

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of :  
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 :  
 LYNN TILTON, :  
 PATRIARCH PARTNERS, LLC, : Administrative Proceeding  
 : File No. 3-16462  
 PATRIARCH PARTNERS VIII, LLC, :  
 PATRIARCH PARTNERS XIV, LLC, and :  
 PATRIARCH PARTNERS XV, LLC : Judge Carol Fox Foelak  
 :  
 Respondents. :  
----- X

**DECLARATION OF GOUTAM U. JOIS IN SUPPORT OF RESPONDENTS'  
MOTION TO PARTIALLY STRIKE AND PRECLUDE**

I, Goutam U. Jois, under penalty of perjury, affirm as follows:

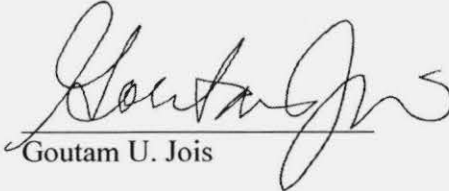
1. I am an associate in the law firm of Gibson, Dunn & Crutcher LLP, attorneys for the above-referenced Respondents. I submit this declaration in support of Respondents' Motion to Partially Strike and Preclude.

2. Attached hereto as Exhibit A is chart identifying the portions of the Rebuttal Report of Ira Wagner that Respondents request be stricken.

3. Attached hereto as Exhibit B is a true and correct copy of the Rebuttal Report of Ira Wagner, highlighted to indicate the specific portions that Respondents request be stricken.

4. I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated: New York, NY  
October 17, 2016

  
Goutam U. Jois

**References in the Rebuttal Report of Ira Wagner to  
Portions of the Report of Marti Murray that Have Been Withdrawn**

| Reference to the Report of Marti Murray   | Wagner Rebuttal Report Page(s) |
|---|--------------------------------|
| Acknowledges that this report was prepared in part in response to Murray's report.  | 2                              |
| Responds to Murray's opinion that "defaulting [a portfolio] company" would not be in the best interests of investors. Argues that contrary to Murray's opinion, Wagner's preferred loan categorization methodology does not require the exercise of default remedies. | 4; 62-63; 67                   |
| Responds to Murray's opinion that flexibility is required by the business strategy by claiming that the consequences of Wagner's preferred loan categorization methodology do not take away that flexibility.   | 63                             |
| Responds to Murray's opinion that Tilton's strategy is more typical of private equity funds by contending that the Zohar CLOs are structured transactions with different responsibilities to the investors.   | 6, 66-67                       |
| Quotes Murray's statement that Wagner's first report incorrectly assumes that loan modification is loan default.  | 38-39                          |
| Responds to Murray's statement that Wagner's first report assumes Zohar investors expect strict compliance with the Indenture.  | 62                             |
| Quotes Murray's statement that private equity funds require commitment of capital for long time periods with limited financial information disclosure.  | 68                             |
| Responds to and quotes Murray's statement that Wagner's initial report ignores the impact of the financial crisis.  | 73-74                          |

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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.

Rebuttal Expert Report of Ira Wagner  
August 31, 2015

## I. Summary Statement of Testimony and Opinions

All opinions and conclusions stated in this report are based on my extensive experience in CLOs, collateralized debt obligations (“CDOs”), and structured finance transactions generally, as described in my initial expert report dated July 10, 2015, the material I reviewed in preparing my initial expert report together with my review and analysis of the expert reports prepared by Mark Froeba (the “Froeba Report”), Glenn Hubbard (the “Hubbard Report”), Marti Murray (the “Murray Report”) and John Dolan (the “Dolan Report” and together the “Tilton Expert Reports”) and the additional documents listed in Appendix 1 (all of the foregoing, the “Reviewed Material”). I reserve the right to revise and update my opinions should new or additional information become available to me after the date of this report. In summary, I am providing the following rebuttal testimony and opinions:

**A. Tilton’s Experts do not offer any support for or justification of Tilton’s subjective and undisclosed methodology for the categorization of loans in the Zohar CLOs.**

Assets are required to be categorized in the Zohar CLOs based on objective criteria found in each transaction’s Indenture. An important element in determining the categorization of a loan is its payment status; a loan that has not made its contractual loan payment is to be “haircut” for the purposes of calculating the OC Ratio for each transaction. Instead of following the objective criteria, Tilton substituted a subjective and undisclosed methodology for categorizing loans based on whether she was continuing to provide “support” for a company and regardless of whether or not the borrower was making contractual payments of interest when due. Notably, none of Tilton’s Experts offer any support for this methodology and do not attempt to state it is permissible.



**B. Since they do not support Tilton's subjective categorization methodology, Tilton's Expert's unsuccessfully attempt to justify the results of Tilton's categorization methodology under the language of the Zohar Indentures.**

Since they cannot justify or support Tilton's subjective categorization of loans, Tilton's experts seek to justify how Tilton categorized the loans not based on what she actually did, but based on a misreading of the language of the Indenture. Froeba's justification rests on his view that the loans have been "amended" when a contractual payment of interest was not paid and the categorization should be based on the current, i.e. amended terms. But as discussed herein, the evidence shows that Tilton was not amending the loans when accepting less than the contractual amount of interest due:

(1) The terms of the loan before, on, and after the date that Tilton accepted less than contractual interest remained the same, as shown on the Trustee Reports;

(2) Tilton was not documenting the acceptance of less than contractual interest other than recording the amount, if any, received;

(3) Under the Zohar II and Zohar III Indentures, changes in the terms of the loans which resulted in a reduction in the rate of more than 3% had to be reported to the Rating Agencies, which Tilton did not do based on my review of an exemplar loan to American LaFrance ("ALF"); and

(4) In the regular submission of a package of information by Patriarch to the Rating Agencies for ALF at the time it was not making payments of the contractual amount of interest due (including periods in which no interest was being paid at all), the information included the terms of the loan showing full interest was due and that there was no forbearance of interest -- all indicating that no amendment of the loan had taken place. These packages also incorrectly showed the ALF loan to be current.

Froeba and Murray further argue that under the Indenture, an amendment is not in and of itself a default. This is irrelevant for two reasons: (1) Nowhere in my opinion or evaluation do I state that an amendment is by itself a default; and (2) as discussed previously, Tilton was not amending the loans when less than the contractually due amount of interest was received.

**C. Categorizing a loan as Category 1/Defaulted under the Indenture does not require Tilton to “default the company.”**

Murray’s opinion fundamentally confuses categorization of loans with the exercise of default remedies following the failure to make a contractual payment – “defaulting the company.” As I stated in my original report and reaffirm here, these are not the same thing. Proper categorization is independent of whether or not Tilton chooses to exercise such default remedies. There is no requirement in the Indenture to default the company if the loan is categorized as Category 1 in Zohar I and Zohar II and a Defaulted Investment in Zohar III (“Category 1/Defaulted”). Murray fails to recognize this important distinction, rendering her opinions in this matter not relevant to the question of the proper categorization of loans under the Indenture.

**D. Contrary to the opinions of Tilton’s Experts, properly categorizing loans in the Zohar CLOs is not inconsistent with the economics of Tilton’s Strategy. Tilton had flexibility to manage the portfolio even with the proper categorization of the loans.**

Hubbard argues that the categorization methodology that I put forward is inconsistent with the economics of Tilton’s investment strategy. It is not. The OC Tests included in the Zohar transactions are not set at hair-trigger levels as is implied by Hubbard’s argument. Rather, as discussed herein, there is large cushion in the OC Tests; a significant amount of defaults would have to take place before an event of default under the Indenture was reached. The remedy that would be hit first -- the redirection of cash flow to make principal payments to the Zohar debt investors instead of payments to Tilton of the subordinated management fees and

preferred share distributions -- does not take away the flexibility Murray states is required to manage the strategy. Additionally, Froeba and Hubbard undercut this argument by both discussing other provisions and features of the Zohar CLOs that would serve to provide Tilton with flexibility to manage the OC Ratios.

**E. The discussion of the Interest Coverage Test and the size of the cushion is not relevant to the proper categorization of loans.**

Hubbard and Froeba point to the Interest Coverage Test ("IC Test") level as an indicator of the expectation that the loans owned by the Zohar CLOs will not make their full payments of interest. As discussed herein, there are many other factors that can impact the IC Test, and the cushion is designed to handle all of these factors, not just the default in contractual payments. For example, the IC Ratio will vary based on the level of LIBOR, the yield at which investments can be acquired over the reinvestment period, the early payoff of higher yielding assets, and the mix of fixed and floating rate assets. The fact that there is a large cushion between the IC Ratio and the IC Test level is not relevant to the proper categorization of loans that have not made their contractual payment of interest under the Indenture.

**F. Tilton's Experts fail to consider the investors' interests in the Zohar CLOs, the protections they had in the Indentures, and the implications of their opinions for those protections.**

In my experience structuring and marketing CLOs, the objectives of both the Collateral Manager (for flexibility to implement its investment strategy) and the senior debt investors (for a low risk investment) have to be considered to successfully undertake a CLO transaction. These two interests are brought together in the terms of the transaction, which are documented in the Indenture. Specifically, the Indenture documents investment guidelines, permitted and prohibited Collateral Manager actions, and protections offered to investors. It is unreasonable to assume that a Collateral Manager pursuing a strategy involving risky speculative grade investments can



do so without limitation if funds are raised from investors in the CLO market. Rather, based on my experience, the Collateral Manager's discretion is balanced by protections to investors. In the Zohar CLOs, this is reflected in the Collateral Manager's flexibility to manage the assets, on the one hand, and features such as the the loan categorization methodology and OC Tests (to measure the performance of the assets), on the other hand. Yet, Tilton's Experts generally fail to consider the interests of the investors.

While Murray states that Tilton's strategy is more commonly found in private equity funds, the Zohar CLOs are not private equity funds. They are highly structured transactions designed to fund Tilton's strategy with debt that was designed to be of low risk and high investment quality and had covenants and terms, including the categorization of loans and the OC Tests designed for the protection of investors. As a result of raising money in the CLO market, Tilton took on obligations to the Zohar investors. By failing to properly categorize the assets, Tilton violated these obligations and benefitted through the payment of subordinated management fees and equity distributions while harming investors by denying them their contractual protections under the Indenture.

The opinions of Tilton's Experts on the breadth of Tilton's discretion essentially write out the protections that investors believed they had because, under Tilton's Experts' construction, the amount of assets that were not making their contractual payments would not impact the very test designed to measure that occurrence; there would be virtually no limit to the amount of non- or underperforming assets until an Indenture Event of Default occurred. By design, the OC Test is a protective and self-correcting mechanism designed to take effect before such an event occurs.



**G. The Investors did not have comprehensive information on the portfolio companies to value their Zohar CLO Investments.**

Dolan's statement that that "comprehensive information on the Zohar notes and the loans held by the Zohar funds was disclosed to investors"<sup>1</sup> is not supported by the evidence or the information made available to investors in the Trustee Reports. In fact, the investors knew little more than the names of the borrowers and the basic loan characteristics. Since these were generally not public companies, there was virtually no financial information on the companies available to investors; Tilton did not provide this information directly. The market conditions and ratings downgrades that Dolan claims investors could have monitored would only serve to alert investors to directional changes in the value of investments in the Zohar CLOs. Additionally, although the Zohar CLOs owned equity in the portfolio companies, the lack of information meant that it was not possible to actually value these investments or make a determination as to the timing of any receipts related to them. As a result, although Hubbard states that "[t]he nature of the Funds' collateral, which includes both debt and equity of portfolio companies...imply that the Funds' expected sources and timing of cash flows from their collateral is different from those of other CLOs,"<sup>2</sup> in reality the uncertainty and inability to value the equity and project the amount and timing of receipt of payments on the equity means, like all CLOs, investors would have to look to the Zohar debt investments as their source of payment.

**H. The Financial Crisis shows why the protections from properly categorizing the loans was important and would have protected investors.**

During the Financial Crisis, many of the Portfolio Companies failed to make their contractual payments of interest on multiple payment dates yet did not get categorized as Category 1/Defaulted. The protections of the OC Test built into the Indentures are designed to

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<sup>1</sup> Dolan Report, Section IX.

<sup>2</sup> Hubbard Report, ¶24.

take effect in just such an event; yet throughout the crisis, by failing to properly categorize the loans, the OC Ratios did not hit their test levels and Tilton continued to receive the subordinated management fees and preferred share distributions.

## II. Categorization of Loans in Zohar CLOs

**Tilton's experts fail to address the reality of how Tilton was treating loans that failed to pay current interest and the implications for categorization.**

1. As discussed in my initial Report, the categorization of assets in the Zohar CLOs is based on objective and clear criteria set out in the CLO's Indentures. An important element in determining the categorization of a loan in the Zohar CLOs is its payment status; a loan that has not made its contractual loan payment on a timely basis is to be "haircut" for the purposes of calculating the OC Ratio. Under the Indentures, Tilton had only limited downward discretion to categorize an asset as Category 1/Defaulted.<sup>3</sup> She did not have discretion to treat a loan that had not paid its contractual loan payments as anything other than Category 1/Defaulted. Yet that is what she did, according to her own testimony.

2. *In her testimony, Tilton repeatedly explained her approach to the categorization of the assets as subjective and reflective of her support for the company:*

"...the categories, we have discretion over choosing the categories."<sup>4</sup>

"...we did look through the definition of a Category 4. It's not insolvency, it's not a default; but it's otherwise waived or modified by Section 7.7(a). It's you know not in a formal bankruptcy or restructure, and that we don't believe it will have a declining credit quality based on our support over the passage of time."<sup>5</sup>

"Q: And why is that, that in and of itself, the agreement to pay less than full interest would not change the category?"

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<sup>3</sup> See Wagner Report ¶54.

<sup>4</sup> Tilton Testimony (6/24/2014) 89:1 - 2.

<sup>5</sup> *Id.*, 122:18 - 24.

A: Because the categorizations are based on the *belief in the future recovery and the reorganization*, not based on how much interest is collected. The categorizations are based on the *belief in the ultimate reasonableness of the recovery and the future*.<sup>6</sup>

“Or Category 4, we are still giving it our financial support, our efforts, and there’s a reasonable chance of a turnaround.”<sup>7</sup>

“...this really comes down to the fact do we believe with additional funding and additional strategic and operational support that the company performance will improve over the passage of time.”<sup>8</sup>

In summary, Tilton’s approach, ignoring the plain language of the Indentures, and which she herself admitted is subjective, rests primarily on the view that she has discretion over both (1) the decisions and actions of the lender with regards to the borrower pursuant to Indenture Section 7.7(a) and (2) the categorization of assets based on her subjective decision to “believe in” and continue to provide “support” for a company.

3. None of Tilton’s Experts offered a reading of the Indenture that supports Tilton’s subjective approach to the categorization of loans or stated that her approach is correct. While Tilton’s Experts discuss the importance of the flexibility Tilton has to manage assets, none of them even attempts to justify a discretionary approach to categorizing the assets based on her support of the company.

4. Since they cannot and do not attempt to provide a basis for Tilton’s subjective approach to the categorization of assets, Tilton’s Experts instead unsuccessfully attempt to provide a theoretical justification for not categorizing assets that have not made their contractual payments under the objective criteria of the Indenture as written.

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<sup>6</sup> *Id.*, 88:14 – 21.

<sup>7</sup> Tilton Testimony (2/12/2013) 171:5 – 7.

<sup>8</sup> Tilton Testimony (6/24/2014) 122:11 – 15.



## Analyzing the Payment Status and Current Terms of the Loans

5. Froeba hypothesizes that, had Tilton been “amending” the terms of the loans, it would be these amended loan terms that would govern the categorization of assets. *However, there is overwhelming evidence that Tilton was not amending the loans, but rather was simply accepting less than the contractually required interest payment on various loans – an action that required Tilton to categorize those loans as Category 1/Defaulted under the clear language of the Zohar Indentures.*

6. As an initial matter, Froeba clearly does not refute the application of the plain language of the Indenture; instead he takes a position that an amended loan should be evaluated under the objective criteria of the Indenture on its current terms in evaluating whether it should be categorized as a default as discussed in his report:

The Wagner Report affirms that CLOs categorize loans based on objective criteria...However, it ignores that a loan amendment could, by changing the current terms of the loan, also change the categorization of that loan under the CLO’s rules.<sup>9</sup>

7. It cannot be understated that Froeba is accepting both the plain language of the Indenture and that the Zohar transactions categorize loans based on objective criteria; he therefore is also rejecting Tilton’s understanding and subjective approach to loan categorization. He is changing the discussion at hand from whether the categorization language is objective (which he concedes that it is) and whether Tilton’s subjective categorization is the proper approach (which he does not claim it is) to whether a loan has been “amended” when Tilton has accepted less than the contractual amount of interest due.

