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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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

MEMORANDUM OF LAW IN OPPOSITION TO THE DIVISION'S MOTION TO STRIKE RESPONDENTS' FURTHER AMENDED WITNESS LIST AND REQUESTS FOR HEARING SUBPOENAS TO PREVIOUSLY UNDISCLOSED WITNESSES

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October 18, 2016

Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Respondents"), respectfully submit this brief in opposition to the Securities and Exchange Commission ("SEC") Division of Enforcement's ("Division") Motion to Strike Respondents' Further Amended Witness List And Requests for Hearing Subpoenas to Previously Undisclosed Witnesses (the "Division's Mot.").

INTRODUCTION

It is now clear that members of the Division's staff, including Amy Sumner, improperly shared with MBIA Insurance Corporation ("MBIA") and its counsel at the time, Susan DiCicco, confidential, proprietary documents produced by Respondents to the Division in conjunction with the Division's investigation but unrelated to MBIA's anticipated testimony. Particularly concerning, the Division expressly authorized MBIA to use that information against Respondents in separate civil litigation, so long as the Division was not identified as the source, and further agreed at MBIA's behest not to tell Ms. Tilton of the disclosure of her company's confidences without first informing MBIA.[1] Having attempted to wipe its fingerprints from the documents that were improperly disclosed to MBIA, *see infra* p. 4, the Division cannot now complain that Respondents took too long to uncover the misconduct or to subpoena Ms. Sumner and Ms. DiCicco, the principal architects of the Division's alliance with MBIA.

That is particularly true where, as here, evidence of the Division's misconduct was buried amidst hundreds of thousands of pages of documents, which Respondents have been forced to

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[1] These facts are also set forth in detail in Respondents' Memorandum of Law in Support of Their Motion to Compel MBIA to Produce Documents Responsive to Respondents' Subpoenas, at 2-8 (Oct. 5, 2016) ("Mot. to Compel"). Because many of the same facts are relevant to the issues here, Respondents have set forth those facts again in this memorandum.

wade through during a compressed and fundamentally inequitable timeframe. It was only recently, when Respondents were preparing to cross-examine MBIA witnesses and also preparing, in a separate proceeding, to block MBIA's attempt to improperly force the sale of Zohar I's collateral, *see infra* pp. 6-7, that Respondents uncovered traces of collusion between the Division and MBIA. And only after unearthing such evidence did Respondents realize it would be necessary to subpoena the individuals centrally involved in that misconduct: Ms. Sumner and Ms. DiCicco.

Although the Division argues that requiring Ms. Sumner to testify would "disrupt[] the adversarial process" (Division's Mot. at 6), the opposite is true: prohibiting Respondents from examining the two individuals at the center of the information-sharing arrangement—who possess unique, firsthand knowledge about the improper coordination between the Division and MBIA—would irreparably harm Respondents' fundamental right to present a meaningful defense and to expose conduct unbecoming of government officials that undermines the Division's case. *See infra* pp. 7-9. Further, Respondents should have the opportunity to question Ms. Sumner at the upcoming hearing regarding a separate incident of misconduct in this case: her role in the improper acquisition of documents from another noteholder witness, Värde, *after* the Division's OIP was filed.[2] *See* Mem. of Law in Supp. of Resp. Mot. to Preclude the Division's Witness, Matthew Mach, from Testifying and for Expedited Briefing, at 12-13 (Oct.

[2] Respondents also intend to question Ms. Sumner about her knowledge of and role in withholding until this past Thursday exculpatory information concerning two other Division trial witnesses that the Division felt compelled to belatedly disclose in only the most general of terms—yet another sequence of events unbecoming of government officials that further undermines the Division's case. *See* Mem. of Law in Supp. of Resp. Mot. to Stay the Proceedings and Compel the Division to Make Further Disclosures Regarding Two Division Witnesses, and for Expedited Briefing and an Evidentiary Hr'g (Oct. 16, 2016).

11, 2016) ("Mot. to Preclude"). Respondents therefore respectfully request that Your Honor deny the Division's motion and issue hearing subpoenas to Ms. Sumner and Ms. DiCicco.

BACKGROUND

A. The Division Staff and MBIA Improperly Collude Against Respondents.

As set forth in detail in Respondents' Motion to Compel, MBIA underwrote financial guaranty insurance on the senior notes in the Zohar I and II Funds, which ultimately resulted in an exposure of roughly $1 billion. *See* Mot. to Compel, at 2. During the financial crisis, MBIA suffered substantial insurance losses, due in part to defaults on mortgage-backed securities pools and certain CDOs. *See id.* And at various points, MBIA has been on the brink of receivership by the New York State Department of Financial Services. *See id.*

MBIA first began discussions with the Division in 2011, after unsuccessfully suing Respondents in the United States District Court for the Southern District of New York for alleged breaches of contract (unrelated to the allegations at issue here). *See id.* at 3. At that time, the Division lawyers investigating Respondents explained to MBIA that they were interested in obtaining from MBIA information about the Zohars, including "what [MBIA was] told about these deals." *See* Resp. Ex. 540 at SECNOTES000495; *see also* Declaration of Lisa H. Rubin, dated October 18, 2016 ("Rubin Decl."), Ex. 1 at 107:21-108:2 (testimony of A. McKiernan). For its part, MBIA made clear to the Division its desire to "own" for itself all of "Zohar 1." *See* Resp. Ex. 540.

Around the same time, MBIA drew Respondents into a series of discussions with, among others, MBIA's Chief Risk Officer and President, Anthony McKiernan (a Division witness), about a potential restructuring of Zohar I. *See* Mot. to Compel, at 4. Throughout these discussions, MBIA engaged in covert communications with the Division, during which MBIA related to the Division the details of its confidential settlement communications with

Respondents. *See id.* at 4-5. By late August 2013, MBIA notified the Division that it had negotiated a tentative agreement with Respondents on certain critical issues related to the restructuring. *See id.* Undoubtedly, the Division realized that the proposed restructuring of Zohar I would significantly undermine its case: any investor, such as MBIA, that agreed to a restructuring essentially would be approving of Respondents' continued and past management of the Zohars, thereby gutting the Division's theory of Respondents' purported misconduct.

Shortly thereafter, in December 2013 and January 2014, the Division made the alarming decision to share with MBIA a treasure trove of confidential, proprietary information about several portfolio companies that Respondents had provided to the Division under the rubric of the Division's investigation, in contravention of applicable regulations and the SEC's stated policy on document sharing.[3] *See* Mot. to Compel, at 5-7. Specifically, Ms. Sumner, counsel for the Division, shared with MBIA's counsel at the time, Ms. DiCicco, nearly 40 of Respondents' confidential financial documents, including financial statements, interest payment and accrual listings, balance sheets, and income statements for eight of the Zohar I portfolio companies—information which the Division knew was extremely valuable to MBIA. *See* Resp. Exs. 516 & 518 (Dec. 18, 2013 and Jan. 30, 2014 e-mails from, *inter alia*, Ms. Sumner to Ms. DiCicco).

More alarming still, the Division expressly authorized MBIA to use the confidential documents to target Respondents in civil litigation. *See* Resp. Ex. 516 (Dec. 17, 2013 e-mail from S. DiCicco to A. Sumner); *see also* Rubin Decl., Ex. 1, at 109:10-14, 110:25-111:15 (testimony of A. McKiernan). MBIA was explicitly permitted to "freely commence litigation

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[3] Indeed, the Division's own notes in this matter make clear that its improper decision to authorize MBIA to use the portfolio companies' confidential information in unrelated civil litigation against Respondents was a flagrant departure from SEC policy. *See* Resp. Ex. 511 at SECNOTES000715 ("Susan DiCicco . . . . Want to send you dox . . . . Need your rep use only for purposes of interview [and] will destoy after . . . ." (emphasis in original)).

against Ms. Tilton, Patriarch," or their affiliates, "based on information MBIA learn[ed] from the documents." Resp. Ex. 516. The only constraint on MBIA's power was that it was prohibited from "cit[ing] or attach[ing] any of the documents received from the SEC to any complaint while those documents remain confidential and non-public." *Id.*; *see also* Rubin Decl., Ex. 1 at 106:18-25 (testimony of A. McKiernan). Further, the Division agreed "not to inform Ms. Tilton, Patriarch or their representatives that the documents and information [had] been provided to MBIA" unless it first consulted with MBIA. *See id.* Thus, MBIA was free to use Respondents' confidential documents against them, so long as those documents could not be traced back to the Division.

B. MBIA Improperly Attempts to Force the Sale of Zohar I's Collateral.

Armed with the portfolio companies' confidential information, and unbeknownst to Respondents, who continued to try to negotiate a restructuring, MBIA chose to reject the possibility of restructuring the Zohars in favor of an adversarial approach, *see* Mot. to Compel at 6, intent on "own[ing]" for itself all of "Zohar 1." *See* Resp. Ex. 540 at SECNOTES000495. Most recently, MBIA has exploited its role as the Controlling Party under the Zohar I Indenture by attempting to direct the Trustee to engage in a rigged sale to MBIA of Zohar I's collateral at a price well below market value. *See* Rubin Decl., Ex. 2 (Mem. in Supp. of Order to Show Cause). At Patriarch's request, the sale to MBIA, which was scheduled to occur on September 15, 2016, was temporarily restrained by Judge Sidney H. Stein of the United States District Court for the Southern District of New York. *See id.*, Ex. 3 (Sept. 15, 2016 order). Patriarch subsequently delved into preparation for the preliminary injunction hearing, including by reviewing MBIA-related documents. During the hearing, which took place on October 10, 2016, Judge Jed S. Rakoff questioned MBIA's President, Anthony McKiernan, at length about the email from Ms. DiCicco to Ms. Sumner, which memorializes the improper information sharing arrangement

between the Division and MBIA as "proposed by the SEC." *See id.*, Ex. 1 at 107:17-112:11; *see also* Resp. Ex. 516.[4]

C. MBIA Unreasonably Refuses to Comply with Respondents' Subpoena While Continuing to Communicate with the Division.

As set forth in Respondents' Motion to Compel, MBIA has unreasonably refused to produce documents responsive to Respondents' subpoena, which Respondents need in order to, *inter alia*, prepare for cross-examination of Mr. McKiernan, the MBIA executive whom the Division has indicated it will call at the upcoming hearing. *See* Mot. to Compel, at 8. MBIA has done so despite Respondents' good faith efforts to work with MBIA to narrow the scope of certain requests. *See id.* at 9-10. By contrast, MBIA has maintained open lines of communication with the Division. *See id.* at 10. Indeed, the Division has communicated with MBIA even after filing the OIP,[5] *see id.*, including with regard to the MBIA's compliance with the 2016 Subpoena, *see* Rubin Decl., Ex. 4 at Tilton-SEC-A-000000002724 (email exchange between A. Sumner and MBIA's current counsel regarding 2016 Subpoena).

ARGUMENT

I. Respondents Only Recently Discovered the Improper Information Sharing Between the Division and MBIA, Which the Division Had Attempted to Conceal.

