable Hearsay, Including Emails Authored By Individuals Not On The Division's Witness List, Should Be Excluded.

The Division attempts to admit a number of nontestimonial exhibits plagued by unreliability and multiple levels of hearsay. For example:

- Exhibit 129 appears to be a Natixis employee's notes from an investor call with Lynn Tilton. The author of these notes is unknown, the declarants of the various hearsay statements embedded in the notes are unknown, and no one from Natixis is on the Division's Amended Witness List.

- Exhibits 140 and 142 are emails exchanged between Lynn Tilton and Todd Kaloudis, discussing issues at Patriarch and the portfolio companies. Todd Kaloudis is not on the Division's witness list and is the author of statements that are plainly double hearsay (for example, "Moody's told us this month they no longer can estimate ratings on our collateral based on what we provide them with.").

- Exhibit 174 is an email exchange between Raina Patel and Susan Reed (Moody's) discussing Patriarch Partners. No one from Moody's is on the Division's Amended Witness List.

- Exhibit 184 is an email conversation between Barto von Stroe (Rabobank) and David Williams (Natixis). Neither von Stroe nor Williams are on the Division's Amended Witness List.

- Exhibit 190 is an email conversation between Thomas Ringel and Jason Cameron (Cutwater). In the email, Ringel reports what an S&P evaluator said about Zohar III. Ringel, Cameron, and this unnamed S&P evaluator are all absent from the Division's Amended Witness List.

These examples are only a few of the many exhibits that contain hearsay and bear insufficient indicia of reliability, including because they encompass multiple levels of hearsay and because declarants are in many cases not on the Division's Amended Witness List, as a

result of which the hearsay statements cannot be corroborated or subjected to cross-examination.[2]

In an administrative proceeding, "[m]ere uncorroborated hearsay . . . does not constitute substantial evidence." *Consol. Edison Co. v. NLRB*, 305 U.S. 197, 230 (1938); *see also* 5 U.S.C. § 556(d) (2012) (requiring that evidence in administrative proceedings be "reliable" and "probative"). The hearsay statements on the Division's exhibit list also do not bear a "satisfactory indicia of reliability so that its use is fair," as required by Amended Rule 320.

In its comments to the Amended Rule 320, the Commission noted that the admission of hearsay testimony should be evaluated for reliability on a case-by-case basis in light of "the motives or potential bias of the declarant; the availability and credibility of the declarant; . . . the

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[2] Other exhibits containing unreliable hearsay include Exhibits 25 & 36 (no indication of author), 54 (author is not on the Division's witness list), 75-88 (either author is not identified or is not on the Division's witness list), 137 (sender is not on the Division's witness list), 141 (double-hearsay emails written by authors not on the Division's list), 152 (same), 173 (same), 176 (same), 181 (sender and recipients are not on the Division's witness list), 192 (same), 193 (double-hearsay emails written by authors not on the Division's witness list). The Division's hearsay exhibits also include the thirteen investigative testimony transcripts (Exhibits 194-206) that are the subject of Respondents' separate Motion *in Limine* to Exclude Transcripts of Investigative Testimony, Including Division Exhibits 194 Through 206 (Sept. 1, 2016). For the reasons explained therein, as well as those discussed in the instant brief, those transcripts should not be admitted into evidence, in whole or in part. Indeed, in its opposition to that motion, the Division acknowledges that, "should it seek to admit the investigative testimony transcripts of any non-party witness, it must comply with the provisions of Rule 235(a)," which it has not done, and it represents that it "does not, at this point, intend to seek the introduction of such testimony . . . ." Division of Enforcement's Opposition to Respondents' Motion *in Limine* to Exclude Transcripts of Investigative Testimony, Including Division Exhibits 194 Through 206 (Sept. 9, 2016) at 1-2. With respect to Ms. Tilton's investigative testimony (Exhibits 202 & 203), however, the Division asserts that it has "not yet determined whether it will seek to admit [it]," *id.* at 3, and argues that it would be proper to do so under Amended Rule 235(b), *id.* The Division does not, however, explain how that rule justifies the wholesale admission of Ms. Tilton's entire investigative testimony simply because portions of it might be used "for any purpose," or why it would need to introduce that out-of-court testimony when Ms. Tilton will be testifying live at the hearing. *See id.*

availability of the missing witness and any attempts to compel witness testimony; and whether or not the hearsay is corroborated by other evidence in the record," among other considerations. *See* Amendments to Rules at 50,226-27.