8. Froeba’s opinions rest on his assertion that the default status of a loan should be based on its “amended” i.e., current terms. He further incorrectly claims that I argue that loan

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<sup>9</sup> Froeba Report, ¶80.



amendments are not effective for purposes of determining whether a payment default has occurred in the Zohar CLOs.<sup>10</sup> In fact, I made no such argument. Based on my experience in structuring and marketing CLOs, in evaluating whether a loan should be categorized as Category 1/Defaulted for purposes of the Indenture I would consider the relevant Indenture definitions, the written terms of the loan, the payment status of the loan, entries made by Patriarch in its internal loan tracking system, the Trustee Reports, actions taken by Tilton, and the current loan terms. My review of that evidence confirms that Tilton was not “amending” loan terms, and therefore confirms my opinion that loans that paid less than the contractual amount of interest due should have been categorized as Category 1/Defaulted. (In addition, as will be discussed below, Froeba spends considerable time in his report on an irrelevant position in this matter – that an amendment is not in and of itself a reason to categorize an asset as Category 1/Defaulted. No such provision exists in the Zohar Indentures and consequently, this is not a position that I took in my report.)

9. In my experience, in order to understand the terms of a loan I would first look at the underlying loan documents, including any documents that amended the terms of the loan from those at origination. However, as Tilton herself testified, the acceptance of reduced or missed payments was rarely documented. The only “documentation” was in the recordation of the amount of the payment made in Patriarch’s system:

Q: And who ultimately makes the decision to accept less than the contractual amount of interest?

A: Generally it would be me.

Q: Is that decision documented somewhere?

A: The decision is always documented in the actual payment that the company makes, and listed in the Trustee Report by CDO obligation; but from time to time, there are formal documents that amend, that defer, that waive, or that forgive.

Q: What dictates when there will be a formal document?

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<sup>10</sup> *Id.*, ¶12.

A: Often when there's, you know, a true change in the contractual rate or if there's forgiveness; but generally, I can't tell you the exact instances. But it's also documented in our Loan Operation System, and it – I believe it's also documented in the trustee's Loan Operation System.

Q: How is it documented in the Loan Operation System – Patriarch's?

A: By the difference between the calculation of the contractual rate, versus the received. And when there a change of the contractual rate or formal forgiveness, then it will often be re-documented into the system and calculated going forward.<sup>11</sup>

10. The above testimony from Tilton undercuts Froeba's argument that the terms of the loan were "amended" when Tilton accepted less than the contractually required interest payment. Tilton herself states that there will be a formal document when there is "*a true change in the contractual rate.*" She then goes on to state the decision to accept less than the contractual rate is documented by "*the difference between the calculation of the contractual rate, versus the received.*" Thus, in fact the acceptance of less than the contractual payment is not an amendment to the current terms of the loan; the borrower has just paid less than the required amount and Tilton received and accepted it.

11. In contrast with Froeba, who views the acceptance of less than the contractual payments an amendment, Tilton herself lacks specificity in what the acceptance of a lower or missed payment actually is, using the words amend, waive, defer, or forgive interchangeably, concluding that when there's not a formal agreement, *it could probably fall into any category:*

Q: When you say that loan agreements are amended by "course of conduct", what do you mean by that?

A: Any time we accept less interest than the contractual rate, we basically amended that agreement on collection. By 7.7-A, we are agreeing *to defer, to waive, to forgive, to amend* that agreement of contractual rate of interest.<sup>12</sup>

And subsequently:

Q: Okay. And then what's the difference between a waiver or a deferral or a forbearance? You used all those terms—

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<sup>11</sup> Tilton Testimony (6/24/2014) 58:4 – 19.

<sup>12</sup> *Id.*, 61:6 – 12.

A: Oh, because *sometimes they're similar, sometime they're distinct*. Sometimes, you know, we'll just waive the – you know, part of the interest. Sometimes it will be deferred and expected to be paid late – you know, in the next period. Sometimes it's deferred for a very long period, but will be paid when the company is in a different position of performance. What was the last one?

Q: Forbearance.

A: Forbearance. Sometimes, you know, to me, you know, forbearance, you know, is another form of waiver; but sometimes the forbearance agreement will be just to – for a period of time to reduce, but we expect them to come back in the short term. So it really is about duration and it is about expectation of company performance and ability to pay.

Q: And when a company does not pay, is the concept of whether it's a waiver, versus a deferral or forbearance – is that captured somewhere?

A: Sometimes. From time-to-time it will be a formal agreement that will, you know, edify one of the many choices.

Q: Okay. What about when there's not a formal agreement?

A: *It probably could fall into any category.*<sup>13</sup>

In sum, Tilton's own testimony is strong evidence that she was not "amending" the terms of a loan when that loan paid less than the contractual amount of interest due.

#### **Example – ALF Term Loan coded 855-11**

12. To further assess whether Tilton was "amending" loan terms, I conducted an analysis of a loan to American LaFrance ("ALF") coded 855-11 from Zohar II and Zohar III. I focused on the period from January 2009 through April 2010 (the "Review Period"), a period in which there were numerous dates for which contractual interest was not paid as described below. This review shows that: (1) Tilton was not amending the loans when contractual payments of interest were not made, but rather was simply accepting less than the contractual amount of interest due; and (2) there was no change to the contractual terms of the loan because the terms were the same before, on, and after the dates the contractual amount of interest due was not received. Additionally, as described below under the heading "Credit Estimate Process," Tilton was required to request a new credit estimate (a "Credit Estimate"), the process for obtaining a rating on a company that does not have a publicly monitored rating, following an amendment

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<sup>13</sup> *Id.*, 66:16 – 67:18.



that reduced the interest rate on a loan by more than 3% or waived the payment. I found that, during the Review Period, no such request was made in connection with the failure to pay the contractual amount of interest due by the borrower and acceptance of the payment by Tilton.

### **Loan Documents, Payments and Amendments**

13. I began reviewing ALF 855-11 by reading the relevant loan document – the Amended and Restated Credit Agreement dated as of July 17, 2008 for ALF (the “Credit Agreement”). According to the Credit Agreement, the original loan terms had a floating rate of interest of LIBOR + 8%, with payments of interest due monthly.<sup>14</sup> For purposes of calculating the rate, there was a floor on the level of LIBOR of 2%.<sup>15</sup> In other words, the rate on the loan while these terms were in force would not be less than 10%.

14. I next reviewed the payments on this loan to Zohar II and Zohar III as listed in spreadsheets extracted from Patriarch’s system and provided to the Division (“Patriarch Spreadsheets”). Although the terms of this loan call for monthly payments, the spreadsheets show that no payments were received at all during the Review Period after 7/1/09 until 4/7/10 in Zohar II, and after 3/1/09 until 3/5/10 in Zohar III. Throughout this period, the interest rate on this loan was 10%. At 10%, monthly interest for the amount of the loan owned would be approximately \$374,582 for Zohar II and \$744,733 for Zohar III (adjusted slightly for the calculation being based on the actual number of days in a month and assuming a year of 360 days, as stated in the Credit Agreement). Thus, if the loan was paying interest under the contractually-required terms, there would be payments of approximately those amounts each month. Comparing the amounts actually paid in the tables below with the amount of interest that

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<sup>14</sup> PP100206 – 7. The loan was changed to quarterly pay and the margin was reduced in June 2011 pursuant to written amendment of the loan. These changes were noted in the Trustee Reports for dates following the relevant amendments.

<sup>15</sup> PP100197.



would be contractually due shows that for all the payment dates but one during the Review Period (the January 2009 payment for Zohar II), the contractual amount of interest due was not paid. Below are the spreadsheets submitted to the Division in their entirety for this loan:

Zohar II

| Facility | Portfolio | Name     | Effective | Type <sup>16</sup> | Amount          |
|----------|-----------|----------|-----------|--------------------|-----------------|
| 855-11   | Zohar 2   | American | 7/17/08   | P                  | \$44,949,848.59 |
| 855-11   | Zohar 2   | American | 8/1/08    | INT_PAY            | \$196,281.01    |
| 855-11   | Zohar 2   | American | 9/1/08    | INT_PAY            | \$392,140.61    |
| 855-11   | Zohar 2   | American | 9/1/08    | INT_PAY            | \$417,896.24    |
| 855-11   | Zohar 2   | American | 9/1/08    | REV_INT_PAY        | \$392,140.61    |
| 855-11   | Zohar 2   | American | 9/1/08    | REV_INT_PAY        | \$12,877.82     |
| 855-11   | Zohar 2   | American | 10/1/08   | REV_INT_PAY        | \$392,140.61    |
| 855-11   | Zohar 2   | American | 10/1/08   | INT_PAY            | \$392,140.60    |
| 855-11   | Zohar 2   | American | 10/1/08   | INT_PAY            | \$392,140.61    |
| 855-11   | Zohar 2   | American | 11/1/08   | INT_PAY            | \$453,024.55    |
| 855-11   | Zohar 2   | American | 12/1/08   | INT_PAY            | \$418,455.00    |
| 855-11   | Zohar 2   | American | 1/1/09    | INT_PAY            | \$387,068.14    |
| 855-11   | Zohar 2   | American | 2/1/09    | WAIVE_INT_PAY      | \$304,473.81    |
| 855-11   | Zohar 2   | American | 3/1/09    | WAIVE_INT_PAY      | \$275,008.60    |
| 855-11   | Zohar 2   | American | 3/25/09   | WAIVE_INT_PAY      | \$275,008.60    |
| 855-11   | Zohar 2   | American | 3/25/09   | WAIVE_INT_PAY      | \$29,465.20     |
| 855-11   | Zohar 2   | American | 4/1/09    | REV_INT_PAY        | \$212,504.11    |
| 855-11   | Zohar 2   | American | 4/1/09    | INT_PAY            | \$212,504.11    |
| 855-11   | Zohar 2   | American | 4/1/09    | INT_PAY            | \$239,790.00    |
| 855-11   | Zohar 2   | American | 5/1/09    | INT_PAY            | \$200,000.00    |
| 855-11   | Zohar 2   | American | 7/1/09    | INT_PAY            | \$250,000.00    |
| 855-11   | Zohar 2   | American | 4/7/10    | INT_PAY            | \$229,170.19    |
| 855-11   | Zohar 2   | American | 7/7/10    | INT_PAY            | \$6,864.57      |
| 855-11   | Zohar 2   | American | 10/6/10   | INT_PAY            | \$171,614.19    |
| 855-11   | Zohar 2   | American | 1/7/11    | INT_PAY            | \$171,614.19    |
| 855-11   | Zohar 2   | American | 4/7/11    | INT_PAY            | \$171,614.19    |
| 855-11   | Zohar 2   | American | 1/9/12    | REV_INT_PAY        | \$1,877.76      |
| 855-11   | Zohar 2   | American | 1/9/12    | INT_PAY            | \$18,777.65     |
| 855-11   | Zohar 2   | American | 1/9/12    | REV_INT_PAY        | \$18,777.65     |
| 855-11   | Zohar 2   | American | 1/9/12    | INT_PAY            | \$1,877.76      |

<sup>16</sup> According to the testimony of Karen Wu, a Vice President for Structured Finance at Patriarch, the entry "WAIVE\_INT\_PAY" was an entry "to reduce the interest amount. It doesn't mean it was waived. That's just how it was labeled." (Wu Testimony (April 10, 2014), 135:6-8.) She also stated that "REV\_INT\_PAY" "has the same effect." (*Id.*, 135:23.) Wu was not questioned about the entry INT\_PAY, which I assume means the interest paid by the borrower.

|        |         |          |          |         |             |
|--------|---------|----------|----------|---------|-------------|
| 855-11 | Zohar 2 | American | 1/9/12   | INT_PAY | \$1,877.76  |
| 855-11 | Zohar 2 | American | 4/10/12  | INT_PAY | \$1,806.93  |
| 855-11 | Zohar 2 | American | 7/10/12  | INT_PAY | \$17,490.21 |
| 855-11 | Zohar 2 | American | 8/8/12   | INT_PAY | \$-         |
| 855-11 | Zohar 2 | American | 9/6/12   | INT_PAY | \$-         |
| 855-11 | Zohar 2 | American | 10/10/12 | INT_PAY | \$1,734.10  |
| 855-11 | Zohar 2 | American | 11/7/12  | INT_PAY | \$-         |
| 855-11 | Zohar 2 | American | 1/9/13   | INT_PAY | \$17,965.10 |

Zohar III

| Facility | Portfolio | Name     | Effective | Type            | Amount          |
|----------|-----------|----------|-----------|-----------------|-----------------|
| 855-11   | Zohar 3   | American | 7/17/08   | WAIVE_PRINC_PAY | \$0.01          |
| 855-11   | Zohar 3   | American | 7/17/08   | S               | \$0.02          |
| 855-11   | Zohar 3   | American | 7/17/08   | P               | \$89,367,980.78 |
| 855-11   | Zohar 3   | American | 8/1/08    | INT_PAY         | \$390,240.18    |
| 855-11   | Zohar 3   | American | 9/1/08    | INT_PAY         | \$779,642.54    |
| 855-11   | Zohar 3   | American | 9/1/08    | INT_PAY         | \$805,245.85    |
| 855-11   | Zohar 3   | American | 9/1/08    | REV_INT_PAY     | \$779,642.54    |
| 855-11   | Zohar 3   | American | 10/1/08   | INT_PAY         | \$779,642.54    |
| 855-11   | Zohar 3   | American | 11/1/08   | INT_PAY         | \$1,749,062.95  |
| 855-11   | Zohar 3   | American | 11/1/08   | REV_INT_PAY     | \$848,372.72    |
| 855-11   | Zohar 3   | American | 12/1/08   | INT_PAY         | \$831,960.05    |
| 855-11   | Zohar 3   | American | 1/1/09    | WAIVE_INT_PAY   | \$605,345.96    |
| 855-11   | Zohar 3   | American | 2/1/09    | WAIVE_INT_PAY   | \$605,345.96    |
| 855-11   | Zohar 3   | American | 3/1/09    | WAIVE_INT_PAY   | \$546,764.09    |
| 855-11   | Zohar 3   | American | 3/1/09    | INT_PAY         | \$123,514.55    |
| 855-11   | Zohar 3   | American | 3/1/09    | INT_PAY         | \$250,000.00    |
| 855-11   | Zohar 3   | American | 3/1/09    | INT_PAY         | \$25,000.00     |
| 855-11   | Zohar 3   | American | 3/5/10    | INT_PAY         | \$250,000.00    |
| 855-11   | Zohar 3   | American | 6/4/10    | INT_PAY         | \$17,746.13     |
| 855-11   | Zohar 3   | American | 12/7/10   | INT_PAY         | \$165,523.79    |
| 855-11   | Zohar 3   | American | 3/7/11    | INT_PAY         | \$170,934.62    |
| 855-11   | Zohar 3   | American | 6/7/11    | INT_PAY         | \$50,575.81     |
| 855-11   | Zohar 3   | American | 6/8/11    | INT_PAY         | \$23,602.04     |
| 855-11   | Zohar 3   | American | 9/7/11    | INT_PAY         | \$36,982.65     |
| 855-11   | Zohar 3   | American | 12/7/11   | INT_PAY         | \$3,802.87      |
| 855-11   | Zohar 3   | American | 3/7/12    | INT_PAY         | \$3,802.87      |
| 855-11   | Zohar 3   | American | 6/6/12    | INT_PAY         | \$14,450.91     |
| 855-11   | Zohar 3   | American | 7/10/12   | INT_PAY         | \$-             |
| 855-11   | Zohar 3   | American | 8/8/12    | INT_PAY         | \$-             |
| 855-11   | Zohar 3   | American | 9/6/12    | INT_PAY         | \$3,799.92      |
| 855-11   | Zohar 3   | American | 10/10/12  | INT_PAY         | \$-             |
| 855-11   | Zohar 3   | American | 11/7/12   | INT_PAY         | \$-             |
| 855-11   | Zohar 3   | American | 12/6/12   | INT_PAY         | \$18,984.23     |
| 855-11   | Zohar 3   | American | 1/9/13    | INT_PAY         | \$-             |

15. After seeing that full contractual interest was not being paid during the Review Period, I reviewed the documented amendments to the loan from origination through April 2010 to see if there were any changes to the interest payment terms of the loan. There were 10 such amendments during this period representing the First through the Tenth Amendment to the Credit Agreement for ALF. None of these amendments dealt with the missed interest payments presented above or changed the interest payment terms of the loan. Rather, in each case, they documented new drawings and loans under the Credit Agreement. In contrast, in the spring of 2011, there were a series of amendments that, among other things, changed the payment frequency on the loans to quarterly, the margin on the loan to 0% for one year, and the LIBOR floor to 1%, resulting in a 1% interest rate on the loan following June 2011.

#### **Trustee Reports**

16. I turned next to the terms of the ALF Loan as reported in the Trustee Reports for the Review Period. Specifically, I reviewed the reported terms for the interest component of loans in which Tilton accepted less than the contractual amount of interest due to see if those terms had been "amended" in the Trustee Reports. As described below, I found that they were not.