As detailed above, the Division provided MBIA with confidential, proprietary information concerning the portfolio companies, which was produced on a confidential basis by

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[4] Earlier today, Judge Rakoff lifted the temporary restraining order but ordered that the Trustee re-notice on Monday, October 24, 2016 a significantly modified sale that, *inter alia*, is to remain open for at least 30 days, and further ordered the Trustee to provide "prominent" notice to a "reasonably wide group of prospective bidders."

[5] The Division's post-OIP communication with noteholders such as MBIA seems to be standard operating procedure in this case. As outlined in Respondents' Motion to Preclude, at 12-13, the Division contacted and impermissibly obtained documents from another investor, Värde, after filing the OIP, in violation of Rule 230(g) of the SEC Rules of Practice.

Respondents, and authorized MBIA's use of that information in litigation against Respondents. *See supra* p. 4. The sole restriction placed on MBIA's use of Respondents' confidential information was that MBIA not "cite or attach any of the documents received from the SEC to any complaint while those documents remain confidential and non-public." *See supra* p. 4. The Division also agreed that it would "not inform Ms. Tilton, Patriarch or their representatives that the documents and information [had] been provided to MBIA." *See id.* Having deliberately concealed its improper arrangement with MBIA, the Division cannot now complain that Respondents took too long to discover that misconduct or subpoena the individuals involved.

Further, evidence of the alliance between the Division and MBIA was buried among hundreds of thousands of pages of documents produced to Respondents in this matter, which the Division amassed over more than half a decade, and which Respondents have been forced to sift through in only a fraction of that time. It was only recently, while preparing to cross-examine MBIA witnesses and also preparing, in a separate proceeding, to challenge MBIA's self-serving bid to acquire the Zohar I collateral through a commercially unreasonable—and unlawful—sale, *see supra* pp. 5-6, that Respondents discovered evidence of the improper alliance between the Division and MBIA. And only after uncovering such evidence did Respondents realize it would be necessary to subpoena the architects of that alliance: Ms. Sumner and Ms. DiCicco.

II. Ms. Sumner Possesses Unique, Firsthand Knowledge of Information that Is Crucial to Respondents' Defense.

The Division's attempt to shield Ms. Sumner from her obligation to testify in this matter is unavailing. In arguing that Ms. Sumner should not be required to testify, the Division relies heavily on the Eighth Circuit's decision in *Shelton v. American Motors Corporation*, 805 F.2d 1323, 1327 (8th Cir. 1986), for the proposition that "Respondents have the burden of establishing that: (i) the information sought from the [opposing party's] attorney is actually relevant and non-

privileged; (ii) the information is crucial to the case; and (iii) no other means exist to obtain the information than to take testimony from the attorney." Division's Mot. at 6. But multiple courts, including the Second Circuit, have criticized *Shelton* as unduly restrictive. *See, e.g., In re Subpoena Issued to Dennis Friedman*, 350 F.3d 65, 67 (2d Cir. 2003) (characterizing the *Shelton* rule as "rigid" and espousing "a more flexible approach"); *Wilson v. O'Brien*, 2010 WL 1418401, at *2 (N.D. Ill. Apr. 6, 2010) (collecting cases that have criticized *Shelton* as "overly strict"); *accord, e.g., Younger v. Mfg. Co. v. Kaenon, Inc.*, 247 F.R.D. 586, 588 (C.D. Cal. 2007).

And even under *Shelton*, Respondents have established the necessity of compelling Ms. Sumner's testimony. *First*, the information sought, which concerns Ms. Sumner's communications with MBIA, a third party, is not privileged. And if privilege issues were to arise, Your Honor could address those issues "question by question" at the hearing. *See In re Cnty. of Orange*, 208 B.R. 117, 122 (Bankr. S.D.N.Y. May 7, 1997) (permitting deposition of opposing counsel).

Second, the information sought is "crucial to the preparation of [Respondents' defense]." *Ed Tobergate Assocs. Co. v. Russel Brands, LLC*, 259 F.R.D. 550, 554 (D. Kan. 2009) (permitting deposition of opposing counsel). The improper exchange of information between the Division and MBIA is of central importance to this case: MBIA's self-serving version of events, which it fed to the Division over a two-year period, forms the basis of the Division's theory of Respondents' purported misconduct; MBIA's receipt of the portfolio companies' confidential information coincided with its decision (unbeknownst to Respondents) to abandon restructuring negotiations for Zohar I, which would have flatly contradicted the Division's allegations that investors such as MBIA were defrauded; and the sharing of information between the Division and MBIA is directly relevant to the testimony—and credibility—of Mr. McKiernan, the MBIA

witness whom the Division has indicated it will call at the upcoming hearing. *See In re Cnty. of Orange*, 208 B.R. at 122 (permitting deposition of opposing counsel regarding his involvement in an agreement implicated in the litigation); *see also Younger Mfg. Co.*, 247 F.R.D. at 588 (allowing deposition of an opposing attorney where he was a "fact witness to communications" implicated in the suit).

Third, no other means exist to obtain the information sought. Ms. Sumner is the Division attorney who provided the portfolio companies' confidential information to MBIA; as such, she has unique, firsthand knowledge. Unless the Division can produce another witness who has personal knowledge of the Division's decision to improperly disclose confidential information and authorize the use of such information in litigation against Respondents, Respondents must be permitted to examine Ms. Sumner.[6] *See, e.g.*, *Nguyen v. Excel Corp.*, 197 F.3d 200, 209 (5th Cir. 1999) (upholding district court's decision to authorize depositions of opposing counsel). Additionally, Ms. Sumner was centrally involved in the Division's improper acquisition from Värde of documents *after* filing the OIP, *see* Mot. to Preclude at 12-13, and Respondents also intend to question Ms. Sumner regarding her knowledge of and role in withholding until this past week exculpatory information concerning two other Division witnesses, *see supra* p. 2 n.2. It is therefore crucial that Respondents have the opportunity to examine Ms. Sumner at the upcoming hearing.

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[6] Respondents also intend to question Ms. Sumner regarding the Division's understanding of—and any involvement in—MBIA's unreasonable refusal to comply with the 2016 Subpoena that Your Honor duly issued. *See supra* p. 6.

CONCLUSION

For the reasons set forth above, Respondents respectfully request that Your Honor deny the Division's motion to strike Respondents' further amended witness list and requests for hearing subpoenas to Ms. Sumner and Ms. DiCicco.

Dated: New York, New York
October 18, 2016

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EXHIBIT 1

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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PATRIARCH PARTNERS XV, LLC, and OCTALUNA, LLC,

Plaintiffs,

v.

U.S. BANK NATIONAL ASSOCIATION and MBIA INSURANCE CORPORATION,

Defendants.

----------x

New York, N.Y.

16 Civ. 7128 (JSR)

October 10, 2016
10:10 a.m.

Before:

HON. JED S. RAKOFF,

District Judge

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inquiries that they had.

MR. HOFF: Your Honor, I don't know how you want to view the relevance issue. My objection is this is irrelevant.

THE COURT: Let me look at it for a second.

MR. HOFF: The whole discussion with the SEC -- I'm not sure what that has to do with whether or not the trustee can liquidate all the collateral.

THE COURT: I think it is tangentially relevant and consistent with the position I took on other relevance objections. So I will receive it. Plaintiffs' Exhibit 15 is received.

(Plaintiff's Exhibit 15 received in evidence)

BY MR. BRODSKY:

Q. Let me direct your attention to Ms. DiCicco's email, December 17, 2013, at 11:57 a.m. to Ms. Sumner of the SEC, Ms. Lee of the SEC, and other attorneys at Bingham McCutchen where Ms. DiCicco was at the time.

If you look at paragraph 5, isn't it not true that it says, "Based on information MBIA learns in the documents or otherwise, MBIA may freely commence litigation against Ms. Tilton, Patriarch, or their related entities"?

A. Yes.

Q. The only thing that the SEC didn't want you to do was cite or attach the documents to any complaint; right?

A. That's correct.

Q. You requested that the SEC not tell Ms. Tilton or Patriarch about the receipt of these documents or your potential use of them unless giving you got a heads-up first. Correct?

A. That's what it says here, yes.

Q. And that's what you understood at the time.

A. I don't recall back to 2013 on this.

MR. BRODSKY: No further questions, your Honor.

THE COURT: Cross-examination.

CROSS-EXAMINATION

BY MR. HOFF:

Q. Mr. McKiernan, do you have any understanding as to whether or not MBIA has any obligations in the indenture to the trustee in connection with costs incurred by the trustee relating to the sale of the collateral?

A. I believe we were going to be covering the trustee's costs.

Q. I'd like to show you Defendants' Exhibit 10.

THE COURT: Before you do that, I apologize. Just on the exhibit that was before the witness a few minutes ago, Exhibit 15, Plaintiffs' Exhibit 15, would you explain to me the context of what's going on here.

THE WITNESS: The SEC approached MBIA toward the end of 2011/beginning of 2012 and had initially started asking us questions periodically about the Zohar transactions. We did not get full color as to what they were doing, or they never gave us full color on what their ultimate end purpose was.

From time to time they would ask us questions about the transactions which we would answer.

THE COURT: So it says here in the paragraph we're looking at on page 2 of this exhibit -- this is from your counsel to the SEC.

Do I have that right?

THE WITNESS: That's correct.

THE COURT: "Based on our prior discussions, we understand that you have certain documents you plan to share with MBIA and its counsel in furtherance of having additional off-the-record discussions with MBIA concerning the Zohar 1 and Zohar 2 transactions.

"We appreciate the opportunity to review these documents in advance of meeting with the staff so that we can review and digest the material and then have a more efficient and productive meeting."

So do I understand it correctly, your counsel said, you want some information from us, and it will be much better if we can see some of the underlying documents?

THE WITNESS: My understanding was from the initial meetings we've had with the SEC -- and I've had meetings with the SEC on other things before -- they asked for our input because we've had such experience in the structured finance market. In this case, as we progressed down questions on Zohar, we were under the understanding they wanted to give us

specific documents asking specific questions.

We weren't sure what type of information they had. We were concerned if they just showed it to us at the meeting, we wouldn't know --

THE COURT: You didn't want to be blind-sided. So you wanted to see the documents. But now the problem was that they had a confidentiality arrangement with Zohar?

THE WITNESS: I don't know what the SEC's arrangement was.

THE COURT: There follows then a bunch of conditions, and these were conditions that had been arrived at -- it looks to me like they had already been negotiated. This is kind of a confirmatory email. Yes?

THE WITNESS: It looks like that, yes.

THE COURT: The first is "The documents provided are confidential material and will be treated confidentially by MBIA and its counsel."

So was that the SEC's, if you know, desire to keep these confidential? Or was it that they had obtained them under some sort of confidentiality agreement, or don't you know?

THE WITNESS: I don't know the answer to that.

THE COURT: Two, "MBIA and its counsel will not use the documents provided for any purposes other than cooperating with the SEC's investigation of Patriarch."