These considerations plainly weigh in favor of excluding the hearsay the Division seeks to introduce. *First*, the Division has not asserted that the witnesses from whom it seeks to introduce hearsay statements are unavailable. These witnesses are, in fact, the opposite of the witnesses described in the comments to Amended Rule 320: they either will testify before Your Honor or would have testified had the Division called them to do so. It is inappropriate to permit the Division to strategically employ out-of-court statements that were not subject to cross-examination and strategically forgo its opportunity to elicit live testimony from the same individuals that would be subject to cross-examination before Your Honor. *Second*, the Division has made no effort to demonstrate that the hearsay is "corroborated by other evidence in the record." *Third*, it would plainly be prejudicial to Respondents to allow the introduction of such statements, especially where the Division has chosen not to call the declarants as witnesses.

The Division's attempt to introduce hearsay statements—and, in some cases, double hearsay—through uncorroborated, un-cross-examined, and mostly nontestimonial exhibits should not be permitted.

II. The Admission of Hearsay Evidence Without The Right To Cross-Examine Declarants Would Jeopardize Respondents' Due Process Rights.

Respondents in an adjudicative administrative proceeding are entitled to due process. *See Galvan v. Press*, 347 U.S. 522, 530-31 (1954) (finding the constitutional guarantees of substantive and procedural due process are fully applicable in administrative proceedings); *In re Gregory M. Dearlove*, Release No. 315, 2006 WL 2080012, at *55 (ALJ July 27, 2006) ("[T]he due process clause of the Constitution and the Administrative Procedure Act do ensure the

fundamental fairness of an administrative hearing."). Indeed, Respondents are entitled to "the full panoply' of safeguards" of due process, including the right to confront witnesses against them. *See In re Kevin Hall*, Exchange Act Release No. 3080, 2009 WL 4809215, at *22 & n.97 (Dec. 14, 2009) (quoting *Hannah v. Larche*, 363 U.S. 420, 442 (1960)) (distinguishing between investigative and adjudicative Commission proceedings and explaining that a witness's right of confrontation applies in the latter); *cf. In re Piper Capital Mgmt., Inc.*, Admin. Proc. Rulings Release No. 577, 1999 SEC LEXIS 301, at *18 (ALJ Jan. 15, 1999) (noting that where "people's professional reputations, careers and livelihoods are at stake . . . protecting Respondents' rights to due process is paramount").

While the Federal Rules do not apply in administrative hearings, that fact does not diminish Respondents' right to a fair hearing based on reliable evidence, including Respondents' right of confrontation. *See* Rules 300, 320, 326. Indeed, while ALJs may admit hearsay evidence pursuant to Rule 320 that would typically be excluded under the Federal Rules to the Respondents' detriment,[3] under Rule 326 Respondents have the right "to conduct such cross-examination as, in the discretion of the Commission or the hearing officer, may be required for a full and true disclosure of the facts." Further, "[t]he Administrative Procedure Act (APA) recognizes that the opportunity to cross-examine is an important safeguard of the accuracy and

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[3] The Rules afford respondents significantly fewer procedural safeguards than those provided in federal court, and deprive respondents of vital due process protections. For example, until the SEC's recent amendments to Rule 233, which do not apply in this case, an ALJ could not grant respondents' requests to take depositions for discovery purposes unless the ALJ found that it was "likely" that "the prospective witness . . . w[ould] be unable to attend or testify at the hearing because of age, sickness, infirmity, imprisonment, other disability, or absence from the United States." Rule 233(b). Moreover, Rule 360 forces administrative proceedings to be conducted on truncated timelines inappropriate for complex proceedings seeking to impose severe penalties. *See* Rule 360(a)(2).

completeness of testimony in agency adjudications." *See In re Barry C. Scutillo*, Release No. 183, 2001 WL 461287, at *31-32 (ALJ May 3, 2001) (excluding Division's proposed expert report because the expert was unavailable for cross-examination) (citing 5 U.S.C. § 556(d)). The admission of hearsay evidence, without the ability to subject the declarant to cross-examination, disregards this important safeguard for a fair trial. *See* 3 Wigmore on Evidence § 1018 (Chadbourn rev. 1974) (noting that "[t]he whole purpose of the Hearsay rule" is satisfied where the witness is "present and subject to cross-examination"); *see also California v. Green*, 399 U.S. 149, 155 (1970).

To achieve a full and fair adjudication of the facts at issue in this proceeding, Your Honor should exclude unreliable hearsay and require the Division instead to present live testimony from witnesses, subject to cross-examination.

CONCLUSION

For the reasons set forth above, Respondents respectfully move to preclude the Division from introducing into evidence any exhibits, or portions of exhibits, comprising hearsay, including (but not limited to) Exhibits 129, 140, 142, 174, 184, and 190.

Dated: New York, New York
September 12, 2016

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