17. As a threshold matter, I assume the Trustee reports were accurate with respect to loan terms. As part of the process of preparing the monthly reports for Zohar II and Zohar III, the Indentures require the Collateral Manager to compare the information in the reports with respect to the loans with the information contained in its records, and within three business days after receipt of such monthly report, notify the Issuer and the Trustee if the information contained in the report does not conform to the information maintained by the Collateral Manager. If there is a discrepancy that cannot be worked out between the Trustee and the



Collateral Manager, there is a process to have an independent accountant review and if there is an error in the report, it is required to be revised.<sup>17</sup> As a result, I assumed that the reports were accurate and any inaccuracies or errors were resolved according to this process.

18. Because the Trustee Reports for Zohar I do not include the individual payments of interest made by the borrowers, I used Zohar II and Zohar III for my evaluation. The Trustee Report for August 31, 2008 for Zohar II and for July 31, 2008 for Zohar III confirm the holdings for the ALF Loan and the interest payment terms as stated in the Credit Agreement.<sup>18</sup> These reports confirm the principal balance owned by each CLO, the spread (or margin) of 8.000%, and the payment frequency. In addition, for Zohar II, the report indicated the All-In Rate, the Cash Coupon and the Non-Cash Pay Interest Rate; for Zohar III, the report indicated the Coupon and Non-Cash Pay Rate.<sup>19</sup>

19. Below is an excerpt from the August 2008 Trustee Report for Zohar II following the origination of ALF 855-11. The relevant loan is shown in the line item "855-11" under the heading "Category 4" indicating this loan is categorized in Category 4. For Zohar II, based on the Index at the time of the Trustee Report of 2.46380% and the Spread of 8.0000%, the All-In-Rate and Cash Coupon for the loan are 10.46380%. The Non-Cash Pay Interest Rate is zero and the Payment Frequency is monthly. These terms agree with the terms of the Credit Agreement.

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<sup>17</sup> See Article 10 of each of the Zohar Indentures.

<sup>18</sup> I reviewed the August 2008 Report for Zohar II because the date of information for the Zohar II July 2008 Report was July 9, 2008, before the date of the Credit Agreement, and thus the ALF Loan was not included on the July 2008 Report.

<sup>19</sup> The "All-In Rate" is the full rate of interest being charged, equal to the index plus the applicable spread on the loan. The "Cash Coupon" is the amount of the applicable interest rate that is payable in cash. The Non-Cash Pay Rate would indicate any amount of interest that would accrue but not be paid on a current basis. There is no Non-Cash Pay Rate for this loan and accordingly the amount shown is "0." For Zohar III, the "Cash Coupon" column is not present, but because it shows the Coupon and the Non-Cash Pay Rate, based on my experience, the Cash Coupon would be equal to the Coupon minus the Non-Cash Pay Rate.



| Current Asset Characteristics II |                      |                           |             |             |                  |                 |                |                |             |                            |                   |
|----------------------------------|----------------------|---------------------------|-------------|-------------|------------------|-----------------|----------------|----------------|-------------|----------------------------|-------------------|
| Security I.D.                    | Funded Balance       | Unfunded Exposure Balance | PIK Balance | Coupon Type | Applicable Index | Index Rate      | Spread         | All-in-Rate    | Cash Coupon | Non-Cash Pay Interest Rate | Payment Frequency |
| <b>Category 1</b>                |                      |                           |             |             |                  |                 |                |                |             |                            |                   |
| 825_20                           | 5,611,337.51         | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Quarterly         |
| 825_27                           | 151,000.00           | 99,000.00                 | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Monthly           |
| 825_18                           | 35,015,402.36        | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Quarterly         |
| 148_02                           | 1,662,652.79         | -                         | -           | Floating    | LIBOR (6 months) | 3.83000%        | 2.00000%       | 5.83000%       | 5.83000%    | -                          | Monthly           |
| 148_01                           | 5,381,497.43         | -                         | -           | Floating    | LIBOR (6 months) | 3.83000%        | 2.00000%       | 5.83000%       | 5.83000%    | -                          | Monthly           |
| 148_03                           | 2,738,576.91         | -                         | -           | Floating    | LIBOR (6 months) | 3.83000%        | 2.00000%       | 5.83000%       | 5.83000%    | -                          | Monthly           |
| 149_01                           | 8,496,255.40         | -                         | -           | Floating    | LIBOR (6 months) | 3.83000%        | 2.00000%       | 5.83000%       | 5.83000%    | -                          | Monthly           |
| 141_06                           | 2,446,169.63         | -                         | -           | Floating    | LIBOR (6 months) | 2.99000%        | 2.00000%       | 4.99000%       | 4.99000%    | -                          | Semiannual        |
| <b>Totals / Wtd Avg:</b>         | <b>61,903,162.05</b> | <b>99,000.00</b>          | -           |             |                  | <b>2.88610%</b> | <b>5.9614%</b> | <b>8.8279%</b> |             |                            |                   |
| <b>Category 4</b>                |                      |                           |             |             |                  |                 |                |                |             |                            |                   |
| 830_04                           | 29,936,949.53        | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Monthly           |
| 991_06                           | -                    | 2,000,000.00              | -           | Floating    | LIBOR (1 month)  | -               | 4.50000%       | -              | -           | -                          | Monthly           |
| 001_03                           | 260,500.00           | 2,800,000.00              | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 4.50000%       | 6.96380%       | 6.96380%    | -                          | Monthly           |
| 001_04                           | 8,504,532.00         | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 4.50000%       | 6.96380%       | 6.96380%    | -                          | Monthly           |
| 855_05                           | 1,195,872.16         | 143,000.00                | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Monthly           |
| 855_11                           | 44,949,846.59        | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 8.00000%       | 10.46380%      | 10.46380%   | -                          | Monthly           |
| 895_01                           | 67,000,000.00        | -                         | -           | Floating    | LIBOR (6 months) | 2.46380%        | 9.00000%       | 11.46380%      | 11.46380%   | -                          | Semiannual        |
| 826_19                           | 18,400,467.69        | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 9.00000%       | 11.46380%      | 11.46380%   | -                          | Quarterly         |
| 826_15                           | 1,800,000.00         | -                         | -           | Floating    | LIBOR (1 month)  | 2.46380%        | 9.00000%       | 11.46380%      | 11.46380%   | -                          | Quarterly         |

20. Next is an excerpt from the July 2008 Trustee Report for Zohar III following the origination of ALF 855-11. The relevant loan is shown in the line item "855-11" under the heading "Category 4" indicating this loan is categorized in Category 4. For Zohar III, based on the Index at the time of the Trustee Report of 2.48% and the Spread of 8.0000%, the Coupon for the loan is 10.4800%. The Non-Cash Pay Interest Rate is zero (resulting in a Cash Coupon equal to the Coupon of 10.4800%) and the Payment Frequency is monthly. These terms agree with the terms of the Credit Agreement.

Current Asset Characteristics - Part II

| Security I.D.                               | Funded Balance          | Unfunded Exposure    | PIK Balance | Fixed / Float | Applicable Index | Index   | Spread   | Coupon   | Non-Cash Pay Rate | Payment Frequency |
|---|-------------------------|----------------------|-------------|---------------|------------------|---------|----------|----------|-------------------|-------------------|
| <b>Second Lien Collateral Investment</b>    |                         |                      |             |               |                  |         |          |          |                   |                   |
| 902_03                                      | -                       | 16,000,000.00        | -           | Floating      | LIBOR (1 month)  | -       | -        | -        | -                 | Semi-Annually     |
| 990_04                                      | -                       | 6,790,697.67         | -           | Floating      | LIBOR (1 month)  | -       | -        | -        | -                 | Semi-Annually     |
| 914_02                                      | -                       | 20,700,000.00        | -           | Floating      | LIBOR (1 month)  | -       | -        | -        | -                 | Semi-Annually     |
| 945_03                                      | -                       | 10,900,000.00        | -           | Floating      | LIBOR (1 month)  | -       | -        | -        | -                 | Semi-Annually     |
| 059_09                                      | 12,970,590.00           | -                    | -           | Floating      | LIBOR (1 month)  | 2.4800% | -        | 2.4800%  | -                 | Semi-Annually     |
| <b>Sub Total:</b>                           | <b>\$ 12,970,590.00</b> | <b>58,490,697.67</b> | <b>-</b>    |               |                  |         |          |          |                   |                   |
| <b>Senior Secured Collateral Investment</b> |                         |                      |             |               |                  |         |          |          |                   |                   |
| 030_04                                      | 10,000,000.00           | -                    | -           | Floating      | LIBOR (1 month)  | 2.4800% | 12.0000% | 14.4800% | -                 | Monthly           |
| 030_06                                      | 3,894,736.84            | -                    | -           | Floating      | LIBOR (1 month)  | 2.4800% | 6.5000%  | 8.9800%  | -                 | Monthly           |
| 938_06                                      | -                       | 3,473,654.21         | -           | Floating      | LIBOR (1 month)  | -       | 6.5000%  | -        | -                 | Monthly           |
| 991_05                                      | -                       | 3,157,694.74         | -           | Floating      | LIBOR (1 month)  | -       | 6.5000%  | -        | -                 | Monthly           |
| 855_10                                      | -                       | 1,777,341.17         | -           | Floating      | N/A              | -       | -        | -        | -                 | N/A               |
| 855_12                                      | 10,793,844.34           | 6,747,201.13         | -           | Floating      | LIBOR (1 month)  | 2.4800% | 8.0000%  | 10.4800% | -                 | Monthly           |
| 855_11                                      | 85,367,980.77           | -                    | -           | Floating      | LIBOR (1 month)  | 2.4800% | 8.0000%  | 10.4800% | -                 | Monthly           |

21. In the tables presented below, I summarize the information reported for ALF 855-11 from the Trustee Reports for each month during the Review Period. Throughout the Review Period, LIBOR had fallen below the 2% floor and as a result, the interest rate on the loan, based on the loan's original terms, would have been 10%. As shown below, the reported interest rate on the loan was in fact 10% throughout the Review Period. Put another way, *there was no change to the terms of the loan reported in the Trustee Reports for either Zohar II or Zohar III.*

22. As noted above, for the 10% rate in effect throughout this period, monthly interest for the amount of the loan owned would be approximately \$374,582 for Zohar II and \$744,733 for Zohar III (adjusted slightly for the calculation being based on the actual number of days in a month and assuming a year of 360 days, as stated in the Credit Agreement). Thus, if the loan was paying interest under the contractually-required terms, there would be payments of approximately those amounts each month. As the tables below make clear, that did not occur.<sup>20</sup>

<sup>20</sup> A comparison of the tables below with the information in the Patriarch Spreadsheets, above, show differences between the dates payments were received by Tilton and dates payments were received by the Trustee. For example, in Zohar II, the Patriarch Spreadsheets show \$200,000

Indeed, in many months, no interest was paid at all. Yet this loan was categorized as a Category 4 throughout this time period in Zohar II and not listed as a Defaulted Investment in Zohar III. Even so, the interest rate listed in the Trustee Report remained at 10% -- it did not change to reflect these lower or non-existent payments. In addition, the shaded cells show months where the payment would result in an interest rate more than 3% below the contractual rate. As discussed below, had Tilton been amending the loans by reducing the interest rate by more than 3%, or waiving the payment, she would have been required to apply for a new Credit Estimate for this loan. However, I did not see any such requests for a new Credit Estimate in connection with the failures to make the contractual interest payment.

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was received on 5/1/09 and \$250,000 on 7/1/09. The Trustee Reports show the \$200,000 as received on 7/7/09 and the \$250,000 on 10/6/09. Similarly, for Zohar III, the Patriarch Spreadsheets show \$123,514.55, \$25,000 and \$250,000 all being received on 3/1/09 but the Trustee Reports show \$123,514.55 being received on 6/8/09, \$250,000 on 9/8/09, \$25,000 on 12/8/09. I could not find an explanation for these discrepancies.



Zohar II

| Trustee Report Date | Balance    | Category | Payment   | Date of Receipt | Index Rate | Spread | All-in Rate | Cash Coupon | Non-Cash Pay Interest Rate | Payment Frequency |
|---------------------|------------|----------|-----------|-----------------|------------|--------|-------------|-------------|----------------------------|-------------------|
| Jan-09              | 44,949,849 | 4        | 1,258,547 | 7-Jan           | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Feb-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Mar-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Apr-09              | 44,949,849 | 4        | 239,790   | 8-Apr           | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| May-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Jun-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Jul-09              | 44,949,849 | 4        | 200,000   | 7-Jul           | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Aug-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Sep-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Oct-09              | 44,949,849 | 4        | 250,000   | 6-Oct           | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Nov-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Dec-09              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Jan-10              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Feb-10              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Mar-10              | 44,949,849 | 4        | 0         |                 | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |
| Apr-10              | 44,949,849 | 4        | 229,170   | 7-Apr           | 2.00       | 8.00   | 10.00       | 10.00       | 0.00                       | Monthly           |

Zohar III

| Trustee Report<br>Date | Balance    | Listed as<br>Defaulted,<br>Non-Current or<br>Non-<br>Performing? | Payment | Date of<br>Receipt | Index | Spread | Coupon | Non-Cash<br>Pay Rate | Payment<br>Frequency |
|------------------------|------------|--|---------|--------------------|-------|--------|--------|----------------------|----------------------|
| Jan-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Feb-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Mar-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Apr-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| May-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Jun-09                 | 89,367,981 | No   | 123,515 | 8-Jun              | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Jul-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Aug-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Sep-09                 | 89,367,981 | No   | 250,000 | 8-Sep              | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Oct-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Nov-09                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Dec-09                 | 89,367,981 | No   | 25,000  | 8-Dec              | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Jan-10                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Feb-10                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Mar-10                 | 89,367,981 | No   | 250,000 | 5-Mar              | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |
| Apr-10                 | 89,367,981 | No   | 0       |                    | 2.00  | 8.00   | 10.00  | 0.00                 | Monthly              |

23. In contrast with the fact that the Trustee Reports showed no changes to the terms of the loan throughout the Review Period, following the 2011 amendments to the loan discussed previously (amendments that changed the payment frequency to quarterly, the margin to zero and the floor on LIBOR to 1%), I found that these changes were accurately reflected in the subsequent Trustee Reports. *This is further evidence that Tilton was not amending or changing the terms of the loans when she accepted less than the contractually required interest payment.*

24. Froeba incorrectly states that “the Mayer Report effectively contradicts the OIP and the Wagner Report. In its analysis, the Mayer Report...derives its information about the interest due on these loans from Patriarch and/or the Trustee reports. In particular, the Mayer Report relies upon stated loan terms *as reported to the Trustee* and bases its default categorization conclusions on variations between stated loan terms and interest collected.”<sup>21</sup> As outlined above, the way Froeba describes Mayer’s analysis is exactly the same way that I analyzed it. Additionally, in this paragraph, Froeba acknowledges that in evaluating the interest payments one can rely on the terms reported in the Trustee Report but then goes on to inexplicably state that the Mayer Report implicitly accepts “amendments that change stated interest (and perhaps payment frequency within a quarterly period), but not for amendments that might change other payment terms which might nevertheless impact default behavior.”<sup>22</sup> The calculation of the contractual amount of interest due is a straightforward calculation based on the amount of the loan, the interest rate, and the payment frequency. If the Trustee Reports are correct with regards to these items (and as described above, it is reasonable to assume that they are), that is all one needs to know to calculate the contractual amount of interest due. In order to

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<sup>21</sup> Froeba Report, ¶81.

<sup>22</sup> *Id.*



have a lower amount contractually due, or no payment contractually due at all, one or more of these reported terms would have to change.

### **Credit Estimate Submissions**

25. The last place I looked for evidence of amendments to the terms of the loans was in the required submissions to the rating agencies pursuant to the Indentures for Zohar II and Zohar III. Both the Zohar II and Zohar III Indentures contain provisions that require Patriarch to request a new Credit Estimate from both S&P and Moody's on assets that do not have a monitored public rating in a number of circumstances, including following a reduction in the interest rate of the loan or the waiver of interest. (These provisions are not present in Zohar I). Specifically, both the Zohar II and III Indentures require the Issuer or the Collateral Manager on its behalf to promptly apply for a new rating whenever one of the following events, among others, occurs: (a) a reduction by more than 3.00% per annum in the rate of interest payable; or (b) a change in, or waiver of, the interest rate resulting in a deferral or capitalization of interest by more than 3.00% per annum. In addition, in the Zohar III Indenture, with regards to a restructuring of any loan that materially modifies the economic terms on which the most recent corporate credit estimate from S&P was based, the Issuer or the Collateral Manager on its behalf must apply to S&P for a corporate credit estimate 14 days prior to the restructuring taking effect.<sup>23</sup> Based on these provisions, if in fact Tilton was amending, waiving, or modifying the terms of a loan by accepting less than the contractual amount of interest, I would expect to see submissions to S&P for new Credit Estimates. I did not see any such submission following the

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<sup>23</sup> See Zohar II Indenture Definition of Moody's Rating, pp. 50-51 and Definition of Rating, pp. 54-55 and Zohar III Indenture Definition of Moody's Rating, pp. 38-39 and Definition of Rating, p. 50.

failure to pay contractual interest (in fact the failure to pay any interest on some monthly due dates) during the Review Period.