So you knew they were investigating Patriarch for something. Yes?

THE WITNESS: At this point.

THE COURT: Did you know what they were investigating Patriarch for?

THE WITNESS: I didn't know the specifics, but they asked us questions about Patriarch's treatment of the collateral, how they were categorizing loans and, therefore, allowing themselves to earn fees.

THE COURT: Three, "You have stressed that MBIA cannot create any documents that reference or summarize any of the confidential documents provided and that the SEC will consider that impermissible use of the documents."

Four, "Notwithstanding the foregoing, based on information MBIA learns from the documents, MBIA may discuss the documents or information with Ms. Tilton or other representatives of Patriarch or reference it in correspondence to Patriarch."

Did you have or did MBIA tell Ms. Tilton or Patriarch that you had been shown those documents?

THE WITNESS: Ms. Tilton knew we were speaking with the SEC and that we had been interviewed several times by the SEC. I don't recall ever telling her that we had received documents from the SEC.

THE COURT: Five, "Notwithstanding the foregoing,

based on information MBIA learns from the documents or otherwise, MBIA may freely commence litigation against Ms. Tilton, Patriarch, or their related entities. MBIA will not cite or attach any of the documents received from the SEC to any complaint while those documents remain confidential and nonpublic. MBIA is free to use other copies of the document if MBIA obtains them from means other than the SEC."

So were you already contemplating a lawsuit against Patriarch or Ms. Tilton or both?

THE WITNESS: We felt that there were very questionable actions being taken by Patriarch that might cause us to take a litigation approach. We were concerned that if the SEC wanted to show us documents that echoed or mirrored our core issues, that somehow we'd be precluded from taking our own actions, which is something we did not want to allow to happen.

THE COURT: Then it says, as still a part of number 5, "In addition, MBIA requests that the SEC not inform Ms. Tilton, Patriarch, or their representatives that the documents and information have been provided to MBIA and its counsel without first apprising MBIA and its counsel of that fact. We appreciate the staff's willingness to accommodate this request."

What was the reason for that?

THE WITNESS: We had agreed to keep conversations and interviews with the SEC confidential. And, if they decided

that they wanted to let Patriarch know that the documents were being provided, we just wanted to know ahead of time.

THE COURT: So you were in a potentially adverse position to Patriarch but one that you didn't want to yet surface? Am I reading that right?

THE WITNESS: We had issues and concerns about how Patriarch had managed the transactions. We had not acted on them at that point because we were in the mode of wanting to see if there was a way to restructure the transactions. So we had actively not gone down the road of litigation at that point.

THE COURT: Go ahead, counsel.

MR. HOFF: Thank you, your Honor. I'm not sure if I asked this question already.

Q. Mr. McKiernan do you have an understanding as to whether or not MBIA has any obligations to the trustee under the indenture in connection with costs incurred by the trustee relating to the sale of the collateral?

A. Again, I believe we were meant to cover those costs.

MR. HOFF: May I approach?

THE COURT: Yes.

BY MR. HOFF:

Q. I'm showing you Defendants' Exhibit 10.

Do you recognize Exhibit 10?

THE COURT: Are you offering 10?

EXHIBIT 2

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

PATRIARCH PARTNERS XV, LLC and OCTALUNA LLC, Plaintiffs, v. U.S. BANK NATIONAL ASSOCIATION and MBIA INSURANCE CORPORATION, Defendants.	Index No. 654819 /2016 IAS Part ___ (_____, J.)

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' APPLICATION BY ORDER TO SHOW CAUSE FOR A TEMPORARY RESTRAINING ORDER, PRELIMINARY INJUNCTION, AND EXPEDITED DISCOVERY

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Dated: September 12, 2016

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Plaintiffs Patriarch Partners XV, LLC ("Patriarch XV") and Octaluna LLC ("Octaluna" and, together with Patriarch XV, "Plaintiffs"), by their attorneys Gibson, Dunn & Crutcher LLP, bring this action for a temporary restraining order and preliminary injunction in respect of a proposed September 15, 2016 sale (the "Proposed Sale") by defendant U.S. Bank ("U.S. Bank" or "Trustee") of collateral (the "Collateral") held by the Trustee on behalf of non-parties Zohar CDO 2003-1, Limited, Zohar CDO 2003-1, Corp., and/or Zohar 2003-1, LLC (collectively, "Zohar I") pursuant to an Indenture Agreement dated November 13, 2003 (the "Indenture") among Zohar I, the Trustee, defendant MBIA Insurance Corporation ("MBIA"), and non-party CDC Financial Products Inc., as Class A-1 Note Agent.

PRELIMINARY STATEMENT

This suit seeks to prevent the Trustee from rigging a September 15, 2016 sale of collateral backing defaulted debt to blatantly favor defendant MBIA, one of three creditors to which the Trustee owes fiduciary duties. Plaintiffs Patriarch XV and Octaluna are the other creditors to whom the Trustee owes a fiduciary duty, and whose interests the Trustee ignores entirely at the behest of its master MBIA. Patriarch XV and Octaluna will be irreparably injured by a sale process designed by MBIA and implemented by the Trustee to ensure that proceeds solely pay the debt owed to MBIA—and indeed, deliver a windfall to MBIA well in excess of what it is owed—without regard to the interests of Patriarch XV and Octaluna, which will be left with nothing but empty pockets and their far greater interests extinguished. The Proposed Sale, involving 132 distinct financial assets and 53 distinct financial entities in 24 distinct industries, has been scheduled on an absurdly short notice to the public of only 20 calendar days, has been restricted for no reason to a very narrow segment of potential investors, and has been limited to a bulk sale of all assets. This sham sale process is designed and virtually guaranteed to deliver collateral worth hundreds of millions of dollars into MBIA's hands at a non-market price and

with MBIA not having to make any cash outlay for the assets. Only a temporary restraining order, followed by a preliminary and then permanent injunction, can prevent Patriarch XV and Octaluna from sustaining irreparable harm from this sham sale process.

Patriarch XV, Octaluna and MBIA are holders of different classes of Notes of a defaulted Collateralized Loan Obligation fund, Zohar I. MBIA owns the most senior Notes (the "A-1 and A-2 Notes). Patriarch XV owns the Class A-3 Notes ("A-3 Notes"). Octaluna owns the Class B Notes ("B Notes") and preference shares ("Preference Shares"). MBIA came to own the Notes after paying insurance claims of $149 million to their original owners as "Credit Enhancer" under the Indenture. MBIA cares only about its self-interest, ensuring that the sale is structured in such a way that by making a "credit bid" against its $149 million claim, MBIA will obtain all of the Collateral, which is worth far more than $149 million, in return for extinguishing that claim. And it will do so without having to transfer a single dollar to anyone for these valuable assets. Meanwhile, Patriarch XV and Octaluna, which are entitled to everything other than that $149 million—including *at least* $286 million in outstanding Notes—will be left empty-handed and receive nothing. For the Trustee to countenance such a scheme evidences shocking disregard for its fiduciary duties.

MBIA has an additional interest in ensuring that it obtains all the Collateral for itself, that the "price" it "pays" is far below market, and that its cash outlay is zero. Specifically, MBIA is a mere four months away from having to cover an almost $800 million insurance claim when Notes come due in January 2017 for Zohar II, a fund similar to Zohar I that also is expected to default. But MBIA recently admitted to the public that it does not have the resources or capacity to pay the anticipated Zohar II claims and that the New York State Department of Financial Services could take control of MBIA. *See* Ex. 5 at 7.[1] That means MBIA in short order will be

[1] All citations in the form "Ex. __" refer to Exhibits to the Affirmation of Mark A. Kirsch dated September 12, 2016 ("Kirsch Affirmation").

in rehabilitation or liquidation, and that the executives who led MBIA to the edge of the cliff, will be out of jobs. In other words, MBIA is drowning in debt, and it plainly sees the Zohar I Collateral as a life raft that can help it stave off a government takeover if it can steal that Collateral now.

As the holder of the senior outstanding Notes, MBIA is deemed the "Controlling Party" under the relevant Indenture, and it has the power to direct the Trustee, as it did on June 27, 2016 (the "June 27 Direction"), to begin a sale process. *See* Ex. 20. But the Trustee has a fiduciary duty to *all* Noteholders, and thus a sale process cannot be lawful without honoring scrupulously the fiduciary duties owed to Patriarch XV and Octaluna. Far from fulfilling its fiduciary duties, the Trustee has literally ignored them for the benefit of one creditor alone, MBIA. Proving itself MBIA's mere catspaw, the Trustee announced a sale process that is transparent in its purpose to deliver a single result – the Collateral to MBIA below-market prices with no cash outlay.

The first disqualifying flaw in the sale process is its timing. The Collateral consists of 132 distinct financial assets relating to 53 distinct financial entities in 24 distinct industries. These assets are largely illiquid. They are complex. They are diverse. It is ridiculous on its face to schedule the sale of such assets only 20 calendar days after the announcement of the sale, not to mention that the 20 days includes three weekends, one of which was extended for a national holiday. A commercially reasonable amount of time for potential bidders to evaluate the Collateral would be months. By truncating the evaluation process of an extremely complex portfolio to 14 business days, MBIA gets exactly what it wants – likely no other bidders, ensuring that its no-cash, below-market price bid will be accepted by the Trustee, and that MBIA has a better chance of surviving in January 2017 when it will have to pay out $800 million in claims.

The second disqualifying flaw in the process is that the Trustee, working to deliver the collateral to its string-puller MBIA at a "fire sale" price, announced that it would reject any bid that was not for all of the Collateral. No partial bids will be allowed. This is obviously not a commercially reasonable approach, not least because it eliminates a viable alternative that the value of the assets sold individually likely would exceed the value of all assets sold as a whole.

The third disqualifying flaw of the sale process is that it evidences an improper attempt by MBIA to steal equity in the "Portfolio Companies" that borrowed from the Fund and that are majority-owned by Octaluna and certain of its affiliates. This equity actually is *not* "Collateral" within the meaning of the Indenture. But the sale announcement is loosely worded, referring to "Other Collateral" being sold as well, in an apparent attempt to permit MBIA to claim later that the sale included unspecified Portfolio Company equity too. Ex. 3. Essentially, MBIA is not content to take the Collateral alone; it also intends to try to steal Portfolio Company equity along with the Collateral.

The fourth disqualifying flaw of the sale process—underscoring that the planned short-notice, "take-it-or-leave-it" sale of highly complex assets is merely a sham—is that the Trustee has shown no effort to market the assets to prospective bidders. It is commercially unreasonable for a Trustee, obligated to act for the benefit of *all* Noteholders by endeavoring to maximize proceeds of a collateral sale, instead to put all of these assets on the auction block for bulk purchase without any marketing effort whatsoever beyond the bare announcement of the impending sale. Again, MBIA and the Trustee have designed a sham process structured to deliver assets worth hundreds of millions of dollars into MBIA's hands at a below-market price, and without competition from other bidders.

The fifth disqualifying flaw of the sham sale process is that, by design, the process will not maximize the yield on sale of the assets but, instead, will deliver a windfall to MBIA well in

excess of its indebtedness, to the deliberate exclusion of Patriarch XV and Octaluna, which will end up with nothing.

Finally, the faithless Trustee, at the direction of MBIA, has gone beyond just structuring a sham sale process; it has outright denied Patriarch XV and Octaluna their rights under the Indenture to review relevant books and records of the Trustee regarding the Proposed Sale of the Collateral, and to discuss their concerns with the Trustee. This denial of their contractual rights impairs their ability to properly evaluate a potential purchase of the Collateral, much less to challenge this sale, which is obviously why the Trustee is refusing to honor the terms of the Indenture. This misconduct by the Trustee, rendering Patriarch XV and Octaluna unable to review books and records and meet with the Trustee, as is their absolute right, is both shocking and causing these Plaintiffs irreparable harm.

In sum, Patriarch XV and Octaluna have been abused by a fiduciary who has behaved as anything but, favoring one creditor (MBIA) to the exclusion of Plaintiffs, and whose mistreatment will continue without this Court's emergency intervention. MBIA's own financial distress is at the heart of its desperate attempt to save itself, in effect, by stealing the Collateral and thereby divesting Plaintiffs—the only other creditors—of all rights to the Collateral and depriving them of any recovery ever on their investments. Indeed, if this Court does not stop the sale, Defendants surely will argue in later litigation that Plaintiffs' rights in connection with their Notes, including the right to recover damages, were extinguished fully by the sale. That is the very definition of irreparable harm. And even if Defendants failed to defeat future litigation on that ground, Plaintiffs would still be subject to irreparable harm, as MBIA's looming insolvency likely would foreclose satisfaction of any damages award. MBIA's attempted money grab will also put a cloud over Octaluna and its affiliates' equity holdings in the Portfolio Companies at a critical time for the companies and Plaintiffs alike. In other words, these Plaintiffs face

irreparable harms without immediate injunctive relief.[2] Indeed, MBIA seeks to snatch this Collateral at a below-market price inconceivable in a real sale process. And a real sale process is all Patriarch XV and Octaluna are asking this Court for—not to prevent a sale process, but to ensure that a commercially reasonable sale process is in place that will provide an opportunity to maximize the yield on the sale of the Collateral.

In order to maximize the yield, the Trustee should be ordered to provide an adequate period of time for potential bidders to evaluate the Collateral. The Trustee must make commercially reasonable efforts to market the sale or at least provide relevant information to potentially interested parties. The Trustee must permit the widest variety of investors that legally can do so, and not limit the bidding to "Qualified Institutional Buyers." The Trustee also must permit bids on individual assets, not just all-or-nothing bids. Moreover, the Trustee cannot be permitted to sell equity interests in the Portfolio Companies as purported "Other Collateral" when such interests are not "Collateral" at all under the Indenture. And the Trustee must permit Patriarch XV and Octaluna to review books and records, as required under the Indenture.

To be clear, Patriarch XV and Octaluna do *not* seek to prevent the sale process. Rather, they seek only to ensure a commercially reasonable sale process fair to all bidders and investors. And they seek expedited discovery to further expose this process for what it is—a sham designed to steer a windfall to MBIA as it struggles to avoid financial collapse. Accordingly, Plaintiffs respectfully request that this Court put a halt to this "fire sale" process now and require the Trustee to conduct a commercially reasonable auction.

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[2] As detailed herein, the Trustee's and MBIA's breaches that require an emergency remedy include: the Trustee's breaches of Section 6.1(f) and 5.4(c) of the Indenture, annexed as Exhibit 2 to the Kirsch Affirmation; the Trustee's violation—aided and abetted by MBIA—of the Trustee's fiduciary duty of undivided loyalty to all trust beneficiaries; the Trustee's violation of Article 9 of the New York Uniform Commercial Code ("UCC"), that mandates that "[e]very aspect" of the Trustee's proposed sale of the Collateral, "including the method, manner, time, place, and other terms, must be commercially reasonable," UCC § 9-610(b); MBIA's breach of Section 5.13(a) of the Indenture; and MBIA's and the Trustee's breach of their implied duties of good faith and fair dealing under the Indenture.

FACTUAL BACKGROUND

The facts relevant to this application are set forth in Plaintiffs' Verified Complaint, which is Exhibit 1 to the Affirmation of Mark A. Kirsch filed concurrently with this memorandum.

LEGAL STANDARDS

Injunctive relief should be granted where a movant demonstrates "a likelihood of success on the merits, danger of irreparable injury in the absence of an injunction, and a balance of the equities in [its] favor." *Gerald Modell Inc. v. Morgenthau*, 196 Misc. 2d 354, 359 (Sup. Ct. N.Y. Cnty. 2003); *see also Gund, Inc. v. SKM Enters., Inc.*, 2001 WL 125366, at *1 (S.D.N.Y. Feb. 14, 2001) (equating standards for temporary restraining order and preliminary injunction).

To establish "a likelihood of success," the movant need not show a "certainty of success"; a "prima facie showing" of merit will suffice. *Parkmed Co. v. Pro-Life Counselling, Inc.*, 91 A.D.2d 551, 553 (1st Dep't 1982). Where, as here, the relief sought would merely preserve the status quo, the plaintiff has a "reduced degree of proof" in establishing its likelihood of success. *Masjid Usman, Inc. v. Beech 140, LLC*, 68 A.D.3d 942, 943 (2d Dep't 2009). Similarly, "[w]here denial of injunctive relief would render the final judgment ineffectual, the degree of proof required" to establish likelihood of success "should be accordingly reduced." *Republic of Lebanon v. Sotheby's*, 167 A.D.2d 142, 145 (1st Dep't 1990). Likelihood of success can be found "even when facts are in dispute." *Ma v. Lien*, 198 A.D.2d 186, 187 (1st Dep't 1993).

Moreover, because temporary restraining orders and preliminary injunctions are designed "to maintain the status quo until there can be a full hearing on the merits," *Pamela Equities Corp. v. 270 Park Ave. Cafe Corp.*, 62 A.D.3d 620, 621 (1st Dep't 2009), the balance of equities presumptively tilts in favor of the party seeking to preserve the status quo, *see CanWest Glob. Commc'ns Corp. v. Mirkaei Tikshoret Ltd.*, 9 Misc. 3d 845, 872 (Sup. Ct. N.Y. Cnty. 2005).

ARGUMENT

I. PLAINTIFFS ARE LIKELY TO SUCCEED ON THE MERITS

A. The Proposed Sale of the Collateral Constitutes a Breach of the Trustee's Fiduciary Duties to Plaintiffs as Noteholders of Zohar I

Plaintiffs are likely to succeed on the merits of their claim against the Trustee for breach of its fiduciary duties in seeking to execute a sham public auction designed to deliver all of the Zohar I Collateral to MBIA and leave Plaintiffs with nothing. In New York, to plead a claim for breach of fiduciary duty, a plaintiff must allege: (1) the existence of defendant's duty to plaintiff, (2) a breach of that duty, and (3) injury to the plaintiff as a result of the breach. *Howe v. Bank of N.Y. Mellon*, 783 F. Supp. 2d 466, 483 (S.D.N.Y. 2011).

As Trustee under the Indenture, U.S. Bank owes significant fiduciary duties to Plaintiffs following the default of Zohar I. Under well-settled New York law, an indenture trustee owes a "fiduciary duty of undivided loyalty to trust beneficiaries" once an event of default by the trust entity occurs. *Beck v. Mfrs. Hanover Trust Co.*, 218 A.D.2d 1, 11 (1st Dep't 1995). Although a trustee's fiduciary duties before an event of default generally are limited to the duties expressly identified in the indenture itself,[3] "the indenture trustee's obligations" after such an event "come more closely to resemble those of an ordinary fiduciary." *Id.* at 12. This is true "regardless of any limitations or exculpatory provisions contained in the indenture," because "[i]t simply does not accord with sound public policy or the ostensible purposes for which an indenture is made and relied upon by its beneficiaries, to allow indenture trustees the benefit of broad exculpatory provisions to excuse their failure to exercise those powers they possess pursuant to the indenture prudently in order to mitigate or obviate the consequences of default." *Id.*

[3] *See Peak Partners, LP v. Republic Bank*, 191 F. App'x 118, 122-24 (3d Cir. 2006) (finding no breach of fiduciary duty by U.S. Bank only on the ground that no "event of default" under indenture had occurred). Here, in stark contrast, it is not disputed that an event of default occurred when Zohar I defaulted in November 2015.

Here, the Trustee breached its fiduciary duties to Plaintiffs by taking steps to effect a Proposed Sale of the Collateral on terms that thwart the basic purpose of the Indenture: to "adequately and effectively protect[]" the interests of *all* the Noteholders, not just MBIA. Indenture at 3. Specifically, the Trustee breached its fiduciary duties when it launched a sale process on less than three weeks' notice with numerous terms designed to minimize competitive bidding and depress the auction price for the Collateral, thereby virtually guaranteeing MBIA will acquire the Collateral through a non-cash credit bid—at the expense of other trust beneficiaries (i.e., Plaintiffs)—for substantially less than the fair value of the Collateral. In short, the Trustee failed to "act prudently to safeguard the assets of the Trust." *LNC Invs., Inc. v. First Fid. Bank, N.A. N.J.*, 173 F.3d 454, 462 (2d Cir. 1999).

The Trustee's unlawful actions are akin to those of the trustee in *Beck v. Manufacturers Hanover Trust Co.*, in which the Appellate Division, First Department reinstated a claim for breach of fiduciary duty against a successor indenture trustee. The trustee had failed to obtain an independent valuation of collateral securing certain corporate bearer bonds that were sold at auction to the sole bidder, a Mexican government-controlled corporation that was the controlling bondholder with the right "to direct and to control the method and place of conducting any and all proceedings for any sale" of the collateral. 218 A.D.2d at 6. Following private negotiations between the trustee and the controlling bondholder (to the exclusion of the other trust beneficiaries), the sale resulted in the undervaluation of the auctioned trust assets, and preventing the plaintiffs, also bondholders, from obtaining full payment. 218 A.D.2d at 6, 16-17. Among other things, the court found persuasive that, "[w]hile denominated an 'auction', [the sale of the collateral] was in its true aspect nothing but a sale to a preordained buyer," given that Mexico "for decades had had designs upon obtaining the collateral and . . . had called for an auction in order finally to make the long contemplated acquisition." *Id.* at 16. According to the court, "[i]t

could have not been clearer that either Mexico or some other entity acting as its nominee would appear at the auction, make a highly leveraged bid, and ultimately purchase the collateral paying only a small portion of the price in cash." *Id.* Against this backdrop, the court concluded that the trustee's failure to "insure the fairness of the 'auction' . . . constituted a clear breach" of the trustee's fiduciary duties of undivided loyalty to the trust beneficiaries "[i]f, as is evidently the case, the Trustee did in fact rely upon" a biased valuation to set the collateral's price. *Id.* at 17.