26. I did find and review a submission from Patriarch to S&P dated April 5, 2010 on ALF. Rather than being submitted as part of the process stated above, it appears to be part of the regular submissions of financial information required to maintain the Credit Estimates assigned to companies that do not have a publicly monitored rating. This submission further supports the fact that there were no amendments taking place in connection with the acceptance by Tilton of less than the contractual interest due. In addition, this information appears to contain information that is not correct as to the payment status of the loans to ALF.

27. The table below presents the loans outstanding to ALF and information on the loans as listed in the submission,<sup>24</sup> as well as the last interest payment made pursuant to the Patriarch Spreadsheets for the loan. The table shows that *although ALF had not made interest payments on the loans listed since July 1, 2009 or earlier, they are all listed as current. Additionally, the Current Cash Pay Rate listed is the full rate of interest of Libor + 8.0% being charged on the loans.* The most recent amendment listed, the 10<sup>th</sup> Amendment dated January 8, 2010, agrees with what I found reviewing the amendments and is not related to unpaid interest as of that date, but instead to additional draws made on the Credit Facility. As stated earlier, none of the nine prior amendments relate to unpaid interest either, but also to additional draws.<sup>25</sup>

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<sup>24</sup> S&P-SEC-PATRIARCH 031301 – 031302 and S&P-SEC-PATRIARCH 031303 – 031402.

<sup>25</sup> The first loan listed in the table below – denoted as Term Loan – is the ALF 855-11 loan discussed in detail above. In addition, I have confirmed the most recent interest payment date for the other ALF loans listed on the submission.

| <i>Name of Loan or Security:</i> | <i>Term Loan</i> | <i>Revolver</i> | <i>Delayed Draw</i> | <i>Term Loan B</i> | <i>Term Loan</i> | <i>DDTL A</i> | <i>DDTL B</i> | <i>DDTL C</i> |
|----------------------------------|------------------|-----------------|---------------------|--------------------|------------------|---------------|---------------|---------------|
|----------------------------------|------------------|-----------------|---------------------|--------------------|------------------|---------------|---------------|---------------|

**Information from Submission to S&P**

|                                    |                  |                  |                  |                  |                  |                  |                  |                  |
|------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Current Credit Agreement/Amendment | 10th Amendment   | 10th Amendment   | 10th Amendment   | 10th Amendment   | 10th Amendment   | 10th Amendment   | 10th Amendment   | 10th Amendment   |
| Date of Latest Amendment           | 1/8/10           | 1/8/10           | 1/8/10           | 1/8/10           | 1/8/10           | 1/8/10           | 1/8/10           | 1/8/10           |
| Latest Forbearance #               | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] |
| Date of Latest Forbearance         | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] |
| Expiration of Latest Forbearance   | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] | [None Indicated] |
| Libor Margin                       | 8.00             | 8.00             | 8.00             | 6.25             | 8.00             | 8.00             | 8.00             | 8.00             |
| Interest Payment Status            | Current          | Current          | Current          | Current          | Current          | Current          | Current          | Current          |
| Current Rate Option                | Libor            | Libor            | Libor            | Libor            | Libor            | Libor            | Libor            | Libor            |
| Current Contractual Rate           | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     | Libor + 6.25%    | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     |
| Current Cash Pay Rate              | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     | Libor + 6.25%    | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     | Libor + 8.0%     |

**Information from Patriarch Payment Spreadsheets**

|                                   |        |        |        |        |                                    |                                    |                                    |                                    |
|-----------------------------------|--------|--------|--------|--------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Most recent interest payment date | 7/1/09 | 4/1/09 | 3/1/09 | 2/1/09 | No interest paid since origination | No interest paid since origination | No interest paid since origination | No interest paid since origination |
|-----------------------------------|--------|--------|--------|--------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|



28. Below are excerpts of the submission to S&P that are the source of the summary information above.

Amendment and Forbearance Information<sup>26</sup>

| American LaFrance, LLC            | 100-01  | 100-02  | 100-03  | 100-04  | 100-05  | 100-06  | 100-07  | 100-08  |
|-----------------------------------|---|---|---|---|---|---|---|---|
| Name of Loan or Security          | Term Loan   | Revolver  | Delayed Draw  | Term Loan B   | Term Loan   | DDTL A  | DDTL B  | DDTL C  |
| Outstanding on Closing Date?      | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     | O/S on Closing Date                                     |
| Acq Date for After-Acquired Asset |   |   |   |   |   |   |   |   |
| CLO Classification of Asset       | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              | Collateral Debt Obligation                              |
| Obligor(s)                        |   |   |   |   |   |   |   |   |
| Currency                          | US Dollars  | US Dollars  | US Dollars  | US Dollars  | US Dollars  | US Dollars  | US Dollars  | US Dollars  |
| Priority and Security             | Senior Secured  | Senior Secured  | Preferred   | Senior Secured  | Senior Secured  | Senior Secured  | Senior Secured  | Senior Secured  |
| Type of Commitment                | Term  | Revolving   | Term  | Term  | Term  | Term  | Term  | Term  |
| Original Date of Facility         | 7/17/08   | 7/17/08   | 7/17/08   | 7/17/08   | 7/17/08   | 7/17/08   | 7/17/08   | 7/17/08   |
| Form of Syndication/Placement     | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             | Single Lender Middle Market                             |
| Special (100MM) Loan Agreement    | Yes   | Yes   | Yes   | Yes   | Yes   | Yes   | Yes   | Yes   |
| Current Credit Agreement/Amend    | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement | 10th Amendment to Amended and Restated Credit Agreement |
| Date of Latest Amendment          | 1/8/10  | 1/8/10  | 1/8/10  | 1/8/10  | 1/8/10  | 1/8/10  | 1/8/10  | 1/8/10  |
| Latest Forbearance #              |   |   |   |   |   |   |   |   |
| Date of Latest Forbearance        |   |   |   |   |   |   |   |   |
| Expiration of Latest Forbearance  |   |   |   |   |   |   |   |   |

Interest Rate and Payment Information<sup>27</sup>

| American LaFrance, LLC  | 100-01       | 100-02       | 100-03        | 100-04       | 100-05       | 100-06       | 100-07       | 100-08       |
|---|--------------|--------------|---------------|--------------|--------------|--------------|--------------|--------------|
| Name of Loan or Security  | Term Loan    | Revolver     | Delayed Draw  | Term Loan B  | Term Loan    | DDTL A       | DDTL B       | DDTL C       |
| Libor Margin - 3% if Libor/Floor (Base Rate if no LIBOR option) | 3.00%        | 3.00%        | 3.25%         | 3.00%        | 3.00%        | 3.00%        | 3.00%        | 3.00%        |
| Prime Margin - 3.50% (Base Rate if no LIBOR option)             | 3.50%        | 3.50%        | 3.50%         | 3.50%        | 3.50%        | 3.50%        | 3.50%        | 3.50%        |
| Acq'd Default Interest Margin                                   | 2.00%        | 2.00%        | 2.00%         | 2.00%        | 2.00%        | 2.00%        | 2.00%        | 2.00%        |
| Revolving Commitment Fee  |              |              |               |              |              |              |              |              |
| Letters Of Credit Commissions                                   |              |              |               |              |              |              |              |              |
| Interest Payment Status   | Current      | Current      | Current       | Current      | Current      | Current      | Current      | Current      |
| Interest Payment Deferral Date                                  |              |              |               |              |              |              |              |              |
| CURRENT RATE OPTION   | Libor        | Libor        | Libor         | Libor        | Libor        | Libor        | Libor        | Libor        |
| CURRENT Contracted Rate   | Libor + 3.3% | Libor + 3.0% | Libor + 3.25% | Libor + 3.0% | Libor + 3.0% | Libor + 3.3% | Libor + 3.0% | Libor + 3.0% |
| CURRENT Cash Flow Rate  | Libor + 3.3% | Libor + 3.0% | Libor + 3.25% | Libor + 3.0% | Libor + 3.0% | Libor + 3.3% | Libor + 3.0% | Libor + 3.0% |

<sup>26</sup> S&P-SEC-PATRIARCH 031312

<sup>27</sup> S&P-SEC-PATRIARCH 031313

29. Similarly, in September of 2009, Patriarch submitted an information package for ALF to Moody's.<sup>28</sup> This also appeared to be part of the regular periodic submission of financial information and not made in connection with the failure to make a contractual payment of interest due. Below are excerpts of the submission to Moody's.

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<sup>28</sup> MIS-SEC-CLO 0010849 and MIS-SEC-CLO 0010850 – 0011001.



Amendment and Forbearance Information<sup>29</sup>

| American LaFrance, LLC            | 100-01   | 100-02   | 100-03   | 100-04   | 100-05   | 100-06   | 100-07   |
|-----------------------------------|--|--|--|--|--|--|--|
| Name of Loan or Security          | Term Loan  | Revolver   | Delayed Draw   | Term Loan B  | Term Loan  | CDTL A   | CDTL B   |
| Outstanding on Closing Date?      | O/S on Closing Date                                    | O/S on Closing Date                                    | O/S on Closing Date                                    | O/S on Closing Date                                    | O/S on Closing Date                                    | O/S on Closing Date                                    | O/S on Closing Date                                    |
| Acq Date for After-Acquired Asset |  |  |  |  |  |  |  |
| CLC Classification of Asset       | Collateral Debt Obligation                             | Collateral Debt Obligation                             | Collateral Debt Obligation                             | Collateral Debt Obligation                             | Collateral Debt Obligation                             | Collateral Debt Obligation                             | Collateral Debt Obligation                             |
| Obligor(s)                        |  |  |  |  |  |  |  |
| Currency                          | US Dollars   | US Dollars   | US Dollars   | US Dollars   | US Dollars   | US Dollars   | US Dollars   |
| Priority and Security             | Senior Secured   | Senior Secured   | Preferred  | Senior Secured   | Senior Secured   | Senior Secured   | Senior Secured   |
| Type of Commitment                | Term   | Revolving  | Term   | Term   | Term   | Term   | Term   |
| Original Date of Facility         | 7/17/2008  | 7/17/2008  | 7/17/2008  | 7/17/2008  | 7/17/2008  | 7/17/2008  | 7/17/2008  |
| Form of Syndication/Placement     | Single Lender Middle Market                            | Single Lender Middle Market                            | Single Lender Middle Market                            | Single Lender Middle Market                            | Single Lender Middle Market                            | Single Lender Middle Market                            | Single Lender Middle Market                            |
| Current Credit Agreement/Amend    | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement | 8th Amendment to Amended and Restated Credit Agreement |
| Date of Latest Amendment          | 8/7/2009   | 8/7/2009   | 8/7/2009   | 8/7/2009   | 8/7/2009   | 8/7/2009   | 8/7/2009   |
| Latest Forbearance #              |  |  |  |  |  |  |  |
| Date of Latest Forbearance        |  |  |  |  |  |  |  |
| Expiration of Latest Forbearance  |  |  |  |  |  |  |  |

Interest Rate and Payment Information<sup>30</sup>

| American LaFrance, LLC  | 100-01       | 100-02       | 100-03        | 100-04       | 100-05       | 100-06       | 100-07       |
|---|--------------|--------------|---------------|--------------|--------------|--------------|--------------|
| Name of Loan or Security  | Term Loan    | Revolver     | Delayed Draw  | Term Loan B  | Term Loan    | CDTL A       | CDTL B       |
| Libor Margin - 0% if Libor-Fix (leave blank if no LIBOR option) | 8.00%        | 8.00%        | 6.25%         | 8.00%        | 8.00%        | 8.00%        | 8.00%        |
| Swap Margin - 0% if Swap-Fix (leave blank if no LIBOR option)   | 9.50%        | 9.50%        | 7.50%         | 9.50%        | 9.50%        | 9.50%        | 9.50%        |
| Add Default Interest Margin                                     | 2.00%        | 2.00%        | 2.00%         | 2.00%        | 2.00%        | 2.00%        | 2.00%        |
| Revolving Commitment Fee  |              |              |               |              |              |              |              |
| Letter of Credit Commissions                                    |              |              |               |              |              |              |              |
| Interest Payment Status   | Current      | Current      | Current       | Current      | Current      | Current      | Current      |
| Interest Payment Default Date                                   |              |              |               |              |              |              |              |
| CURRENT RATE OPTION   | Libor        | Libor        | Libor         | Libor        | Libor        | Libor        | Libor        |
| CURRENT Contractual Rate  | Libor + 8.0% | Libor + 8.0% | Libor + 8.25% | Libor + 8.0% | Libor + 8.0% | Libor + 8.0% | Libor + 8.0% |
| CURRENT Cash Pmt Rate   | Libor + 8.0% | Libor + 8.0% | Libor + 8.25% | Libor + 8.0% | Libor + 8.0% | Libor + 8.0% | Libor + 8.0% |

<sup>29</sup> MIS-SEC-CLO 0010857

<sup>30</sup> MIS-SEC-CLO 0010858

30. In this submission, Patriarch indicated the most recent amendment was the 6<sup>th</sup> Amendment dated 8/7/2009; this amendment documented an increase in the amount of loans outstanding under the Credit Agreement and did not have any reference to the failure to make a contractual interest payment. Like the report submitted to S&P, this report also showed that: (1) there was no amount of forbearance; (2) interest due on the loans was current and (3) the cash payment rate was the full coupon at which interest was accruing on the loans. These statements were not true based on the payment status of the loans.

31. In sum, based on my review of the ALF 855-11 loan, (1) there were numerous payment periods when the contractual payment was either missed or not paid in full; (2) there was no documentation of a change in or amendment to loan terms related to the missed or reduced interest payments; (3) the Trustee Reports showed no change in loan terms during these payment periods; and (4) there were no requests for new Credit Estimates as required by the Zohar II and Zohar III Indentures. *Based on my experience, this evidence overwhelmingly shows that Tilton was not "amending" loans when she accepted less than the full interest due and Froeba's argument that these "amended terms" are what should be used to determine the proper categorization under the Indenture is invalid.* Rather, the evidence shows that Tilton as lender chose not to exercise her rights following an event of default under the Credit Agreement, a decision she has the authority to make. However, this does not change the required categorization of the loan under the Indenture.

32. As a result, working through the Indenture definitions and the reported current loan terms, for the dates in the Review Period, the loan should have been properly categorized as Category 1 for Zohar II and a Defaulted Investment for Zohar III. For all the dates observed, the

ALF 855-11 loan was improperly categorized as Category 4 in Zohar II and not listed as a Defaulted Investment in Zohar III.

33. The evidence also undermines Froeba's claim that "all of the parties with responsibility for monitoring the Zohar CLOs have received regular reports reflecting amendments to the underlying loans."<sup>31</sup> In fact, the Credit Estimate submission to S&P in April 2010 and Moody's in June 2009 appear to have hidden the fact that contractual interest payments were not being made.

34. In addition to the review of the ALF Loan described above, I reviewed the Patriarch Spreadsheets and the Trustee Reports for one loan held by Zohar II for each of the other 14 Portfolio Companies that were provided to me by the Division.<sup>32</sup> My review was of the same Review Period described above. Similar to the ALF Loan, I found the following:

- (1) Each of the loans had multiple payment dates in which the contractual amount of interest due was not paid and one or more dates in which no interest was paid at all.
- (2) The Trustee Reports showed that the Cash Coupon was the same as the All-In Rate, indicating that the full amount of contractual interest was due in cash.
- (3) Each loan was a Category 4 on dates when the contractual amount of interest due was not paid.

35. In sum, based on my experience in and knowledge of the industry, it is my assessment that Tilton was not amending the loans and that CLO investors would not consider Tilton's actions to be amendments; she was simply receiving less than the required interest and taking no action as a result. Instead of properly categorizing the loan as Category 1/Defaulted,

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<sup>31</sup> Froeba Report, ¶11.

<sup>32</sup> I reviewed the following loans: Amweld 816-02, Galey 808-10, Global 188-25, Hartwell 802-12, Heritage 864-02, Intera 092-08, LVD 854-01, MAV 845-03, MD 851-02, Natura 868-09, NetVersant 841-05, Petry 077-10, and Scan Optics 078-05.



she then used her subjective categorization methodology to keep loans as Category 4 in Zohar II and out of the Defaulted Investment category for Zohar III because, presumably, she had determined to continue to believe in and support the underlying companies. Since there is no amendment of the loans, Froeba's opinion and discussion that an amended loan should be evaluated on its current terms is simply not relevant.