Similarly, here, the Trustee has effected nothing more than an unfair, "preordained" sale to MBIA. Among other things, the Trustee failed to produce any marketing plan or confirm that it even has any plan at all; it afforded only three weeks' notice of the commercially unreasonable sale, including over a holiday weekend in the U.S.; it limited permissible buyers to a small group of "qualified institutional buyers"; and it structured the sale as a bulk sale of all the assets, thereby discouraging bidders (including Patriarch) and failing to provide an opportunity to obtain a fair value for the individual assets. *See* Ex. 4. Moreover, the limited notice period provided to the market is "far too short" to afford potential bidders the time needed to conduct meaningful diligence into "such a large and complex portfolio," particularly given that it is "comprised of a very diverse pool of 132 distinct," unregistered, unrated, and illiquid financial assets "relating to 53 distinct entities" operating in 24 different industries. Affidavit of John H. Reohr IV dated September 12, 2016 ("Reohr Aff.") at ¶¶ 11, 12. In view of these facts, "it could not have been clearer" that MBIA would "appear at the auction . . . and ultimately purchase the collateral" with a credit bid for pennies on the dollar. *Beck*, 218 A.D.2d at 16. In short, "[w]hile denominated an 'auction'," the sale of the Collateral was "in its true aspect nothing but" a "ruse" to "deter[] the involvement of other bidders, and rob[] Zohar I of its valuable collateral." *See id.* at 15.

B. By Directing the Proposed Sale of the Collateral, MBIA Is Aiding and Abetting the Trustee's Breach of Fiduciary Duties.

MBIA is likewise liable for having aided and abetted the Trustee's indisputable breach of its fiduciary duties to Plaintiffs. "A claim for aiding and abetting fiduciary duty requires (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damages as a result of the breach." *Higgins v. New York Stock Exchange Inc.*, 10 Misc. 3d 257, 287 (Sup. Ct. N.Y. Cnty. 2005) (citations omitted). Moreover, "[a]nyone who knowingly participates with a fiduciary in a breach of trust is liable for the full amount of the damage." *Id.* (citations omitted).

As previously explained, the Trustee has breached its fiduciary duties to Plaintiffs by taking steps to effect a commercially unreasonable sale of the Collateral. MBIA's knowledge of this breach "may . . . be implied from a strong inference of fraudulent intent . . . and a motive is probative of that inference." *In re Refco Inc. Sec. Litig.*, 826 F. Supp. 2d 478, 517 (S.D.N.Y. 2011) (citations omitted) (finding that plaintiff adequately pled "actual knowledge" of the breach of fiduciary duty because it stated defendant's motive to further a scheme to transfer excess cash from protected accounts in the United States to unprotected offshore accounts); *see also Higgins*, 10 Misc. 3d at 289 (plaintiff stated claim for aiding and abetting breach of fiduciary duty where defendant bank allegedly was "aware of [potential] conflicts" inherent in providing financial services to both corporations in the same merger transaction despite disclaiming those conflicts).

Here, there can be no doubt that MBIA had knowledge of the Trustee's breach of fiduciary duties, given that MBIA directed that breach, instructing the Trustee to sell the Collateral in a highly unusual manner that benefits only MBIA. MBIA's direction also coincides with its admission—as recently as August 8, 2016—that "[t]here can be no assurance that MBIA Corp. will be successful in generating sufficient cash to meet its obligation" to pay the nearly

$800 million in Zohar II Notes in January 2017. Ex. 5 at 7. If MBIA goes into receivership, it can no longer be the Controlling Party. Instead, Patriarch XV would assume that role, and MBIA's scheme to credit bid the Collateral for pennies on the dollar would be foiled.

Moreover, MBIA's instructions to the Trustee "substantially assisted" the Trustee's breach of fiduciary duty. *See* Ex. 20. "Substantial assistance" exists "where the alleged aider and abettor affirmatively assists [the fiduciary] . . . , thereby enabling the breach to occur." *In re Allou Distributors Inc.*, 446 B.R. 32, 58 (Bankr. E.D.N.Y. 2011).

C. The Trustee's Proposed Sale of the Collateral Violates the "Commercially Reasonable" Requirement of UCC § 9-610.

The Trustee violated Article 9 of the UCC, which requires "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, [to be] commercially reasonable." UCC § 9-610(b). A disposition is commercially reasonable if it is made: "(1) in the usual manner on any recognized market; (2) at the price current in any recognized market at the time of the disposition; or (3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition." *Id.* § 9-627(b). In assessing whether a trustee has met this standard, courts look to the "totality of the circumstances," including "accepted business practices" in the relevant industry, "as a guide to what is most likely to protect both debtor and creditor." *Highland CDO Opportunity Master Fund, L.P. v. Citibank, N.A.*, 2016 WL 1267781, at *18 (S.D.N.Y. Mar. 30, 2016) (citation omitted). Here, the Trustee violated Article 9 in several ways.

First, the *timing* of the Trustee's Proposed fire Sale is commercially unreasonable. Only 20 days stand between the notice and the sale. As John Reohr, who has deep expertise in the area of collateral sales, states in his expert affidavit, "[t]his is far too short a period for such a large and complex portfolio" that is "comprised of a very diverse pool of 132 distinct financial

assets relating to 53 distinct entities." Reohr Aff. at ¶¶ 11, 12; *see also* Affidavit of Steven L. Schwarcz dated September 12, 2016 ("Schwarcz Aff.") ¶ 4.7 ("Requiring that bids be submitted by September 15, less than a three-week period, further exacerbates the commercial unreasonableness of the Proposed Sale."). These assets "are privately issued securities from small companies with little or no publicly available information; evaluating each individual collateral interest is a time consuming proposition." Reohr Aff. at ¶ 13. Mr. Reohr estimates that, "[f]or the types of assets in the Zohar I portfolio, an orderly portfolio liquidation allowing for individual asset sales could take an organized investment bank from six months to one year."[4] *Id.* ¶ 14; *see also In re Frazier*, 93 B.R. 366, 369 (Bankr. M.D. Tenn. 1988) ("plaintiffs acted with unreasonable haste in their efforts" to sell a jet where sale was held "approximately three (3) weeks" after plaintiffs decided to sell, yet experts opined that a "fair and proper sale" or "commercially reasonable" sale would require between "ninety (90) days" and "one (1) year").

The Trustee also issued the Sale Notification and Invitation to Bid (the "Invitation") on August 26, 2016, just before Labor Day weekend, *see* Exs. 3, 4, further ensuring that the sale would not be a competitive process. Courts take note of such timing issues in assessing commercial reasonableness. *See, e.g., Highland*, 2016 WL 1267781 at *18-19 (finding "probative" expert opinion noting that December 31 deadline for bids on collateral was not consistent with "normal business conditions" because "most broker-dealers and investors are only partially staffed" on that day). "[T]he timing [here is] not likely to enhance competitive bidding." *Id.* at 19. To the contrary, it virtually ensures MBIA will be the only bidder.

Second, the *nature* of the sale is commercially unreasonable. Further limiting the pool of potential buyers, the Trustee offered the Collateral on an "all (but not less than all)" basis, rather

[4] By way of contrast, it is "market practice" to provide "1 to 2 weeks before attempting to sell" for an "institutional seller of a large list of investment grade, liquid, 1940 Act registered, and transferable structured credit securities." *Id.*

than allowing bids on specific assets. *See* Ex. 3 at 1. That approach "is not standard fixed income market practice and will likely result in lower sale proceeds." Reohr Aff. ¶ 15. An "all or nothing" sale of illiquid assets "will force any potential bidder into deeply discounting large portions of the collateral interests to meet the time constraint, or alternatively they will not bid at all." *Id.* ¶ 16; Schwarcz Aff. ¶ 4.7 ("[R]equiring that bids be for the entire Portfolio, and thus disallowing Partial Bids, makes the Proposed Sale commercially unreasonable."). This is confirmed by Comment 3 to UCC 9-610, which states that though Article 9 "does not specify a period within which a secured party must dispose of collateral . . . it might be more appropriate to sell a large inventory in parcels over a period of time instead of in bulk."

Potential bidders' due diligence efforts will only further be frustrated by the Trustee's failure to sufficiently define the Collateral for sale, instead providing only a vague description as to the "Other Collateral" to be included in the disposition. *See* Ex. 3, 4. And the Collateral is to be sold on an "AS IS AND WHERE IS" basis, *see* Exs. 3, 4, which is "unusual and . . . will not engender confidence from potential buyers." Reohr Aff. ¶ 18. To make matters worse, the Trustee even *further* limited the pool of potential buyers to a small group of "qualified institutional buyers." *See* Schwarcz Aff. ¶¶ 4.9, 4.11 ("Restricting bidders to QIBs limits the universe of potential bidders for Zohar I's assets. . . [and] makes the Proposed Sale commercially unreasonably be needlessly restricting the parties eligible to bid.").

Finally, the Trustee has initiated the sale, blindly accepting MBIA's direction despite obvious red flags that MBIA is exerting influence over the sale process to obtain the Collateral at a steeply discounted price, at the expense of other Noteholders. This type of collusion is strictly prohibited by the UCC. *See, e.g.*, *First Interstate Credit Alliance, Inc. v. Nicholson*, 1990 WL 89367, at *2 (S.D.N.Y. June 15, 1990) (denying motion for summary judgment that plaintiff held a commercially reasonable sale because defendant "alluded to the possibility of coll[u]sion"

between seller and another bidder, "both of whom" were "accused of maintaining an artificially low price in order to reap a greater profit by reselling the [collateral] at a later date"); *see also O'Brien v. Chase Home Fin.*, LLC, 42 A.D.3d 344, 344-45 (1st Dep't 2007) (finding that motion court erred in dismissing plaintiff's motion to enjoin defendants' closing of a sale because there were "issues of fact" as to whether "there was collusion between the mortgagee . . . and buyer").

For all of these reasons, the Proposed Sale is commercially unreasonable, and injunctive relief is necessary to stop it. *See* UCC § 9-625(a) (when a secured party "is not proceeding in accordance with" a commercially reasonable sale, injunctive relief is appropriate to "restrain . . . disposition of collateral"); *see also id.* § 9-102(73)(E) (a trustee is a "secured party").[5]

D. For the Same Reasons, MBIA's Instructions to the Trustee to Consummate the Proposed Sale Constitutes a Breach of the Indenture.

MBIA's instructions to the Trustee to conduct this Sale on such patently unreasonable terms constitutes a breach of contract by MBIA. Section 5.13 the Indenture mandates that MBIA, as the Controlling Party, has "the right to cause the institution of . . . and direct the time, method and place of conducting any Proceeding for any remedy available to the Trustee," but only "*provided that*: (a) such direction shall not conflict with any rule of law; . . . and (d) any direction to the Trustee to undertake a sale of the Collateral shall be made only pursuant to, and in accordance with, Sections 5.4 and 5.5." Indenture § 5.13 (emphasis added). The Indenture therefore expressly prohibits MBIA from directing the Trustee to initiate any proceedings, including any sale of the Collateral, that "conflict[s] with any rule of law." *Id.* § 5.13(a).

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[5] At least one court has found that UCC section 9-625 does not authorize courts to unwind improper collateral sales after the fact. *See In re Inofin Inc.*, 512 B.R. 19, 89-90 (Bankr. D. Mass. 2014) (finding Massachusetts UCC section 9-625(a) was "inapplicable to" a claim seeking to void a commercially unreasonable sale because "[i]ts provisions are cast in the present tense and are intended to curtail violations of UCC provisions *while they are occurring*." (emphasis added)). Because Plaintiffs cannot be compensated by money damages, *see infra* at pp. 19-22, Plaintiffs will suffer irreparable harm should the Proposed Sale be consummated now.

By directing a sale of Collateral comprising 132 diverse, complex assets on less than three weeks' notice, on an all or nothing basis, thereby ensuring there will be no meaningful competition, MBIA has caused the Trustee to act in "conflict" with a "rule of law," *id.* § 5.13(a), namely, UCC sections 9-610(b), which requires "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms," to "be commercially reasonable," and 9-627(b)(3), which mandates that sales be held "in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition."

E. The Trustee Has Breached the Indenture by Failing to Provide Plaintiffs with Books and Records Concerning the Proposed Sale

The Trustee's refusal to allow Plaintiffs to examine books and records relating to the Notes constitutes a breach of Indenture Section 6.1(f), which states that "[t]he Trustee . . . , upon reasonable (but no less than three Business Days') prior written notice," permit any Noteholder "to examine all books of account, records, reports and other papers of the Trustee relating to the Notes . . . and to discuss the Trustee's actions, as such actions relate to the Trustee's duties with respect to the Notes, with the Trustee's officers and employees." Plaintiffs have repeatedly sought access to the Trustee's books and records relating to the Proposed Sale and any related marketing efforts, as well as the opportunity to discuss those matters with the Trustee's officers. Ex. 9 at 1; Ex. 12 at 4-5.

On September 2, 2016, the Trustee flatly refused to permit inspection on the purported basis that certain materials had or would be made "available through the Liquidation Agent," and that Section 6.1(f) of the Indenture "does not give [Plaintiffs] the right to demand disclosure of the specified communications with third parties concerning the Auction." Ex. 13 at 3. But the Indenture does not relieve the Trustee of its obligation under Section 6.1(f) to provide its own books and records to a Noteholder upon valid request, simply because some unidentified marketing materials have been provided to the Liquidation Agent for distribution to potential

third-party bidders—strangers to the Indenture—upon execution of documents restricting those books and records to use in connection with submitting a bid. Nor does Section 6.1(f) contain any exemption relieving the Trustee of its obligation to provide books and records that happen to constitute communications. *See* Indenture § 6.1(f).[6]

F. By Orchestrating this Unlawful Proposed Sale, the Trustee and MBIA Have Breached the Implied Covenant of Good Faith and Fair Dealing.

"Implicit in all contracts is a covenant of good faith and fair dealing," which "embraces a pledge that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'" *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 389 (1995). A party breaches this covenant when it "acts in a manner that, although not expressly forbidden by any contractual provision, would deprive the other party of the right to receive the benefits under their agreement." *ARB Upstate Commc'ns LLC v. R.J. Reuter, L.L.C.*, 93 A.D.3d 929, 934 (3d Dep't 2012).

It is difficult to imagine a plainer case of one party to a contract (MBIA) wholly defeating the very purpose for which the contract was created. Indeed, the fundamental objective of the Indenture is to grant to the Trustee the Collateral in trust "for the benefit and security" of the parties to the Indenture, including *all* the Noteholders. Indenture, Granting Clauses. Yet, after years of feigning interest in a consensual restructuring of the Zohar funds, MBIA has designed and the Trustee has implemented a sham sale process to deliver to MBIA Collateral worth far more than its $149 million claim against the fund, while seeking to strip Plaintiffs of all of their rights to repayment under the Indenture. MBIA has directed the Trustee to sell the Collateral on

[6] The Trustee has breached the Indenture in several other respects as well. For example, the Trustee breached the Indenture by accepting MBIA's instructions to conduct the Proposed Sale on terms contrary to the Indenture's proviso that any such direction must "not conflict with any rule of law." Indenture § 5.13(a); *see* UCC §§ 9-610(b), 9-627(b)(3). The Trustee also breached Section 5.4 of the Indenture, which provides that Noteholders have the right in a foreclosure sale to "bid and purchase the Collateral *or any part thereof*," Indenture § 5.4(a) (emphasis added), by limiting the Proposed Sale to "all or none" bids on the entire portfolio of Collateral.

less than three weeks' notice, ensuring that there will be no meaningful competition in its steeply discounted credit bid for the Collateral. MBIA simply will transfer the assets held "for the benefit and security" of all fund creditors directly into its coffers at a deflated price, all under the "guise of business dealings." *Lehman Bros. Int'l (Europe) v. AG Fin. Prod., Inc.*, 2013 WL 1092888, at *3 (Sup. Ct. N.Y. Cnty. Mar. 12, 2013); *see Rebecca Broadway Ltd. P'ship v. Hotton*, 2016 WL 438201 (1st Dep't Aug. 18, 2016) (affirming summary judgment against publicity agent who breached covenant of good faith and fair dealing by misusing producer's confidential information to sabotage theatrical production agent was hired to promote).

There is no mystery surrounding MBIA's motivations for pursuing this course. In January 2017, MBIA will face a claim on its Zohar II insurance to the tune of nearly $800 million. *See* Ex. 1. Threatened with rehabilitation or liquidation by regulators, MBIA hastily directed a fire sale of the Collateral, knowing full well its actions would jeopardize Plaintiffs and the associated Portfolio Companies. This is a clear breach of the implied covenant of good faith and fair dealing.

Any attempt by MBIA to argue that Plaintiffs' bad faith claim should be defeated because MBIA has the power, as the Controlling Party, to direct the Trustee to sell or foreclose upon the Collateral, as provided under Section 5.13 of the Indenture, should fail. New York law prohibits MBIA from exercising any of its contractual rights, including directing the sale of the Collateral, "for an illegitimate purpose and in bad faith" as a part of a scheme to deprive another party to the contract of the benefits of its bargain. *Richbell Info. Servs., Inc. v. Jupiter Partners, L.P.*, 309 A.D.2d 288, 302–03 (1st Dep't. 2003) (denying motion to dismiss on the ground that defendant had exercised his contractual veto power in bad faith as part of a scheme to deprive plaintiffs of benefits of their joint venture); *see also Lehman Bros. Int'l (Europe) v. AG Fin. Prod., Inc.*, 2013 WL 1092888, at *3 (Sup. Ct. N.Y. Cnty. Mar. 12, 2013) (same).

Nor can MBIA argue that it has discretion under the Indenture to direct a sale of the Collateral on such terms. *See Maddaloni Jewelers, Inc. v. Rolex Watch U.S.A., Inc.*, 41 A.D.3d 269, 270 (1st Dep't 2007) (although contract afforded defendant significant "discretion," the implied covenant obligated [defendant] to exercise such discretion in good faith, not arbitrarily or irrationally"); *1-10 Indus. Assocs., LLC v. Trim Corp. of Am.*, 297 A.D.2d 630, 631-32 (2d Dep't 2002) ("Here, although the letter agreement did not contain a provision requiring [defendant] to act reasonably in approving or rejecting proposed relocation sites, [defendant] had an implied obligation to exercise good faith in reaching its determination.").

II. PLAINTIFFS AND THEIR AFFILIATES WILL BE IRREPARABLY HARMED IF THE SALE IS CONSUMMATED

If the Proposed Sale takes place as planned on September 15, Plaintiffs and their affiliates will suffer immediate irreparable harm. Irreparable injuries are those that "cannot be repaired, restored, or adequately compensated in money, or where the compensation cannot be safely measured." *Int'l Union of Operating Eng'rs, Local No. 463 v. City of Niagara Falls*, 191 Misc. 2d 375, 380 (Sup. Ct. Nassau Cnty. 2002); *see also Penstraw, Inc. v. Metro. Transp. Auth.*, 200 A.D.2d 442, 442 (1st Dep't 1994) (irreparable harm established where money damages are not readily ascertainable, and "calculation of future damages would be unreliable and risky"). Thus, a "showing of irreparable damage to plaintiffs has been made out [where] it appears that, in the absence of a restraint . . . , plaintiffs would likely sustain a loss of business impossible, or very difficult, to quantify." *Willis of N.Y., Inc. v. DeFelice*, 299 A.D.2d 240, 242 (1st Dep't 2002).

First, the Proposed Sale irreparably will violate Plaintiffs' inspection rights under the Indenture. For months before noticing the Proposed Sale, the Trustee has refused to provide any information or distribute any waterfall payments of interest since *March*. Plaintiffs do not even know how much cash is held by Zohar I (or the two other Zohar funds) today. Yet the Trustee's

behavior in connection with the Proposed Sale is even more inexplicable. The Trustee has refused to provide Plaintiffs any books and records relating to the Proposed Sale or to discuss the Proposed Sale with them, in violation of Section 6.1(f) of the Indenture. Plaintiffs' inability to review this information prevents them from valuing the assets that comprise the Collateral. "Loss of [the right to inspect corporate books] alone has been recognized as irreparable harm." *Street v. Vitti*, 685 F. Supp. 379, 384 (S.D.N.Y. 1988).

Second, if the Proposed Sale process were not improperly restricted to "all or nothing" bids, Octaluna or its affiliates would bid for individual Collateral assets. That lost business opportunity is itself an irreparable harm. *See Register.com, Inc. v. Verio, Inc.*, 356 F.3d 393, 404 (2d Cir. 2004) (finding that the "loss of reputation, good will, and business opportunities" is irreparable harm). This is only compounded by violation of Octaluna's express rights as a Noteholder, under Section 5.4(c) of the Indenture, to "bid for and purchase the Collateral *or any part thereof*." Indenture § 5.4(c); *see also Bank of America, N.A. v. PSW NYC LLC*, 2010 WL 4243437, at *10 (Sup. Ct. N.Y. Cnty. Sept. 16, 2010) ("In appropriate circumstances, the loss of a bargained-for contractual right of control can constitute irreparable harm.") (citations omitted).