#### **Meaning and Purpose of Indenture Section 7.7a**

36. Tilton's experts also quote portions of Section 7.7a of the Zohar Indentures in an attempt to justify Tilton's categorization practice. Indeed, Froeba embellishes the provision with words that are not there ("even to avoid a default").<sup>33</sup> I repeat here the entire provision, because it is important to examine what exactly it says and what are its implications.

The Zohar Obligors (or the Collateral Manager on behalf of such Person) may, without the consent of the Holders of any Notes or the Credit Enhancer, enter into any amendment, forbearance or waiver of or supplement to any Underlying Instrument included in the Collateral, so long as such amendment, forbearance, waiver or supplement does not contravene the provisions of any Transaction Document or contravene any applicable law or regulation. For the avoidance of doubt and notwithstanding anything else contained herein, the parties hereto acknowledge and agree that the Collateral Debt Obligations will consist of stressed and distressed loans that may be the subject of extensive amendment, workout, restructuring and/or the other negotiations and, as a consequence thereof, the Issuer or the Zohar Subsidiary may receive by way of amendments, modifications, exchanges and/or supplements to such Collateral Debt Obligations, Equity Kickers, Equity Workout Securities and/or the relevant Underlying Instruments (i) interests in loans, debt securities, letters of credit or leases that do not satisfy the provisions of the definition of "Collateral Debt Obligation" and/or the Eligibility Criteria and/or (ii) Equity Workout Securities.<sup>34</sup>

37. Reading the provision in its entirety shows that the emphasis is not on the ability of the Collateral Manager to enter into any amendment, forbearance or waiver of or supplement to the terms of the Collateral, but rather to clearly inform the parties to the transaction that as a

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<sup>33</sup> Froeba Report, ¶57.

<sup>34</sup> Zohar I Indenture, p. 120. The same provision is included in the Zohar II and Zohar III Indentures.

consequence of the nature of the collateral and the negotiations of the Collateral Manager, the CLO may receive securities that do not meet the Indenture definitions of "Collateral Debt Obligation," the "Eligibility Criteria" and/or "Equity Workout Securities."

38. In his report, Froeba states,

Wagner does not explain why the parties to the Zohar Indentures would have added such unique and explicit language if it does no more than describe discretion that the Collateral Manager already enjoys without the language. He ignores the compelling inference that they added this language to make it clear that they were expanding the Collateral Manager's discretion and not simply to describe it. Wagner himself acknowledges that Patriarch bargained for this provision (See Wagner Report ¶19).<sup>35</sup>

39. This is simply not the case. As I stated in my report at ¶45, *what is unique about the provision is "what is being expressly acknowledged in the provision – that as a consequence of an amendment, workout or restructuring, the CLO may receive various securities that do not satisfy the Indenture requirements to acquire and hold securities."* This is indeed unique; in my experience, most other CLOs would be more constrained in their ability to receive and hold securities that do not meet the Indenture definitions of "Collateral Debt Obligation," the "Eligibility Criteria" and/or "Equity Workout Securities".<sup>36</sup> In fact, as discussed below, transactions cited by Froeba support this statement.

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<sup>35</sup> Froeba Report, ¶62.

<sup>36</sup> Further, I did not acknowledge, as Froeba states, that Patriarch bargained for this provision in my report. This is ¶19 of my report in its entirety:

In my experience, the Indenture is a carefully negotiated document among all the parties to the transaction. The Indenture generally goes through numerous rounds of review and comments before it is completed. In addition to the signatories to the Indenture and their counsels, the Underwriter, Collateral Manager, Rating Agencies, and each of their counsels, will be involved in the negotiation of the terms of the Indenture. In some CDO transactions, investors and their counsel will also participate in reviewing and commenting on the Indenture. Great care is taken to make sure the Indenture accurately states how the CDO is intended to work throughout the life of the transaction.



40. While Froeba states that he “does not recall having seen a similar provision [to 7.7a] in any other CLO,”<sup>37</sup> in fact the Offering Memorandum for the NewStar Credit Opportunities Funding II transaction (“NewStar”), put forward by Froeba for comparison with the Zohar transactions, states that the Issuer or the Collateral Manager on its behalf has essentially the same rights to amend or modify loans as in the Zohar CLOs. In the Risk Factors, the NewStar Offering Memorandum states:

*Limited Control of Administration and Amendment of Debt Obligations.* The Issuer, or the Collateral Manager on its behalf, will exercise or enforce, or refrain from exercising or enforcing, any or all of its rights in connection with the Debt Obligation or any related documents or will refuse amendments or waivers of the terms of any Debt Obligation and related documents in accordance with the portfolio management practices and the standard of care specified in the Collateral Management Agreement and certain provisions of the Indenture. The Issuer’s ability to change the terms of the Debt Obligations will generally not otherwise be restricted by the Indenture. The Noteholders will not have any right to compel the Issuer to take or refrain from taking any actions other than in accordance with its portfolio management practices and the standard of care specified in the Collateral Management Agreement.

The Issuer, or the Collateral Manager, on its behalf, may, subject to the underlying documents and in accordance with the applicable provisions of the Collateral Management Agreement and the Indenture, extend or defer the maturity, or adjust the outstanding balance of any Debt Obligation, or otherwise amend, modify or waive the terms of any related underlying document, including the payment terms thereunder. Any amendment, waiver or modification of a Debt Obligation could postpone the expected maturity of the Notes and/or reduce the likelihood of timely and complete payment of interest or principal under the Notes.<sup>38</sup>

41. The Zohar III Offering Memorandum includes virtually the same Risk Factor, even including its title:

*Limited Control of Administration and Amendment of Collateral Investments.* The Issuer will exercise or enforce, or refrain from exercising or enforcing, any or all of its rights in

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In other words, this paragraph in my report was a general statement about the drafting process for a CLO Indenture. I did not discuss here the specific drafting history of the Zohar CLOs.

<sup>37</sup> Froeba Report, ¶58.

<sup>38</sup> NewStar Credit Opportunities Funding II Ltd Offering Memorandum dated December 12, 2007, pp. 74 – 75.



connection with the Collateral Investments or any related documents or will refuse amendments or waivers of the terms of any Collateral Investments or any related documents or will refuse amendments or waivers of the terms of an Collateral Investment and related documents in accordance with its portfolio management practices and the standard of care specified in the Indenture. The Issuer's ability to change the terms of the Collateral Investments will not otherwise be restricted by the Indenture. The Class A Noteholder will not have any right to compel the Issuer to take or refrain from taking any actions other than in accordance with its portfolio management practices and the standard of care specified in the Indenture.

The Issuer may, in accordance with its portfolio management standards and subject to the transaction documents, extend or defer the maturity, or adjust the outstanding balance of any Collateral investment, or otherwise amend, modify or waive the terms of any related loan agreement, including the payment terms thereunder. Any amendment wiaver of modification of a Collateral Investment could postpone the expected maturity of the Notes and/or reduce the likelihood of timely and complete payment of interest or principal under the Class A Notes.<sup>39</sup>

42. NewStar does have a provision, more typical of CLOs, that requires it to sell certain securities it may receive in connection with the workout or restructuring of a loan. The NewStar Offering Memorandum states the following:

Except as otherwise provided in the Indenture, the Issuer will be required to use commercially reasonable efforts to sell any Equity Workout Security within two years after receipt thereof (or within two years after such alter date as such security may first be sold in accordance with its terms and to the extent permitted by applicable law); provided that the foregoing will not apply to any Equity Workout Securiry receive in exchange for a defaulted Obligation if the market value of all other proceeds received by the Issuer with respect to such Defaulted Obligation equals or exceeds the aggregate of the Principal Balances of the Debt Obligation that became such Defaulted Obligation. Any other security or other consideration received pursuant to an exchange offer or otherwise upon foreclosure that is not a Debt Obligation or an Eligible Investment is to be sold within one year after the Issuer's receipt thereof (or within one year of such later date as such security or other consideration may first be sold in accordance with its terms and applicable law).<sup>40</sup>

Such a provision is not present in the Zohar CLOs, which supports my opinion about what in fact is unique in the Zohar Indentures' Section 7.7a – it gives Patriarch the right to acquire and hold

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<sup>39</sup> Zohar III Offering Memorandum, pp. 46 - 47.

<sup>40</sup> NewStar Offering Memorandum p. 187.

(rather than the obligation to sell) otherwise ineligible securities received in connection with an amendment, workout, or restructuring.

43. *In sum, the comparison of these two transactions confirms that Patriarch's discretion to amend, etc. loans is not unique; what is unique and therefore disclosed and documented is the ability in the Zohar transactions to obtain and hold securities that would otherwise be ineligible and in other CLOs would be required to be sold.*<sup>41</sup>

44. The risk factor stated in the Zohar III Offering Memorandum also supports my view on the purpose of 7.7a stating exactly what I said makes the provision unique:

*Workouts and Restructurings.* The Collateral is expected to include a material amount of stressed and distressed loans that may be the subject of extensive amendment, workout, restructuring and other negotiations and, as a consequence thereof, the Issuer or the Zohar Subsidiary may (as a result of amendments, modifications, exchanges and/or supplements to such Collateral, Equity Kickers and the relevant Underlying Instruments) receive interests in loans, debt securities, letters of credit or leases that do not satisfy the provisions of the definition of "Collateral Investment" and the Eligibility Criteria referred to herein.<sup>42</sup>

**Tilton's Experts' Discussion of whether an Amendment is by itself a Default under the Indenture is not relevant to this matter.**

45. Froeba spends a considerable amount of his report discussing the fact that there is no provision to treat an amendment as a default under the Zohar Indentures, "rebutting" a point that I did not make or imply because such a provision is not present in the Zohar transactions. In her report, Murray also repeats Froeba's incorrect assertion by saying that I am basing my conclusion on the "unsubstantiated assumption that a loan with modified payment terms is by

<sup>41</sup> Like NewStar, the GSC Partners Gemini Fund Limited transaction ("Gemini"), also cited by Froeba in his report, has a provision requiring the sale of equity and defaulted securities under a range of time frames from 5 days to 3 years from the date in which it is legally able to be sold. Gemini Offering Memorandum pp. 84-85.

<sup>42</sup> Zohar III Offering Memorandum, p. 41.

definition a defaulted loan.”<sup>43</sup> In evaluating the proper categorization of an asset that did not make its contractual payment, I did not automatically base the categorization on whether the loan had been amended to avoid default, as Froeba and Murray imply I did.

46. Moreover, Froeba’s discussion of the terms of other CLOs regarding amended loans does not refute my point that loans that have not paid their contractual interest should be haircut for purposes of the OC Ratio. Froeba cites 3 CLOs -- Colts 2005-2 Limited (“Colts”), Gemini, and NewStar -- and states “explicit language was added to a CLO’s defaulted security definition to address sole-lender risk and make clear that an amended loan should be categorized as a defaulted security.”<sup>44</sup> In fact, Froeba is wrong. That provision is only present in two of the three transactions cited. Additionally, Froeba does not discuss how these definitions interact with the provisions to haircut loans for purposes of each transaction’s OC Test. Separate and apart from the provision Froeba talks about, all three transactions separately provide for loans that have not made their contractual interest payments to be haircut – the same requirement that exists in the Zohar CLOs.

47. As an initial matter, Froeba is wrong about one of the examples - Gemini does not have the provision to treat an amendment as a default. In Gemini, the definition cited by Froeba, refers not to an amendment at all but to a “distressed exchange or other debt restructuring where the Issuer or obligor of such Collateral Debt Obligation *has issued to the debt holder a new security or package of securities.*”<sup>45</sup> In other words, this definition applies only to a situation in which a new security or package of securities has been issued, not when an existing loan has been amended.

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<sup>43</sup> Murray Report, ¶51.

<sup>44</sup> Froeba Report, ¶71.

<sup>45</sup> Gemini, p. 146.



48. Indeed, like the Zohar CLOs, Gemini *does* define a Defaulted Obligation to include an asset which has not made its contractual payment of interest or principal. The definition of Defaulted Obligations for the Gemini transaction includes an asset in which “there has occurred and is continuing, for the lesser of 3 Business Days and any applicable grace period (as the case may be, ‘the cure period’) a default with respect to the payment of interest or principal, provided, however, a Collateral Debt Obligation shall constitute a Defaulted Obligation only until such payment default has been cured...”<sup>46</sup> The OC Ratio (in the Gemini transaction, the Par Value Ratio) calls for haircutting all Defaulted Obligations as defined in that transaction.<sup>47</sup> Therefore, in Gemini, as in the Zohar CLOs, an asset that had not made its contractual payment or cured such failure would be haircut.

49. Although the NewStar and Colts transactions do have provisions regarding amendments to loans, Froeba fails to discuss or consider the larger point as to how these provisions interact with the haircutting of an asset for purposes of those transactions’ overcollateralization tests. As discussed here, for each of these transactions, the payment status is an independent part of the determination as to what will receive a haircut, regardless of whether there was a loan amendment. For both NewStar and Colts, a loan that fails to make its contractually required interest payment must be haircut.

50. In NewStar, assets that meet the definition of Defaulted Obligations are haircut for the purpose of calculating the transaction’s overcollateralization ratio. In addition to including loans that meet the defined term “Restructured Obligation,” (which includes a loan amended to avoid a default), the definition of a Defaulted Obligation also includes an asset that

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<sup>46</sup> *Id.*, p. 145.

<sup>47</sup> *Id.*, p. 81.

has defaulted as to the scheduled payment of interest.<sup>48</sup> Thus, in the NewStar CLO, as in the Zohar CLOs, a loan that fails to make its contractual payment of interest must be haircut for purposes of the OC Ratio.

51. In Colts, while it is true that that a Defaulted Loan includes a loan that would be delinquent but for any amendment or modification, the relevant definition for what is haircut does not include the defined term of Defaulted Loan at all. Instead, the relevant definition for calculating the loan balance for the purpose of the transaction's Overcollateralization Ratio is "Aggregate Outstanding Loan Balance," which refers more broadly to loans that are "delinquent by more than 5 days in any portion of a payment of interest on or principal of such loan, in which case the balance will be haircut to its "Recovery Value."<sup>49</sup>

52. *Thus all 3 of the transactions Froeba cites separately provide for the haircutting of an asset that has not made its contractual payment.* While it is true that the Zohar transactions do not also include a provision to consider an asset that has been amended to avoid a default as Category 1/Defaulted, they do require such treatment for an asset that has not made its contractual interest payment.

**Drafting History and Course of Conduct do not support Tilton's subjective categorization methodology**

53. Froeba's conclusion that the drafting history "reveals an intention to treat the Zohar CLOs differently from other similar CLOs and to allow them to give effect to amended loan terms" is both irrelevant and wrong based on a reading of the evidence.

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<sup>48</sup> NewStar, Definition of Defaulted Obligation, p. 186; Definition of the Overcollateralization Ratio Test, p. 128.

<sup>49</sup> Colts, Definition of Aggregate Outstanding Loan Balance, p. 102.

54. First, Froeba's claim that the drafting history reveals an intention to give effect to "amended loan terms" is not relevant because when less than the contractual amount of interest due was received, as discussed previously, the loan terms were not being amended.

55. Further, Froeba's opinion about the drafting history rests on a single email exchange between S&P and Natixis, the underwriter of the Zohar CLOs, in connection with the amendment of the Zohar I transaction that has nothing to do with an amendment to the terms of the loan. Further, Froeba failed to follow this exchange to its conclusion where Natixis proposed a change in the Supplemental Indenture draft to address S&P's concerns. A reading of that email exchange shows that S&P asked that the Defaulted Obligation definition in Zohar I "include any *new loan or restructure* made with respect to an existing obligor in the portfolio without which such obligor would have defaulted on its existing obligations."<sup>50</sup> (Emphasis added.) Similar to the language in Gemini discussed above, this request refers to a new loan or restructure of the existing loan, not an amendment to avoid a default.

56. Additionally, Froeba is wrong when he states that "the parties rejected this proposal."<sup>51</sup> Froeba failed to consider the email correspondence between Natixis and S&P subsequent to the referenced email. Later that day, Natixis distributed to S&P a new markup of the proposed second supplemental indenture based on S&P's comments.<sup>52</sup> The S&P analyst then communicated internally that he "read through the amendment changes that Lorraine [from Natixis] forwarded me. I believe that the changes capture our requests."<sup>53</sup> The draft supplemental indenture shows that language was inserted that if an obligation "is restructured or refinanced and such restructuring or refinancing has not been factored into such [credit] estimate

<sup>50</sup> S&P-SEC-PATRIARCH 038502.

<sup>51</sup> Froeba Report, ¶76.

<sup>52</sup> NNA\_SEC\_00114313.

<sup>53</sup> S&P-SEC-Patriarch 038486.



or such model then the Issuer, or the Collateral Manager on behalf of the Issuer, shall promptly reapply to Standard & Poor's for a new corporate credit estimate..."<sup>54</sup> Thus, S&P would have an opportunity to re-rate a loan following any such restructuring or refinancing and could rate the loan D or defaulted if it felt that was the effect of the event.