Third, the Proposed Sale would allow MBIA to reap a windfall at Plaintiffs' expense by using a credit bid to obtain the Collateral (including significant cash) at a fire-sale price, rather than allowing Zohar I to sell Collateral assets through a commercially reasonable sale that would recoup the fair value of those assets. If MBIA's plan succeeds, MBIA will own *all* the Collateral in Zohar I—and Defendants undoubtedly will argue that such sale fully and forever extinguishes Plaintiffs' rights to or interest in the Collateral. In particular, Defendants likely will contend that the Proposed Sale binds all Noteholders, including Plaintiffs and MBIA, "divest[s] all right, title and interest whatsoever, either at law or in equity, of each of them in and to the property sold," and serves as "a perpetual bar, both at law or in equity, against each of them . . . and against any

and all Persons claiming through or under them." Indenture § 5.4(c). Thus, if the sale goes forward, Defendants will argue in any later litigation Plaintiffs bring to recoup their losses that MBIA's ownership of the Collateral terminates Patriarch XV and Octaluna's rights to repayment of the Class A-3 Notes and Class B Notes, respectively, and to any and all payments owed to it under the waterfall. *See id.* §§ 11.1, 11.2. The extinction of all Plaintiffs' rights and interests as Noteholders, without any recourse, is the very definition of irreparable harm—and the damages that Plaintiffs would suffer, were this to occur, are not readily ascertainable.

Even if Defendants failed to defeat future litigation on that ground, Plaintiffs would still be subject to irreparable harm: Due to MBIA's admitted financial distress, the Collateral likely would end up in the hands of the New York State Department of Financial Services through a receivership, or distributed to MBIA's creditors following its liquidation. Indeed, on information and belief, MBIA's current financial condition has deteriorated to the point that it is presently insolvent or threatened by imminent insolvency, such that the New York State Department of Financial Services has lawful grounds to seek an order of rehabilitation or receivership against MBIA, N.Y. Ins. Law §§ 7402, 7404, that would constitute a "Credit Enhancement Event" under the Indenture resulting in MBIA's loss of contractual status as the "Controlling Party" of Zohar I. *See* Indenture at 21 (definition of "Credit Enhancement Event"). On information and belief, the Department of Financial Services is actively examining MBIA's financial state.

MBIA's looming insolvency could also doom Plaintiffs' efforts to recover damages stemming from MBIA's misconduct, further harming Plaintiffs irreparably. *See Serio v. Black, Davis & Shue Agency, Inc.*, 2005 WL 3642217, at *16 (S.D.N.Y. Dec. 30, 2005) ("A serious threat of insolvency by a defendant can constitute such a 'substantial chance' of irreparable harm."); *Felix v. Brand Serv. Grp. LLC*, 101 A.D.3d 1724, 1726 (4th Dep't 2012) (affirming

preliminary injunction where plaintiffs showed that "funds in [an] escrow account, if dispersed, likely will not be recoverable due to defendants' precarious financial position").

Further, with the impending maturity of Zohar II, it would be optimal for Octaluna and certain of its affiliates to monetize successful Portfolio Companies to maximize value for all Zohar Fund beneficiaries, including but not limited to, the Zohar I Noteholders. But a September 15 sale would instantly place a cloud of uncertainty over all the affected Portfolio Companies, impeding Octaluna and its affiliates' ability to restore, maintain, and monetize value to the Portfolio Companies or transfer its own equity at a critical juncture for Plaintiffs, their affiliates, and the Companies. No reasonable fund or businessperson would buy controlling equity in a Portfolio Company when MBIA (or anyone else who acquires that collateral from MBIA) may later claim that equity is within the Collateral purportedly acquired in this auction. As a result, Portfolio Companies in which Octaluna or its affiliates have invested hundreds of millions of dollars may be claimed to have been sold, in whole or in part, without their consent, and Octaluna and its affiliates' ability to sell such assets would be effectively immobilized following the sale, causing it to lose opportunities of incalculable value.

MBIA's continued bad faith and fraudulent acts—which the Trustee is facilitating in violation of its own duties—thus threaten Plaintiffs with catastrophic and irreversible harm. The sole solution is to temporarily, preliminarily, and permanently enjoin the Proposed Sale from going forward, and similarly enjoin MBIA from directing and the Trustee from conducting any future sale process that fails to adhere to the requirements of UCC Article 9 and the Trustee's and MBIA's contractual and/or fiduciary obligations to Plaintiffs

III. THE EQUITIES WEIGH HEAVILY IN PLAINTIFFS' FAVOR

In this case, the balance of the equities entirely favors Plaintiffs: Plaintiffs stand to suffer substantial and irreparable harm if an injunction does not issue, *see supra* Part II, whereas

Defendants will not be harmed if the status quo is maintained, as Plaintiffs request, by an order temporarily enjoining the Collateral sale until a proper process, designed to provide an opportunity to maximize the yield to Noteholders, is put in place. *See Gramercy Co. v. Benenson*, 223 A.D.2d 497, 498 (1st Dep't 1996) ("[T]he balance of the equities tilts in favor of plaintiffs, who merely seek to maintain the status quo . . . ."); *see also CanWest Glob. Commc'ns Corp. v. Mirkaei Tikshoret Ltd.*, 9 Misc. 3d 845, 872 (Sup. Ct. N.Y. Cnty. 2005) ("[S]ince [plaintiff] merely seeks to maintain the status quo, the balance of equities tilt in its favor."). An injunction will merely preserve that longstanding status quo pending a decision on the merits, and provide sufficient time for this Court to fully evaluate the merits of Plaintiffs' claims. If, however, the injunction is not granted, the status quo will be severely and irreparably disrupted by the sale of the Collateral and the extinguishment of Plaintiffs' Notes. Thus, the equities clearly "lie in favor of preserving the status quo while the legal issues are determined in a deliberate and judicious manner." *State v. City of N.Y.*, 275 A.D.2d 740, 741 (2d Dep't 2000).

Moreover, because "the failure to grant preliminary injunctive relief would cause greater injury to [Plaintiffs and Patriarch] than the imposition of the injunction would cause to [Defendants]," *Clarion Assocs. v. D.J. Colby Co.*, 276 A.D.2d 461, 463 (2d Dep't 2000)—and would in fact cause Defendants no harm at all—the balance of equities weighs heavily in favor of granting temporary relief, *see Cooperstown Capital, LLC v. Patton*, 60 A.D.3d 1251, 1253 (3d Dep't 2009) ("[T]he possibility of plaintiff losing any real say in [the company], as opposed to maintaining the status quo where defendants suffer no actual harm, suggests that the equities balance in plaintiff's favor."); *Ma v. Lien*, 198 A.D.2d 186, at 186-87 (same).

THE COURT SHOULD ORDER EXPEDITED DISCOVERY

Plaintiffs have no interest in seeing a sale of the Collateral unnecessarily delayed. Plaintiffs therefore seek expedited discovery so that the merits of this matter are reached as swiftly as possible and a commercially reasonable sales process is in put in place.

This Court should direct Defendants to provide such expedited discovery—including both documents and deposition testimony—concerning the Proposed Sale, any associated marketing efforts, and any other potential efforts to dispose of the Collateral. Particularly in light of the Trustee's inexplicable failure to honor its contractual books-and-records obligations to Plaintiffs, expedited disclosure is critical.

The CPLR expressly authorizes the Court to order expedited discovery. *See* CPLR ¶¶ 3101(a), 3106(a), 3107, 3120; *see also* 22 NYCRR § 202.12(c). "The decision of whether to grant expedited discovery is within the discretion of this Court." *Rational Strategies Fund v. Hill*, 2013 WL 3779654, at *2 (Sup. Ct. N.Y. Cnty. July 18, 2013); *accord, e.g.*, *Hochberg v. Maimonides Med. Ctr.*, 37 A.D.3d 660, 660 (2d Dep't 2007) (affirming trial court's "provident[] exercise [of] its discretion in . . . setting an expedited discovery schedule"). Courts frequently authorize expedited discovery in order to develop the factual record bearing on applications for preliminary injunctive relief. *See, e.g.*, *In re Topps Co., Inc. S'holder Litig.*, 2007 WL 5018882, at *1 (Sup. Ct. N.Y. Cnty. June 8, 2007) (expedited discovery granted in advance of injunction hearing involving alleged breach of fiduciary duty). Pre-hearing discovery is particularly appropriate in cases where, as here, there are significant and time-sensitive "costs associated with the decision" to enjoin or not enjoin a business transaction, which give rise to a pressing "need to resolve th[e] dispute efficiently." *Rational Strategies*, 2013 WL 3779654, at *2.

Moreover, Defendants are in exclusive possession of the critical documents and testimony that will fully confirm their motives for pursuing this improper sale process, the complete nature and extent of MBIA's directions to the Trustee regarding the terms of the

Proposed Sale, and the full extent of the Trustee's departures from commercially reasonable practices and its fiduciary duty to Plaintiffs. Expedited discovery is therefore warranted to ensure that such evidence is made available to the Court. *See, e.g., Sylmark Holdings Ltd. v. Silicone Zone Int'l Ltd.*, 5 Misc. 3d 285, 302 (Sup. Ct. N.Y. Cnty. 2004).

CONCLUSION

The Court should preserve the status quo by issuing a temporary restraining order and preliminary injunction that enjoins Trustee U.S. Bank from conducting a sale of the Zohar I Collateral, and enjoins MBIA from seeking to instruct the Trustee to conduct any such sale, until the questions concerning the lawfulness of the sale can be resolved on the merits. The Court should further order an expedited schedule to trial and expedited discovery here.

Dated: New York, New York
September 12, 2016

Respectfully submitted,
GIBSON, DUNN & CRUTCHER LLP

By: *s/ Mark A. Kirsch*

Randy M. Mastro
Mark A. Kirsch
Robert F. Serio

200 Park Avenue
New York, New York 10166
Tel: (212) 351-4000

Attorneys for Plaintiffs

EXHIBIT 3

STEIN, J.
PART I

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

~~At IAS Part ___ of the Supreme Court of the State of New York, held at the County Courthouse, 60 Centre Street, New York, New York, on the ___ of September, 2016~~

~~PRESENT: Hon. _____, J.S.C.~~

~~SUPREME COURT OF THE STATE OF NEW YORK~~
~~COUNTY OF NEW YORK~~

CASE NO. 1:16-CV-07128

PATRIARCH PARTNERS XV, LLC and OCTALUNA LLC,

Plaintiffs,

v.

U.S. BANK NATIONAL ASSOCIATION and MBIA INSURANCE CORPORATION,

Defendants.

~~Index No. 654819/2016~~

~~IAS Part~~

~~Justice~~

ORDER TO SHOW CAUSE

The Court having considered the Summons and Verified Complaint in this action, to be utilized as an Affidavit pursuant to CPLR 105(u); the Affirmation of Mark A. Kirsch, dated September 12, 2016, and exhibits annexed thereto; the Affidavit of John H. Reohr IV, and exhibits annexed thereto; the Affidavit of Steven L. Schwarcz, and exhibits annexed thereto; and the memorandum of law of Plaintiffs Patriarch Partners XV, LLC and Octaluna LLC (collectively, "Plaintiffs") in support of their application by order to show cause for a temporary restraining order and preliminary injunction in respect of a proposed September 15, 2016 sale by the Trustee (the "Proposed Sale") of collateral (the "Collateral") held by the Trustee on behalf of non-parties Zohar CDO 2003-1, Limited, Zohar CDO 2003-1, Corp., and/or Zohar 2003-1, LLC

argument dated September 13, 2016, and upon the record in Item 23 herein

(collectively, "Zohar I"); and having found sufficient reason alleged and good cause appearing therefore, it is hereby:

ORDERED that Defendants U.S. Bank National Association ("U.S. Bank" or the "Trustee") and MBIA Insurance Corporation ("MBIA") (collectively, "Defendants"), or Defendants' attorneys, show cause before ~~this Court, at IAS Part ___ of the Supreme Court~~ the United States District Court for The Southern District of New York of ~~the State of New York~~, County of New York, located at ~~60 Centre Street~~ 500 Pearl Street, New York, New York, 10007, on the 6 day of October, 2016 at 10:A.m., or as soon thereafter as counsel can be heard, why an order should not be issued, pursuant to ~~CPLR §§ 6301, 6313, 3101(a), 3102(b), 3106(a), 3107, and 3120~~ Fed. R. Civ. P. 65:

a. Granting Plaintiffs a preliminarily injunction, pending trial and determination of Plaintiffs' application for a permanent injunction, enjoining and restraining Defendants, their agents, servants, employees, officers, attorneys, and all other persons in active concert or participation with them, from (i) proceeding in any way with and/or consummating the Trustee's Proposed Sale of the Collateral; (ii) directing and/or instructing any person (including but not limited to any liquidation agent appointed by the Trustee) to proceed in any way with and/or consummate the Trustee's Proposed Sale of the Collateral; (iii) proceeding in any way with and/or consummating any future proposed sale of the Collateral or any part thereof; or (iv) directing and/or instructing any person to proceed in any way with and/or consummate any future proposed sale of the Collateral;

b. Compelling the Trustee to provide Plaintiffs with all books and records concerning the Proposed Sale and any related marketing efforts;

c. Granting Plaintiffs expedited discovery in connection with their preliminary injunction application in advance of any hearing on that application; and

d. Granting Plaintiffs such other relief as this Court deems just and proper;

and it is further

ORDERED that, pending the hearing and determination of Plaintiffs' application for a preliminary injunction, Defendants, their agents, servants, employees, officers, attorneys, and all other persons in active concert or participation with them are temporarily enjoined and restrained from (i) proceeding in any way with and/or consummating the Trustee's Proposed Sale of the Collateral; (ii) directing and/or instructing any person (including but not limited to any liquidation agent appointed by the Trustee) to proceed in any way with and/or consummate the Trustee's Proposed Sale of the Collateral; (iii) proceeding in any way with and/or consummating any future proposed sale of the Collateral or any part thereof; or (iv) directing and/or instructing any person to proceed in any way with and/or consummate any future proposed sale of the Collateral or any part thereof; and it is further

ORDERED that, pursuant to CPLR §§ 3101(a), 3102(b), 3106(a), 3107, and 3120, Plaintiff shall be permitted to serve requests for production of documents (in the form attached hereto as Exhibits 1 and 2), and to notice the deposition of one representative of each Defendant, upon entry of this Order, and that Defendants shall produce all documents responsive to Plaintiffs' requests no later than fourteen days prior to the date set forth below for oral argument on Plaintiffs' application for a preliminary injunction (the "Oral Argument Date"), and shall produce their representatives for deposition within seven days prior to the Oral Argument Date; and it is further

ORDERED that service upon Defendants of a copy of this Order to Show Cause, together with the papers upon which it was granted, along with the Summons and Verified Complaint, by hand, facsimile, or electronic mail on or before 5:00 p.m. on the 14 day of September, 2016, shall be deemed good and sufficient service thereof; and it is further

ORDERED that answering and responsive papers to the motion for a preliminary injunction, if any, shall be served by hand or by electronic mail on Mark A. Kirsch, of the law firm Gibson, Dunn & Crutcher LLP, 200 Park Avenue, New York, New York, 10166, counsel for Plaintiffs, on or before 12:00 Noon on the 27 day of September, 2016; and it is further

ORDERED that reply papers, if any, be served upon Defendants, or their attorneys, if any, by hand or email delivery on or before the 2nd day of October, 2016 at noon; and it is further

ORDERED that oral argument is directed on Plaintiffs' application for a preliminary injunction on the ~~___~~ day of ~~_____~~, 2015 at ~~__~~:~~____~~ ~~__~~m., or as soon thereafter as counsel may be heard.

Ordered that the hearing on plts' motion for a preliminary injunction shall take place on October 6 at 10 A.M.

SECURITY WILL BE POSTED IN THE AMOUNT OF $ 250,000.

BY: 12:Noon on Sept 15

ENTERED:
9/14/16

~~U.S.C.~~ U.S.D.J.
PART I

EXHIBIT 4

Document Title: RE: Response to Notice of Subpoena
Document Date: 2016-08-31 11:17:00
ID: GC-L001:00042983
Email From: "hoff [partner], jonathan m." <jonathan.hoff@cwt.com>
Email To: "'sumner, amy a.'" <sumnera@sec.gov>
Email CC:
Email BCC:
Attachments Names:
Document Type: eMail/eMail without attachment

To: Sumner, Amy A.[SumnerA@SEC.GOV]
From: Hoff [PARTNER], Jonathan M.
Sent: Wed 8/31/2016 11:17:09 AM
Importance: Normal
Subject: RE: Response to Notice of Subpoena

OK. FYI, several months before the stay was entered, Patriarch had served a subpoena to MBIA, to which MBIA responded and engaged in meet and confer discussions with Patriarch. From our perspective, those discussions were largely completed at the time the stay was entered. A couple weeks ago, GDC resurrected the discussions about the subpoena. We advised that the parties had reached agreement on pretty much everything and that we were not going to re-open discussions. We haven't heard anything in response.

JMH

From: Sumner, Amy A. [mailto:SumnerA@SEC.GOV]
Sent: Wednesday, August 31, 2016 11:13 AM
To: Hoff [PARTNER], Jonathan M.
Subject: RE: Response to Notice of Subpoena

It's not clear to us to which subpoenas that order is referring, but Respondents did request several subpoenas to be issued to investors, so I think that it likely relates to that. We've asked for clarification, but haven't received it yet. (Those investor subpoenas weren't directed to McKiernan or MBIA, although there was one directed to David Crowle).

I don't have reason to believe that this order has anything to do with the Division's subpoena to MBIA. No further developments on that, but will let you know when there is a ruling.

From: Hoff [PARTNER], Jonathan M. [mailto:jonathan.hoff@cwt.com]
Sent: Wednesday, August 31, 2016 8:28 AM
To: Sumner, Amy A.
Subject: RE: Response to Notice of Subpoena

Amy, I saw the attached and assume it has nothing to do with the motion concerning the SEC subpoena to MBIA. Is that correct? Otherwise, have there been any developments with respect to Patriarch's motion concerning the subpoena to MBIA?

Thanks.

Jonathan M. Hoff

Partner

Cadwalader, Wickersham & Taft LLP

One World Financial Center

New York, NY 10281

Tel: +1 212.504.6474

Cell Phone: [redacted]

Fax: +1 212.504.6666

jonathan.hoff@cwt.com

www.cadwalader.com

From: Sumner, Amy A. [mailto:SumnerA@SEC.GOV]
Sent: Monday, August 01, 2016 1:05 PM
To: Hoff [PARTNER], Jonathan M.
Subject: RE: Response to Notice of Subpoena

Not yet.

From: Hoff [PARTNER], Jonathan M. [mailto:jonathan.hoff@cwt.com]

Sent: Monday, August 01, 2016 11:04 AM
To: Sumner, Amy A.
Subject: RE: Response to Notice of Subpoena

Did they file a motion?

Jonathan M. Hoff

Partner

Cadwalader, Wickersham & Taft LLP

One World Financial Center

New York, NY 10281

Tel: +1 212.504.6474

Cell Phone: +[redacted]

Fax: +1 212.504.6666

jonathan.hoff@cwt.com

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From: Sumner, Amy A. [mailto:SumnerA@SEC.GOV]
Sent: Monday, August 01, 2016 1:03 PM
To: Hoff [PARTNER], Jonathan M.
Subject: RE: Response to Notice of Subpoena

Yes. We will oppose their motion. I will keep you in the loop.

Thanks,

Amy

From: Hoff [PARTNER], Jonathan M. [mailto:jonathan.hoff@cwt.com]
Sent: Monday, August 01, 2016 10:36 AM
To: Sumner, Amy A.
Subject: Response to Notice of Subpoena

I assume you've seen this. We'll await the timely filing of their motion.

Thanks.

Jonathan M. Hoff

Partner

Cadwalader, Wickersham & Taft LLP

One World Financial Center

New York, NY 10281

Tel: +1 212.504.6474

Cell Phone: +[redacted]

Fax: +1 212.504.6666

jonathan.hoff@cwt.com

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From: Rubin, Lisa H. [mailto:LRubin@gibsondunn.com]
Sent: Thursday, July 28, 2016 7:17 PM
To: Hoff [PARTNER], Jonathan M.
Cc: Zweifach, Lawrence J.; Bliss, Dugan; Heinke, Nicholas; Sumner, Amy A.; Carolyn Schiff
Subject: Response to Notice of Subpoena

Dear Mr. Hoff,

Please see attached correspondence from Lawrence Zweifach of our firm.

Regards,

Lisa Rubin

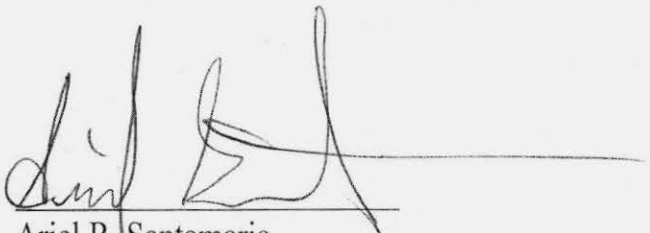
CERTIFICATE OF SERVICE

I hereby certify that I served true and correct copies of 1) Respondents' opposition to the Division's motion to Strike Respondents' Further amended witness list and requests for hearing Subpoenas to Previously Undisclosed Witness and a memorandum of law in support thereof, and 2) the Declaration of Lisa H. Rubin in Support of Respondents' opposition to the Division's motion to Strike Respondents' Further amended witness list and requests for hearing Subpoenas to Previously Undisclosed Witness and its exhibits on this 18th day of October, 2016, in the manner indicated below:

United States Securities and Exchange Commission
Office of the Secretary
Attn: Secretary of the Commission Brent J. Fields
100 F Street, N.E.
Mail Stop 1090
Washington, D.C. 20549
Fax: (202) 772-9324
(By Facsimile and original and three copies by hand)

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

Dugan Bliss, Esq.
Division of Enforcement
Securities and Exchange Commission
Denver Regional Office
1961 Stout Street, Ste. 1700
Denver, CO 80294
(By Email pursuant to parties' agreement)



Ariel R. Santamaria