57. Froeba's argument that in the course of conduct of the parties the Trustee has not disputed the categorization also cannot be given weight. In CLOs, the Trustee is entitled to rely on information provided to it by the Collateral Manager. In each of the Zohar CLO Indentures, Section 6.3(a) states:

the Trustee may rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, email, request, direction, consent, order, note or other paper or document reasonably believed by it to be genuine and to have been signed, sent or presented by the proper party or parties.<sup>55</sup>

*The categorization of loans was determined by Patriarch and provided to the Trustee. These categorizations were reported to the investors as delivered by Patriarch. There is no requirement or expectation that the Trustee will independently verify Patriarch's categorization.*

58. With regard to the conduct of the rating agencies, Froeba offers that they "were monitoring both the credit estimates of the underlying portfolio and the ratings on the notes issued by the Zohar CLOs."<sup>56</sup> However, Froeba ignores the fact that ultimately, the rating agencies withdrew their ratings from Zohar III (both S&P and Moody's) and Zohar I (Moody's) because of the lack of information being received on the underlying loans, in particular, the lack of updated information in order to keep the credit estimates current. Additionally, as described above for ALF, the rating agencies were not being informed about the failure of a borrower to

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<sup>54</sup> NNA\_SEC\_0114316.

<sup>55</sup> See the Zohar CLO Indentures, Section 6.3(a).

<sup>56</sup> Froeba Report, ¶77.

pay the contractual amount of interest due, and the package of financial information on ALF submitted to each appeared to hide this information. Thus, Froeba's statement with regards to the rating agencies' course of conduct is fundamentally wrong.

59. Froeba also discusses a difference between the Zohar III definition of Defaulted Investment and the definitions that result in a loan being categorized as Category 1 in Zohar I and Zohar II – the elimination of the parenthetical “without regard to any applicable grace period or any waiver of such default” from subsection (a)(i) of the definition of Defaulted Obligation in Zohar I and Zohar II:

“Defaulted Obligation”: Any Collateral Debt Obligation (other than any Originated Special Loan/Preferred Security that is a Preferred Security) included in the Collateral: (a) (i) with respect to which a default as to the payment of principal and/or interest has occurred (*without regard to any applicable grace period or any waiver of such default*), but only so long as such default has not been cured;(ii) with respect to which the Collateral Manager has received written notice stating, or as to which the Collateral Manager believes, that ...(C) a default as to the payment of principal and/or interest (beyond any applicable grace period) has occurred and is continuing on another obligation of the same issuer that is senior or pari passu in right of payment to such Collateral Debt Obligation (but in each case only so long as such default has not been cured or waived);

60. Froeba takes the position that the elimination of this phrase means that in Zohar III, the waiver of a default is not disregarded and has the effect of avoiding categorization of a loan in which a defaulted payment is later “waived” as a Defaulted Investment.<sup>57</sup> I disagree.

61. As an initial matter, if Froeba is correct, he is conceding that a “waiver” of default *would* require categorization of the loan as a Defaulted Obligation for Zohar I and Zohar II.

62. Additionally, Froeba's opinion about the purpose of the removal of the parenthetical is merely speculation. Froeba cites no evidence supporting his opinion. Tilton herself testified that she did not recall the reason why this language was changed:

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<sup>57</sup> Froeba Report ¶65-67.

Q: ...In Zohar 2, there is a parenthetical phrase that says, "Without regard to any applicable grace period or any waiver of such default." But in Zohar 3, that same parenthetical does not appear although the rest of that definition appears to be the same. Do you recall the removal of that parenthetical between Zohar 2 and 3?

A: I do not.

Q: Do you recall having any discussions about removing that parenthetical?

A: I do not.

Q: Do you – sitting here today, do you have an understanding of why that parenthetical was removed?

A: I don't.<sup>58</sup>

63. Finally, Froeba's opinion that a waiver is not disregarded in Zohar III is not relevant since, as discussed in detail above, Tilton was not "amending" loan terms or "waiving" defaults; she was simply accepting less than the contractual amount of interest due. There is no documentation as to what terms go along with her actions and none reported to the Trustee, which I would expect is she were waiving a default. For example, when Tilton accepted the reduced payment what is the status of the amount unpaid? (This amount could be forgiven or due on a subsequent date.) Does interest apply to the missed payment? Based on my experience, this lack of detail is evidence that Tilton was not "waiving" a defaulted payment when she accepted less than the contractual amount of interest due. Moreover, as discussed earlier, Tilton was not specific about the characterization of the acceptance of a payment that was less than the amount of interest contractually due, using the words amend, waive, defer, or forgive interchangeably. Froeba is simply putting forward a convenient but unsupported justification for Tilton's categorization by arguing that waivers do not apply to Zohar III and that what Tilton was doing was waiving defaults on the loans. There is no basis for either aspect of this position.

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<sup>58</sup> Tilton Testimony (6/24/2014) 25:21 – 26:9.



## Discussion of PIK Loans

64. In my initial report, I made the simple point that the fact that various restrictions on PIK Loans, which by their terms allowed a portion of the interest due to be deferred and capitalized, showed the importance of receiving current cash flow in the Zohar CLOs.<sup>59</sup> Froeba subverts this point to make the claim that “the PIK Loan ‘prohibition’” in the Zohar CLOs actually operates to allow (by not prohibiting) loans in which the borrower can defer virtually all (or a substantial portion) of the interest due on that loan without defaulting.”<sup>60</sup> As an initial matter, nothing in Froeba’s Report changes my initial opinion: the treatment of PIK Loans (which are permitted to defer a portion of their interest due as defined in each Zohar Indenture) as Category 1/Defaulted underscores the importance of receiving current cash flow in the Zohar CLOs and is fully consistent with categorizing loans that do not pay current interest due as Category 1/Defaulted.

65. *Moreover, Froeba is wrong in stating that the PIK Loan definition in the Zohar Indentures allows virtually all interest to be deferred.* Froeba fails to consider that the portion of interest that can be deferred with regards to Zohar II and Zohar III will vary with the level of LIBOR (and will decrease when LIBOR increases). Froeba also fails to note or consider that when calculating the weighted average spread of the collateral in the Zohar CLOs (“WAS”) in order to determine whether the collateral passes the weighted average spread test (the “WAS Test”). The WAS Test is an Indenture test that measures the average margin above the related benchmark index rate for the assets. Under the WAS Test, only the current pay portion of the

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<sup>59</sup> Wagner Report, ¶56.

<sup>60</sup> Froeba Report, ¶88.

security is to be considered and the portion that may be deferred excluded.<sup>61</sup> That means, for example, that for a loan that is required to pay LIBOR, but may defer all of its margin, the spread for purposes of this test will be zero, making it difficult to pass this test and acquire loans with such features.

66. Froeba makes fundamental errors and inferences in his discussion of the features of PIK loans and his related conclusions. Froeba states that I point to the PIK Loan prohibition as evidence that the Zohar Indentures restrict manager discretion over current interest.<sup>62</sup> That is not a correct reading of what I said. Again, nowhere in my report do I read the Zohar Indentures as restricting manager discretion over decisions with regards to the management of the assets, including the decision to allow a borrower not to pay the full amount of contractual interest due. But I do distinguish this discretion from the objective criteria for categorization according to the plain language of the Indentures.

67. Froeba further makes a fundamental error by commenting that the following statement from my initial report is not accurate:

“[E]ven if a PIK loan is contractually performing, the fact that they are allowed to defer a portion of their interest payment, even if they have not done so results in categorizing them as Category 1/ loans or Defaulted Investments.”<sup>63</sup>

This is in fact accurate by definition. If a loan meets the definitional requirements to be a PIK Loan in any of the Zohar Indentures, it is Category 1/Defaulted.

68. Froeba then goes on to make an inaccurate conclusion that “the PIK Loan prohibition only applies to those PIK Loans that give the borrower the right to defer most interest

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<sup>61</sup> See the definition of “Weighted Average Spread” in the Zohar Indentures (as amended for Zohar I).

<sup>62</sup> Froeba Report, ¶13.

<sup>63</sup> Froeba Report, ¶86.

due not just “a portion” of their interest payment. Thus, the proviso in the PIK Loan definition creates an exception that almost overrides the rule.”<sup>64</sup> This statement is not true for Zohar II and Zohar III, because the amount paid must at least be equal to LIBOR and the LIBOR requirement means that the amount that has to be paid as a portion of the total interest requirement will vary with the level of LIBOR. When LIBOR is low, as it has been for the years following the financial crisis, then the amount that can be deferred will be a higher proportion of the total interest due than when LIBOR is at higher levels. For example, consider a loan with a variable interest rate equal to LIBOR + a margin of 5%. The following table shows the interest that can be deferred as a percentage of the total interest charged on the loan. The table shows that the amount of interest that can be deferred for this loan is 90.9% of the total interest when LIBOR is at .50%, half of the total interest with LIBOR at 5%, and 40% of the total interest when LIBOR is at 7.5%. Thus the PIK Loan definition does not allow loans that defer most of the interest due as Froeba states.

| LIBOR | Margin (which may be deferred) | Total Interest Rate | Margin as a Percentage of Total |
|-------|--------------------------------|---------------------|---------------------------------|
| .50%  | 5.00%                          | 5.50%               | 90.9%                           |
| 5.00% | 5.00%                          | 10.00%              | 50%                             |
| 7.50% | 5.00%                          | 12.50%              | 40%                             |

69. Each Zohar CLO also has a WAS Test, which measures the average spread or margin on the loans and compares it to a benchmark set forth in the Indenture. For an asset that has both a current cash pay requirement and an amount that can be deferred, the calculation of WAS includes only the amount that is required to be paid and excludes the amount that can be

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<sup>64</sup> Froeba, ¶86 – 87.



deferred. For example, assume a loan that is required pay LIBOR and can defer its margin of 5.00%. For purposes of calculating the WAS, the spread on this loan would be zero. In Zohar II, the minimum level for the WAS Test is 5%. Thus if all the loans were allowed to defer all but the LIBOR component of the interest payment, the WAS for the assets would be zero, and the test would be failed. *This shows that there is not an intention to allow loans that can defer all or virtually all of their interest payments due to be held by the Zohar CLOs.*

70. Therefore, Froeba's conclusion – that the PIK Loan definition is evidence of the importance in the Zohar CLOs of loans being able to defer interest without defaulting – does not make sense. The acquisition of such loans would be limited by the WAS Test; a sufficient number of such loans would cause the test to fail.

71. Froeba also fails to consider the protections the investors bargained for in the Indentures in choosing to invest in the Zohar transactions, including the loan categorization methodology specified in the Indentures and the OC Tests. His conclusion effectively means there is no real limit or consequence of allowing interest to be deferred on the underlying assets anywhere in the transaction until it actually defaulted on its payments to the investors. The protections of the Interest Coverage Test (the "IC Test"), discussed in the next section, are weaker than the protections from the OC Ratio Tests. While the deferral of interest could cause the IC Test to fail, there is no Indenture Event of Default in the Zohar CLOs based on failing the Interest Coverage Test.

#### **Hubbard's Recalculation of the Loan Categorization and OC Ratios based on the PIK Loan Definition is Fundamentally Invalid**

72. In Section X of his report, Hubbard recalculated the categorization of loans and the OC Ratios for Zohar II and Zohar III assuming that the required interest component of the PIK Loan determination of collateral is relevant to the categorization of collateral as Category

1/Defaulted. He states, “thus, if the collateral that Mr. Mayer considers to be “defaulted” have paid interest of at least LIBOR, I have recategorized them as Category 4 or Collateral Investment and recalculated Mr. Mayer’s Adjusted Numerator and Adjusted OC Ratios accordingly.”<sup>65</sup> This is a fundamentally flawed exercise with results that are therefore invalid.

73. On a threshold level, the assumption underlying the calculation – that the required interest component of the PIK Loan determination of collateral is relevant to the categorization of collateral as Category 1/Defaulted – is demonstrably incorrect. Hubbard is applying a methodology that is nowhere in the Zohar II or Zohar III Indentures. *The relevant definitions that lead to Category 1/Defaulted do not contain any concept that even if the loan did not pay its full contractual interest, it would not be considered Category 1/Defaulted as long as it paid interest greater than or equal to LIBOR. The categorization must follow the terms of the Indenture.*

74. Furthermore, there is nothing supporting the proposition that the loan terms contractually provide for a partial payment of interest. Instead, as reported in the Trustee Reports, the loan terms generally did not provide for partial payments of interest. In Zohar II, the Trustee reported the cash coupon and the non-cash pay coupon rate and in Zohar III, the Trustee reported the non-cash pay coupon rate. These are the relevant rates to use in determining whether contractually due interest was paid; Hubbard did not refer to the contractually due amount in undertaking his calculations. Rather, he inserts into the loans new terms that do not in fact exist.

75. Hubbard further ignores the fact that the relevant definitions that result in a loan being categorized as Category 1/Defaulted require any prior default to be cured (i.e. the missed

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<sup>65</sup> Hubbard Report, ¶49.

payment to be made in full including any capitalized interest owed) before the loan could be removed from those categories. Thus it is not only the current payment that needs to be reviewed, but also whether there were any prior defaults and if they had been cured. I reviewed the Patriarch Spreadsheets for the loans to 14 Portfolio Companies referenced in paragraph 34, above, and found that some loans made no payments at all on dates when interest was contractually due. These loans therefore would be Category 1/Defaulted even if, under Hubbard's hypothetical construct, they later started making interest payments of at least LIBOR. Thus assuming that somehow this false construction that a loan would not be Category 1/Defaulted if its current payment is at least LIBOR were true (which it clearly is not), the requirement that a loan would be Category 1/Defaulted until cured would change Hubbard's results and make the results he did report invalid. This would also apply if any cash payment on a loan was shown to be less than LIBOR and not subsequently cured.

### **Interest Coverage Test**

76. Froeba and Hubbard also attempt to ignore the plain language of the Zohar Indentures by pointing to the level of the cushion in the CLOs' Interest Coverage Ratio ("IC Ratio") tests to argue that parties to the transaction would have known that interest payments would be missed, and thus could not have intended that a missed or reduced interest payment would cause a loan to be categorized as Category 1/Defaulted. *But Froeba and Hubbard's discussion of the Interest Coverage test merely state what is true about the test in all CLOs – that the cushion between the test level and the reported level of the Interest Coverage Ratio ("IC Ratio") means that not all the underlying companies had to make their full interest payments to pass this test.* To conclude from this that loans that did not make their full interest payments were not intended to be haircut for purposes of the OC Ratio does not make sense.



While certain events, such as the failure to pay contractually due interest will cause both ratios to decline, as discussed below, the tests also capture different things. The IC Ratio captures things that can impact the amount of interest earned on the assets, including things not necessarily related to the credit of the loans. Additionally, as discussed in the next section of this report on flexibility within the Zohar CLOs, the OC tests were also structured with a significant cushion before triggers would be hit.

77. The IC Test is a common test in CLOs that generally compares the amount of interest collected with the amount of interest owed on the CLOs notes. The fact that the IC Test had what may be a greater cushion for a reduction in interest than the OC Test has no relevance for how the loans should be categorized and the impact on the OC Test, because they capture different things. The IC Ratio can be impacted by events and changes unrelated to the credit of the loans that have no impact on the OC Ratio. The numerator in the IC Test ratio will include the amount of interest collected on the loans and will vary based on a range of factors, not all of which would result in a change in the OC Test ratio. The IC Ratio is impacted by both the amount of performing loans and the rate being earned on those loans. As the average rate being earned on performing loans declines, the numerator of the IC Ratio, and therefore the ratio itself, will decline. There would be no impact on the OC Ratio because a change in the average contractual rate being earned does not affect the OC Ratio.

78. As in the discussion above on the proportion of interest being deferred for a PIK Loan, the IC Ratio is also impacted by the level of LIBOR. For a given amount of loans and bonds outstanding whose interest rates are set relative to LIBOR, the IC Ratio will increase as LIBOR goes down. Many loans also contain a floor on LIBOR, i.e. for purposes of calculating the interest rate on a loan, the floor level of LIBOR will be used if the actual level of LIBOR is

below the floor. This further improves the IC Ratio because the bonds generally do not have corresponding floors. This is illustrated in the following example

|  |                  |
|--|------------------|
| Amount of Loans                                | 1,250,000,000    |
| Amount of Bonds                                | 1,000,000,000    |
| Margin on Loans                                | 500 basis points |
| Floor on LIBOR                                 | 1%               |
| Margin on Bonds                                | 50 basis points  |
| Ongoing Fees subtracted from interest on loans | 100 basis points |
| Payment Frequency                              | Quarterly        |

|                       |            |            |
|-----------------------|------------|------------|
| LIBOR                 | 5%         | 0.500%     |
| Net Interest on Loans | 28,125,000 | 15,625,000 |
| Net Interest on Bonds | 13,750,000 | 2,500,000  |
|                       |            |            |
| IC Ratio              | 205%       | 625%       |

This table shows that for the same amount of loans and bonds, the IC Ratio can vary dramatically based on the level of LIBOR. By contrast, the OC Ratio would be the same in both circumstances presented.

79. *In sum, the IC Ratio and OC Ratio tests measure different things, and the fact that there is a cushion in the IC Ratio is simply not relevant to the parties' intent regarding the proper categorization of loans for purposes of the OC Ratio.* Among the circumstances that would cause the IC Ratio to decline without an impact on the OC Ratio are: (1) changes in the yields at which new assets can be acquired by the CLO during the Reinvestment Period; (2) disproportionate payoffs of higher yielding assets; (3) changes in the mix of and yields being earned on fixed and floating rate loans; and (4) as described above changes in the level of LIBOR, even if all the interest rates on the loans adjust based on LIBOR.

### III. Flexibility in the Zohar CLOs

80. Tilton's experts also attempt to avoid the plain language of the Zohar Indentures regarding categorization of assets by arguing that categorizing loans that do not pay full contractual interest as Category 1/Defaulted (1) is inconsistent with the Funds' strategy and (2) would limit the flexibility Tilton required to properly manage the assets. As discussed in this section, these positions are both fundamentally wrong. First, like all CLOs, (and structured finance securities in general), the Zohar CLOs are structured and sized to withstand a level of defaults and non-payment of interest consistent with the risk characteristics of the collateral. The proper categorization of assets that do not make their contractual payments is important to measure the actual performance of the assets against the stressed levels of defaults and non-payments analyzed in structuring and rating the transaction. Second, the position that the categorization of loans that do not pay full contractual interest as Category 1/Defaulted would limit Tilton's flexibility is based on incorrectly confusing the categorization methodology specified in the Indenture with placing the loan in default by the Collateral Manager. As I stated clearly in my report, these are not the same thing. Properly categorizing a loan based on its payment status does not require the Collateral Manager to call a default on the borrower.

#### **Properly categorizing assets is not inconsistent with the Zohar Funds' strategy.**

81. Hubbard takes the position that because the Zohar transactions are designed to invest in speculative-grade debt collateral, which have a high risk of missing interest and/or principal payments, the parties should expect that some distressed companies would remit less than full stated interest payments and therefore, it would be inconsistent to actually categorize such missed payments as Category 1/Defaulted. This position is fundamentally flawed with regards to CLOs because while investors expect that there will be some amount of loans that do



not pay their full contractual payments of interest or otherwise default, they also have built in tests that measure the level of defaults and provide for the potential correction of a declining OC Ratio before an Indenture Event of Default is reached, by redirecting subordinate cash flow to the payment of principal on the Zohar notes.

82. The Zohar transactions were structured in order to withstand a level of defaults consistent with the risk characteristics of the assets. Structural features designed to allow the transactions to withstand such defaults include the level of overcollateralization of the transaction and the excess spread resulting from the difference between the yield charged on the assets and the cost of the Zohar CLO debt. Additionally, as discussed in my report there are performance tests including the overcollateralization test and the interest coverage test, with triggers designed to protect investors as the performance of the transaction deteriorates. Properly measuring the performance of the assets is part of the structural integrity of the transaction designed to protect investors.

83. Therefore, although in my experience investors and the rating agencies anticipate that there will be defaults on the assets held by any CLO, it cannot be the case that such defaults would not be properly measured and reported. If the level of defaults approaches the stress level assumed in rating and analyzing the transaction, then the triggers built into the transaction should become operative to protect the investors.

84. In general, a CLO's test levels are not set at "hair-triggers," designed to be hit as soon as defaults begin to occur. Instead, there are significant cushions built into the tests before a trigger is hit. This is the case for the Zohar CLOs as well. Indeed, Froeba and Hubbard

discuss the large cushion in the IC Test but fail to consider the cushion in the OC Test levels.

For example, in Zohar II and III, the test levels for the OC Test include the following<sup>66</sup>:

| Remedy   | Zohar II Test Level  | Zohar III Test Level |
|--|--|----------------------|
| Re-direction of cash flow  | 112%   | 112.7%               |
| Limitation on Acquisition of New Collateral during the Reinvestment Period <sup>67</sup> | 112%   | 112.7% <sup>68</sup> |
| Early termination of the Reinvestment Period   | 105% (A number calculated by adding 3 to the Adjusted Event of Default Overcollateralization Ratio)  | 105%                 |
| Indenture Event of Default   | 102%. (A number calculated by subtracting 28 from the OC Ratio as of the most recent anniversary of the Ramp Up End Date but no less than 102 or more than 107). | 105%                 |

These test levels provide a significant cushion before they would be hit. Based on the minimum amount of collateral the transactions were designed to acquire and the amount of Class A Notes issued, the starting level for the OC Ratio for Zohar II would be 122% and the OC Ratio for Zohar III would be no less than 125%.<sup>69</sup> The amount of assets that could be categorized as Category 1/Defaulted before the OC Ratio would hit a given test level is based on the recovery

<sup>66</sup> Some of these levels may vary based on a matrix of tests and collateral characteristics set forth in the Indenture. The matrix allows the Collateral Manager to choose from a range of collateral characteristics that would then impact the OC Test levels. If the Collateral Manager chooses a riskier portfolio as measured by the Moody's Rating Score, then the OC Test level will be higher. See the definition "Ratings Matrix" in each Indenture.

<sup>67</sup> This is a test that had to be met in order to make or acquire a new loan during the Reinvestment Period. This test level did not apply with regards to a draw on a loan commitment that was previously made by a Zohar CLO.

<sup>68</sup> In Zohar III, if this level is failed, new collateral could continue to be acquired as long as the acquisition maintains or improves the ratio. This would generally be the case as long as the asset was acquired at a price below par.

<sup>69</sup> These OC levels are based on ramp-up provisions in Section 7.13 of the Indenture.

rate assigned to the asset by the rating agencies. The value of the asset for OC Test purposes would be equal to its balance x the lowest of the S&P or Moody's level for the recovery rate.<sup>70</sup> The specific formula for determining the percentage of assets that could be categorized as defaulted equals  $(OC\ Level - Test\ Level)/(100\% - Recovery\ Rate) * (Debt/Assets)$ . For simplicity, I have conservatively assumed a recovery rate of 50%, which is lower than the average recovery rates generally being reported for the Zohar II and Zohar III CLOs in the Trustee Reports. If the average recovery rates are above 50%, which is generally the case for Zohar II and Zohar III, the maximum percentage of defaulted assets would be higher. The following tables present the cushion as a percentage of assets, based on a recovery rate of 50% and the targeted level for the initial overcollateralization ratio in Zohar II and Zohar III.

Zohar II (Assumed Starting OC Ratio: 122%)

| Remedy   | Test Level | Cushion | Maximum Percentage of Defaulted Assets |
|--|------------|---------|--|
| Redirection of Cash Flow/Limitation on Acquisition of New Collateral | 112%       | 10%     | 16.4%                                  |
| End of Reinvestment Period   | 105%       | 17%     | 27.9%                                  |
| Event of Default   | 102%       | 20%     | 32.8%                                  |

<sup>70</sup> There is also generally a provision to refer to the market value of the asset if it is less than the recovery rate, but that only applies if such market value can be obtained. I assume that such market value is not available because of the private nature of the Zohar collateral.



Zohar III (Assumed Starting OC Ratio: 125%)

| Remedy   | Test Level | Cushion | Maximum Percentage of Defaulted Assets |
|--|------------|---------|--|
| Redirection of Cash Flow/Limitation on Acquisition of New Collateral <sup>71</sup> | 112.7%     | 12.3%   | 19.7%                                  |
| End of Reinvestment Period   | 105%       | 20%     | 32%                                    |
| Event of Default   | 105%       | 20%     | 32%                                    |

As these tables show, approximately 16% - 20% of all assets of the CLO would have to be categorized as Category 1/Defaulted before cash flow would be redirected or a new asset could not be acquired, and approximately 32% - 33% of all assets of the CLO would have to be defaulted before an "Event of Default" occurred for the CLO. *These tables show that the OC Tests were not set at "hair trigger" levels.* Thus, it is simply not the case, as Hubbard opines, that because some distressed companies would remit less than full stated interest payments, it would be inconsistent to actually categorize such missed payments as Category 1/Defaulted.

85. *Further, even if the proper characterization of assets triggered these events, such an occurrence would not fundamentally deprive Tilton of the flexibility her experts claim she needs to manage the underlying assets.* With regards to the cash flow triggers, it would be up to Tilton if the reduction of the subordinated management fees or the preferred share distributions would cause her to change her approach to managing the assets; however, this should not be a direct cause of a loss of the discretion she requires. While an Event of Default under the Indenture would be a greater challenge to manage through, even that does not require

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<sup>71</sup> In Zohar III, a new asset can be acquired if this test level is breached as long as such acquisition maintains or improves the ratio.

or mandate a liquidation of the assets or the removal of Tilton from the role as manager. Instead, the remedies after an Event of Default would give the investors a greater say in the management of the assets; Tilton would have to convince the investors as to the best course of action with regards to each asset and work with them to reach solutions to maximize the value for the investors and Patriarch.

86. In addition to the cushions in the OC Tests themselves discussed above, Froeba discusses the fact that the Zohar CLOs do not include two standard provisions in most CLOs as “expanding the Collateral Manager’s discretion.”<sup>72</sup> These include what he calls Deep Discount Purchase Limitations and Par Haircuts for Excess Caa/CCC Concentrations<sup>73</sup> (“CCC Bucket”). As an initial matter, the exclusion of these two provisions simply does not mean that Tilton and Patriarch could ignore the plain language of the Indentures when categorizing loans that had not made contractual interest payments.

87. Further, while the lack of these two provisions does not directly impact the discretion Tilton has to manage the assets, they do provide added flexibility to Tilton to manage the OC Ratios. For example, in most CLOs the acquisition of an asset at a discounted price set below a benchmark of typically 80% would be carried for OC Ratio purchases at its purchase price rather than the par amount of the asset. Since this provision does not apply in the Zohar CLOs, Tilton could increase the OC Ratio by buying low priced assets. This is because the cash used to purchase the asset would go down by the price paid, but the value of the asset for purposes of the OC Ratio would be the full face amount of the asset. The lack of the CCC Bucket also keeps the OC Ratios in the Zohar CLOs higher than they would otherwise be if there were a high concentration of CCC assets due to deteriorating performance of the assets. In other

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<sup>72</sup> Froeba Report ¶108.

<sup>73</sup> Froeba Report ¶114 – 115.

CLOs, the excess concentration of CCC assets above the concentration limit would be haircut, reducing the OC Ratio. Thus, Tilton had other tools at her disposal to support the OC Ratio and potentially avoid or defer hitting the trigger levels for the OC Ratio if she properly categorized the assets. Thus, the fact that these two provisions are not included in the Zohar CLOs actually undercuts Tilton's experts' arguments that properly categorizing loans that missed their contractually required interest payments would have unreasonably restrained Tilton's ability to manage the CLOs.

88. Additionally, while Froeba points out provisions that may be different from other CLOs as discussed in this report, and which give Tilton more flexibility to manage the OC Ratio, he arrives at the fundamentally wrong conclusion – “that the parties viewed the coverage tests, particularly the par test, differently than in standard CLOs.”<sup>74</sup> That is plainly not the case. The parties to the transaction include the investors; as discussed in my report, they understood and expected that assets that had not made the payment of contractual interest due would be Category 1/Defaulted and have haircuts applied for purposes of the calculation of the OC Ratio. *In sum, the OC Tests operate similarly to other CLOs and are designed to haircut assets that are not contractually performing.*

89. Hubbard also talks about aspects of the OC Ratio and the OC Test that would have been operative or available to Tilton as the OC Ratio declined. These include the workings of the test itself – if the trigger were reached, the OC Test would direct cash to pay down the Zohar notes, at a minimum slowing the decline of the OC Ratio from what it would otherwise be without this feature. He also points out many possible steps that Tilton could have taken that would have possibly improved the OC Ratios, including a different mix of assets and purchase

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<sup>74</sup> Froeba Report ¶124.



prices.<sup>75</sup> While what Tilton would have done is purely speculative, the fact that the potential for these actions exists further undercuts the argument that the proper categorization methodology is inconsistent with the Zohar Funds' strategy.

90. Hubbard also mistakenly argues that the categorization of loans as Category 1/Defaulted is inconsistent with the Zohar Fund's strategy because the Fund would be limited in acquiring new assets if Defaulted Assets exceeded 5% of the assets in Zohar III, as an example.<sup>76</sup> This statement demonstrates a lack of understanding of the structure of CLOs. Like virtually all CLOs, the Zohar CLOs have Eligibility Criteria that must be met when acquiring new assets. However, the transactions generally provide that if a particular Eligibility Criteria is not met, a purchase may be made as long as the level of the Eligibility Criteria that is not being met is either not made worse or improved. The Zohar III Indenture states:

Notwithstanding the provisions of Section 12.1(a)...(D) to the extent that any one or more of the Eligibility Criteria in any of clauses (4)(B), (8), (9)(z), (13), (18), (23)(B), (26) through (36), (41) through (45) above are not met, the Issuer and/or the Zohar Subsidiary shall continue to be able to acquire or originate Collateral Investments to the extent any such unsatisfied Eligibility Criteria shall not be made worse...<sup>77</sup>

In Zohar III, the limitation on Defaulted Assets to 5% is in clause (27). Thus, even if Defaulted Assets exceeded 5%, an asset could continue to be purchased provided that it did not make the level of Defaulted Assets worse than it was before such acquisition.<sup>78</sup> Hubbard fails to recognize or acknowledge this provision.

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<sup>75</sup> Hubbard Report ¶34.

<sup>76</sup> Hubbard Report ¶21.

<sup>77</sup> Zohar III Indenture Article 12.1(b).

<sup>78</sup> There is a substantially similar provision in Zohar II; this provision requires the level to be improved.

**Categorizing assets as Category 1/Defaulted is not the same as exercising default remedies.**

91. Murray also attempts to ignore the plain language of the Zohar Indentures regarding categorization of assets by arguing that “Defaulting Portfolio Companies would have harmed the Zohar Funds.”<sup>79</sup> Murray’s entire discussion of flexibility and the impact of properly categorizing assets is fundamentally flawed by the failure to distinguish between the *categorization* of an asset as Category 1/Defaulted for purposes of the Zohar CLO Indentures and Patriarch exercising the *default remedies* against a borrower that failed to pay the contractually due amount of interest. She discusses the fact that defaulting portfolio companies unnecessarily would have harmed the Zohar funds, but fails to recognize that categorizing an asset as Category 1/Defaulted does not require Patriarch to default the company. As I stated in my report, categorizing an asset as Category 1/Defaulted does not require Patriarch to declare a default on the related asset. Tilton can continue to use discretion in managing the asset to maximize the value of the company as she sees fit.

92. Murray also generally criticizes my approach when she states “Wagner repeatedly states in his report that “investors in CLOs expect that the Collateral Manager will follow the Indenture to the letter,” implying a literal reading and interpretation.”<sup>80</sup> The contention that investors in CLOS expect this is correct – it is what investors in CLOs and structured finance securities generally expect; my opinion is based on reading the Indenture and following it. Murray implies there is something wrong with this approach.

93. As a result of her failure to acknowledge the difference between the loan categorization for purposes of the Indenture and defaulting a company, Murray also incorrectly discusses my assertion that the investors were harmed by Tilton’s categorization approach. She

<sup>79</sup> Murray Report, Section IIIC.

<sup>80</sup> *Id.*, ¶51.



states that, "The erroneous embedded assumption underlying Wagner's opinions is that the loan modifications undertaken by Patriarch did not have an important business purpose for the Zohar Funds, even though the Division has not challenged how Tilton used her discretion."<sup>81</sup> Even if Tilton's acceptance of less than the contractual amount of interest due had an important business purpose (and I did not opine on whether they did), as I explained in my initial report the failure to properly categorize loans harmed investors by overstating the Overcollateralization Ratios, failing to properly allocate payments of principal to investors, and potentially denying them their rights following an Indenture Event of Default in Zohar II.

94. Murray also criticizes my report for failing to consider that Tilton's decisions "had the potential to benefit the Zohar Funds for two reasons: 1) they would have provided an enhanced liquidity runway to the Portfolio Companies,...and 2) the Zohar Funds were also equity holders of many of the Portfolio Companies such that they would benefit from the ultimate enterprise value of the companies."<sup>82</sup> This statement again reflects Murray's fundamental failure to recognize the difference between the categorization of the loans and "defaulting the companies." Because they are not the same, Tilton could have properly categorized the loans and still made the same decisions with respect to the companies as long as she remained the Collateral Manager and the investors chose not to remove her or liquidate the loans if an Indenture Event of Default took place. And because the decisions that Tilton made would not have to have changed if she properly categorized the loans, the only impact of Tilton's categorization methodology for the investors was to harm them; there were no benefits.

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<sup>81</sup> *Id.*, ¶61.

<sup>82</sup> *Id.*, ¶62.



#### IV. Investor Considerations

95. As described by Tilton's Experts, the Zohar Funds were designed to invest in highly risky and speculative assets. But Tilton's Experts fail to acknowledge that the Funds financed themselves by offering what was supposed to be low risk and low yielding debt in the CLO market. In order to do this, the CLO had to meet the objectives of *both* the Collateral Manager in carrying out Tilton's strategy *and* the objectives of the investors to invest in low yielding but high credit quality debt. The CLO brought these two together by creating a structure that bridged both of these objectives. This is the approach I took in my extensive experience in structuring, documenting and marketing CLOs – finding a way to meet the needs of both the investors and the Collateral Manager. Yet, nowhere in the Tilton's Experts' Reports is there a discussion of how investors would be protected or impacted based on each Experts' opinions.

96. *The opinions of Tilton's Experts on the breadth of Tilton's discretion essentially write out the protections investors believed they had through the transactions' OC Tests* because under their construction, the amount of assets that were not making their contractual payments would not impact the test designed to measure exactly that occurrence; in fact there would be virtually no limit to the amount of non- or underperforming assets until an Indenture Event of Default was reached. By design, CLOs have mechanisms to protect investors that take effect before such an extreme result would take place.

97. Tilton's Experts also fail to recognize or acknowledge that the transactions reflect the agreement of both Patriarch and the investors to the terms as stated. Additionally, while Tilton's Experts point out that Tilton's strategy involved risky and speculative securities which should be expected to have payment shortfalls, they don't consider the fact that the Zohar CLOs

are highly structured transactions designed to fund Tilton's strategy with debt that was of low risk and high investment quality as signified by the willingness of MBIA to insure Zohar I and Zohar II and the ratings of AAA by S&P and Aaa by Moody's on Zohar III which was uninsured. The investors in the Zohar debt are looking for the return of principal and a modest return on their investment, not equity-like returns that may accrue from the underlying strategy. It is unreasonable to assume that the investors in AAA rated CLO debt would not expect to be protected by tests common to virtually all CLOs and which were clearly present in the Zohar transactions.

98. Hubbard comments on the fact that the credit ratings on the Zohar Funds' *collateral* "...reflect their risk of non-payment" but fails to consider what the high credit ratings on the Zohar CLO *notes* means to the investors. He quotes the definition of the rating of B by Moody's. In contrast, Moody's states that obligations rated Aaa -- such as the senior CLO notes of the Zohar CLOs -- are judged to be of the highest quality, subject to the lowest level of risk.<sup>83</sup> Similarly, S&P states that "an obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong."<sup>84</sup> Thus, the structure of the Zohar CLOs and the protections built in through the Indenture provisions allowed low-risk senior notes to be created from high-risk speculative assets. Based on my experience in the structured finance industry, investors would have expected the structural protections to work as documented in the Indenture in order to limit their risk from non-performing assets. Indeed, among the terms required to obtain the AAA/Aaa ratings were protections to the investors in the form of the OC Tests, the categorization of assets and the results of hitting the triggers.

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<sup>83</sup> Moody's Ratings Symbols and Definitions, August 2015, p. 5.

<sup>84</sup> Standard & Poor's Ratings Definitions, June 22, 2012, p. 5.



99. While of course the Zohar debt investors are interested in the success of Tilton's strategy, as senior investors they do not depend on Patriarch earning high returns on the equity in the Portfolio Companies; they expect to be paid back in full even in scenarios in which Tilton does not get a return or loses money on the equity of the Portfolio Companies. The CLO structure is designed so that even in such an occurrence, the debt investors would not necessarily lose money as well.

100. Murray states that it is unusual to house a Distressed Debt Turnaround strategy in a CLO.<sup>85</sup> However, once Tilton determined to utilize a CLO to finance her strategy, she also had to live within the constraints of the structure. That structure provided flexibility and discretion to manage the assets, but also had a series of tests with regards to the allocation of cash flows and the possibility of reaching an Event of Default based on the performance of the assets. These are standard features of a CLO, designed to protect the debt investors, and it would not be reasonable to assume that a CLO could be successfully structured without any such tests in order to provide maximum flexibility for the Collateral Manager.

101. As a result of raising money in the CLO market, Tilton also took on obligations to the investors. As described in my initial report, by failing to properly categorize the assets, Tilton violated these obligations and benefitted through the payment of subordinated management fees and equity distributions while harming the investors by denying them their contractual protections in the Indenture.

102. The standard of care provisions in each of the Zohar Collateral Management Agreements (the "Standard of Care") requires the Collateral Manager to "use reasonable care and the same degree of skill and attention...exercised by institutional investment managers of

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<sup>85</sup> Murray Report, ¶1(ii)



national standing generally in respect of assets of the nature and character of the Collateral and for clients having similar investment objectives and restrictions...<sup>86</sup> In concluding that Tilton's decisions with respect to the loans met this contractual standard, Murray is weighing Tilton's actions under her incorrect assertion that categorizing an asset would have required Tilton to default the company and harm the Zohar funds. However, categorizing an asset properly would not have required Tilton to default a company. It is not her management approach to the Portfolio Companies that failed the Standard of Care, it is the failure to follow the Indenture, which negatively impacts the investors.

103. Hubbard states, "The nature of the Funds' collateral, which includes both debt and equity of portfolio companies...imply that the Funds' expected sources and timing of cash flows from their collateral is different from those of other CLOs. Mr. Wagner agrees, as discussed below."<sup>87</sup> Hubbard then goes on to take a statement of mine completely out of context to change its meaning: "As described in the Wagner Report, "Patriarch is able to substitute the [Collateral Interest] (bracketed phrase his, not mine) funds owed to the Zohar CLOs for additional equity investments,"<sup>88</sup> implying that I acknowledge that this is what investors in fact expect. Hubbard ignores that what he quotes is from a discussion as to how Tilton's improper actions harmed investors by incorrectly categorizing assets when accepting less than contractual interest and allowing cash to remain within the Portfolio Companies. The point I made in my initial report – and reaffirm here -- is that by allowing the companies to defer interest without properly categorizing the loans improperly benefited Tilton by letting her avoid making additional equity contributions to the companies in order for them to meet their debt obligations, while at the same

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<sup>86</sup> Zohar Collateral Management Agreements, Section 2.4.

<sup>87</sup> Hubbard Report, ¶24.

<sup>88</sup> Id, ¶26.

time avoiding the consequences of potentially failing an OC Test designed to protect investors or at least informing investors that the amount of Category 1/Defaulted assets is rising and the OC Ratio is declining.

104. In discussing the fact that the Funds' collateral includes equity of Portfolio Companies, Hubbard fails to discuss the fact that the investors have virtually no ability to assign value to this equity. The equity securities are generally not traded or quoted, financial information on the companies is not publicly available, and the investors received virtually no financial information on the underlying companies from Tilton. In fact, Murray points out that "[a]s with private equity funds, investors in the Zohar Funds are in essence committing capital for extended periods of time of up to 10-12 years, often with very limited contractual rights to information about Portfolio Companies."<sup>89</sup> Indeed, the limited information provided in the Trustee Reports on equity holdings does not even allow investors to understand what percentage of a company the equity represents. Without financial information, including information on the capital structure of the company itself, it would be virtually impossible for a Zohar debt investor to value the equity owned by the CLOs, let alone try and estimate the timing of any receipts with respect to such investments. As a result, while any payments made would of course, accrue to their benefit, the vague and uncertain returns means the investors have to look to the cash flows on the loans in order to get paid back. Furthermore, the ownership of equity by the Zohar CLOs does not impact the categorization of loans.

105. Just as the other experts fail to recognize or consider the interests of the investors in the Zohar CLOs, so too does the Dolan report fail to credit the rights of investors to receive the correct information as to the categorization of assets and the OC Ratios in the Trustee

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<sup>89</sup> Murray Report, ¶31.

Reports, or the importance of doing so. Instead, he states that investors could figure out the payment status and OC Ratios for themselves, ignoring the fact that they should have no reason to do so if the information was provided correctly.

106. As to the value of the Zohar debt, Dolan points to various market conditions and events which would have informed investors about a decline in value in their Zohar bonds. While these conditions and events point directionally to a decline in value for the investments, they do virtually nothing in actually ascertaining a reasonable assessment of the future performance or valuation of the asset.

107. Dolan offers the opinion that “The global financial crisis would likely have alerted investors to declines in the value of their Zohar investments,”<sup>90</sup> and that “given the Funds’ strategy of investing only in the debt and private equity of distressed companies, it was not reasonable for investors to believe that the Funds would be immune to the effects of the financial crisis...Instead, it would have been more reasonable for investors in the Zohar Funds to expect that the distressed companies being financed by the Funds, which were already considered high risk, would likely have performed worse during the crisis.”<sup>91</sup> He adds that “downgrades of the Zohar notes signaled to investors that the risk of the Zohar notes signaled to investors that the risk of the Zohar investments had increased.”<sup>92</sup>

108. Dolan also offers the opinion that, because MBIA insured the Zohar I and II transactions, “it would have been reasonable for investors in the insured Zohar notes to monitor their investments by monitoring the creditworthiness of MBIA, rather than by monitoring the

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<sup>90</sup> Dolan Report, Section VII.

<sup>91</sup> *Id.*, ¶32.

<sup>92</sup> *Id.*, VIII.



Funds themselves.”<sup>93</sup> In my experience, this is not reflective of how institutional investors monitored such investments. While MBIA provided support for their bonds and their credit is an important part of the value and risk of the investment, many sophisticated investors also monitored the underlying performance to determine how dependent their risk was on MBIA’s support versus the fundamentals underlying the transaction. The events following the onset of the financial crisis show why investors would take such an approach. As noted by Dolan, by early 2009, Moody’s had downgraded MBIA to non-investment grade and by late 2009, S&P had done the same.<sup>94</sup>

109. All of the above points show only that the risk of the Zohar investments had increased and that their value had declined. However, investors would want to determine more than the direction of the value of their investments. They would want to assess the current status of the Zohar assets and try and develop projections of future cash flows. Typically, they would look to the reported status of the assets on the Trustee Reports. This information should conform to the Indenture; investors should not have to do a forensic investigation asset by asset to determine it for themselves. Whether it would be easy or burdensome to do so is irrelevant; the information was supposed to be reported correctly. In my experience, once investors see indicators of under-performance in a transaction, they may choose to do further analysis to determine the risk and project the performance of their investment. But, they do not expect to have to view what is being reported as incorrect or suspect if it is required by the Indenture. To the contrary, the proper reporting of the performance of assets in a securitization as required by the Indenture is a foundation of the structured finance market.

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<sup>93</sup> *Id.*, ¶15a

<sup>94</sup> *Id.*, ¶26.

110. It is not surprising that Dolan found that several of the investors did produce a value for their Zohar notes as discussed in Section X of his report. In general investors such as those cited have to perform such valuations for GAAP accounting and regulatory reporting purposes. But any such valuation would include a consideration of the information being received in the Trustee Reports. The fact that they prepared valuations and all noted a decline in the value of their investments or positions does not change the fact that the loan categories and OC test levels have to be reported correctly pursuant to the Indenture. In my experience, such valuations would consider the payment and default status of the loans as reported by the Trustee. For example, investors would often apply certain haircuts or loss assumptions to loans in default and other assumptions as to future losses and payments to loans that are performing. If the Category 1/Defaulted loans are being underreported, any valuation based on these numbers could be too high.

111. Dolan does not offer a successful rebuttal of the general point I made in my report that “investors would not be expected to ascertain the accuracy of reporting on the payment or default status of the individual assets underlying their investments. If investors had to do such analysis on this type of investment, as they do with more risky below investment grade or high yield securities, they would have to demand more spread or yield as compensation for the effort involved in monitoring and managing their portfolios.”<sup>95</sup> Dolan only shows that the Zohar notes traded within the context of where AAA rated CLO investments were trading at the time the Zohar securities were priced. The Zohar CLOs offered only a modest increment in spread to the interquartile range of spreads on AAA rated CLOs, a spread that would be expected, given the

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<sup>95</sup> Wagner Report, ¶35.

risky characteristics of the strategy and the unusual nature of financing it through a CLO as described by Tilton's experts.

112. I have read the Rebuttal Expert Report of Michael G. Mayer dated August 31, 2015 (the "Mayer Report") in which he describes the many barriers that would be present to automate the calculation of the Zohar CLO OC Ratios that Dolan states would be quick and easy.<sup>96</sup> In particular, Mayer points out a heavy burden of manual data entry and transcription from pdf documents. In my view, based on my experience marketing CLOs to investors, it would be unreasonable to expect investors to undertake this process, particularly in light of the modest spread increment they may have earned in investing in the Zohar CLOs. The information that the investors expect to receive is carefully spelled out in the Indenture. Investors expect that the information specified to be distributed will be accurate, so that they may spend their time reviewing and analyzing it, not generating it themselves because they believe the Collateral Manager is not providing it in accordance with the Indenture.

113. Even if an investor did analyze the individual payments on each asset to determine that contractual payments were not being made, they could not readily compel the Trustee to recalculate the OC Ratios and have the remedy of redirecting the cash flows implemented; this would likely have involved the time and expense of litigation. As a first line of defense, the investors would have depended on the Indenture being followed correctly and the protections of the structure working as bargained for.

114. In discussing the ability of the investors to analyze the Zohar transactions, Dolan makes the statement that "comprehensive information on the Zohar notes and the loans held by

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<sup>96</sup> Mayer Report, ¶4.2.2.



the Zohar funds was disclosed to investors.”<sup>97</sup> In fact, the investors knew little more than the names of the borrowers and the other characteristics disclosed in the Trustee Reports, namely, the industry, the rating on the assets, the terms of the loan and the payments made. Since these were generally not public companies, there was virtually no financial information on the companies available to the investors.

115. In fact, in 2013, Moody’s withdrew the ratings of the Zohar I and Zohar III notes because “it believes it has insufficient or otherwise inadequate information to support the maintenance of the ratings on a going forward basis.”<sup>98</sup> S&P similarly withdrew the ratings on the Zohar III notes in October 2014, stating, “Our internal policies require us to have a sufficient quantity of information received on a timely basis to maintain our ratings. Based on our assessment that we are no longer receiving this, we withdrew our ratings on the transaction.”<sup>99</sup> Further, as discussed above in the review of the ALF loan, the rating agencies themselves were not receiving truthful submissions from Patriarch.

116. Both Murray and Dolan discuss the impact of the financial crisis beginning in 2008 and the impact on the value and performance of the loans held by the Zohar transactions and the realization of value in the underlying companies. As discussed above, Dolan’s view is that investors should have expected the value of their investments to go down during the crisis.

117. Murray goes so far as to state that I ignore “the Financial Crisis, the nature of the assets, and the investment objectives of the Zohar Funds,” but that context is a key factor in

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<sup>97</sup> Dolan Report, Section IX.

<sup>98</sup> Moody’s Rating Action, “Moody’s withdraws the ratings of CLO notes issued by Zohar CDO 2003-1 Limited,” Feb. 26, 2013 and “Moody’s withdraws the ratings of CLO notes issued by Zohar II 2005-1, Limited,” Feb 22, 2013. Moody’s maintained ratings on the Zohar II deal based on the insurance from MBIA. Moody’s Rating Action, “Moody’s downgrades the ratings of CLO notes issued by Zohar II 2005-1, Limited,” Feb 22, 2013.

<sup>99</sup> S&P, “Five Ratings on Zohar III Ltd. Lowered, Six Withdrawn,” Oct 10, 2014.

assessing whether Tilton's decisions to amend loans to avert default was consistent with the Funds' interests."<sup>100</sup> Yet, she ignores the investment objectives of the Zohar CLO investors and the fact that in the Financial Crisis, the loans were not performing yet they continued to be carried as performing investments.

118. In fact, the underperformance and increased risk of the Zohar loans during the Financial Crisis is exactly when the Indenture provisions relating to the categorization of loans and the operation of the OC Test should have become operative to further protect the investors. By not properly categorizing the loans, the OC Test level triggers redirecting cash flow to pay principal to senior note investors were not operative: throughout the time of the crisis, Tilton continued to receive the subordinate management fee and preferred share distributions, even while the loan performance was suffering and the risk of the assets and the underlying strategy itself was increasing.

119. As discussed above, the proper categorization of the loans would not have harmed Tilton's flexibility to manage the companies. It would, however, have offered the investors the protections that they bargained for and were clearly provided in the Zohar Indentures. Taken together, the opinions of Tilton's Experts render the OC Test meaningless and leave the transactions with Tilton's subjective approach to categorization of assets.

Dated: August 31, 2015



Ira Wagner

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<sup>100</sup> Murray Report, ¶72.