UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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

RESPONDENTS' PROPOSED CONCLUSIONS OF LAW

GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166
Telephone: 212.351.4000
Fax: 212.351.4035

BRUNE LAW P.C.
450 Park Avenue
New York, NY 10022
Telephone: 212.668.1900
Fax: 212.668.0315

Counsel for Respondents

December 16, 2016

TABLE OF CONTENTS

I. Causes Of Action Under The Investment Advisers Act Of 1940

1. In the Order Instituting Proceedings ("OIP"), the Securities and Exchange Commission (the "Commission") Division of Enforcement (the "Division") alleged claims against Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Patriarch" or "Respondents") under Section 206(1), (2), and (4) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(1), (2), (4) (the "Advisers Act"), as well as Advisers Act Rule 206(4)-8, 17 C.F.R. § 275.206(4)-8 ("Rule 206(4)-8").

2. The Division bears the burden of proof as to each element of each allegation in the OIP. *See Miguel A. Ferrer*, Admin. Proc. Rulings Release No. 730, 2012 WL 8751437, at *4 (ALJ Nov. 2, 2012).

3. The elements of a claim under § 206(1) of the Advisers Act are that: (1) the respondent made false representations or actionable omissions, or engaged in deceptive conduct; (2) the misrepresentation, omission, or deceptive conduct was material; (3) the misrepresentation, omission, or deceptive conduct was directed to the client (or prospective client) of the respondent, who must have acted as a financial adviser; and (4) the respondent acted with scienter—meaning actual intent to defraud or extreme recklessness. *See* Advisers Act § 206(1); *Lawrence M. Labine*, Initial Decision Release No. 973, 2016 WL 824588, at *28, *30-31 (ALJ Mar. 2, 2016).

4. The elements of a claim under § 206(2) of the Advisers Act are that: (1) the respondent made false representations or actionable omissions, or engaged in deceptive conduct; (2) the misrepresentation, omission, or deceptive conduct was material; (3) the misrepresentation, omission, or deceptive conduct was directed to the client (or prospective

client) of the respondent, who must have acted as a financial adviser; and (4) the respondent acted with scienter or negligence. *See* Advisers Act § 206(2); *Lawrence M. Labine*, 2016 WL 824588, at *28, *30-31.

5. The elements of an allegation under § 206(4) of the Advisers Act or under Rule 206(4)-8, which are coextensive, are that: (1) the respondent made false representations or actionable omissions, or engaged in deceptive conduct; (2) the misrepresentation, omission, or deceptive conduct was material; (3) the misrepresentation, omission, or deceptive conduct was directed to an investor (or prospective investor) in the pooled investment vehicle for which the respondent acted as an investment adviser; and (4) the respondent acted with scienter or negligence. *See* Advisers Act § 206(4); Rule 206(4)-8; *SEC v. Steadman*, 967 F.2d 636, 643 n.5, 647 (D.C. Cir. 1992).

6. The elements of an allegation of aiding and abetting a violation of the securities laws are that: (1) a "primary wrongdoer[] has violated the securities laws"; (2) the respondent provided "substantial assistance" to the primary wrongdoer; and (3) the respondent had knowledge of, or extreme recklessness regarding, the primary violation of the securities laws. *Optionsxpress, Inc.*, Securities Act Release No. 10125, 2016 WL 4413227, at *47 n.185 (Comm'n Aug. 18, 2016) (citing *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004)).

7. Facts that are "wholly outside the framework of the order for proceedings" cannot provide a basis for liability under the securities laws. *Int'l S'holders Servs. Corp.*, Exchange Act Release No. 12389A, 1976 WL 182458, at *4 n.19 (Comm'n June 8, 1976); *see also Brandt, Kelly & Simmons, LLC*, Initial Decision Release No. 289, 2005 WL 1584978, at *8 (ALJ June 30, 2005) (Foelak, J.). Indeed, "new matters of fact or law" that are not "within the scope of the

original order instituting proceedings" are not even admissible. *Pierce v. SEC*, 786 F.3d 1027, 1036 (D.C. Cir. 2015).

8. Rule 206(4)-8 is invalid because it exceeds the authority granted to the SEC in the enabling statute, *see* Advisers Act § 206(4), and is unconstitutionally vague. Contrary to the statutory mandate to "define . . . such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative," *id.*, the rule defines the prohibited conduct as, *inter alia*, "any act, practice, or course of business that is fraudulent, deceptive, or manipulative," Rule 206(4)-8(a)(2). The rule is accordingly inconsistent with Congress's command and provides no meaningful notice of what conduct is prohibited. *See Kolender v. Lawson*, 461 U.S. 352, 358 (1983).

II. Claims Based On Respondents' Loan Categorizations

A. Claims Of Misrepresentation, Actionable Omission, Or Deceptive Conduct

1. There Could Be No Deception Because The Indentures Expressly Authorized Respondents' Conduct.

9. The contracts governing a commercial relationship describe and disclose the conduct that the parties are permitted to engage in with respect to their relationship. *See, e.g.*, *Krys v. Butt*, 486 F. App'x 153, 155 (2d Cir. 2012) (quoting *EBC I, Inc. v. Goldman Sachs & Co.*, 832 N.E.2d 26, 31 (N.Y. 2005)); *accord* Div. Opp. to Respondents' Mot. for More Definite Statement 5 (Apr. 29, 2015) (describing "the terms of the indentures" as "terms that were disclosed to each and every investor"); Div. Opp. to Respondents' Mot. for Summ. Disposition 19 (June 28, 2016) (describing Respondents' alleged fraud as a failure to follow terms "disclosed in the governing documents").

10. Under New York law, a contract is interpreted pursuant to its "clear and unambiguous" meaning if such an unambiguous meaning is available upon "reading the contract as a whole." *Ellington v. EMI Mills Music, Inc.*, 21 N.E.3d 1000, 1003 (N.Y. 2014).

11. Each Zohar's Indenture clearly and unambiguously provides the Collateral Manager discretion to "without the consent of the Holders of any Notes or the Credit Enhancer, enter into any amendment, forbearance or waiver of or supplement to any Underlying Instrument included in the Collateral," and clearly and unambiguously states the parties' "acknowledge[ment] and agree[ment] that the [CDOs] will consist of stressed and distressed loans that may be the subject of extensive amendment . . . ." RX 1 (Zohar I Indenture) § 7.7(a) at 127; RX 8 (Zohar II Indenture) § 7.7(a) at 141; DX 12 (Zohar III Indenture) § 7.7(a) at 134.

12. Both oral and course of performance amendments are valid under New York law. *See Gaia House Mezz LLC v. State St. Bank & Tr. Co.*, 720 F.3d 84, 90-91 (2d Cir. 2013); *United States v. Schwimmer*, 968 F.2d 1570, 1575 (2d Cir. 1993).

13. When a court interprets a contract, the interpretation should not "produce a result that is absurd, commercially unreasonable [or] contrary to the reasonable expectations of the parties." *SportsChannel Assocs. v. Sterling Mets, L.P.*, 807 N.Y.S.2d 61, 61 (App. Div. 1st Dep't 2006).

14. The Zohar I and Zohar II Indentures set forth five characteristics of a current, Category 4 loan: "A [CDO] . . . that (i) is a Current Collateral Debt Obligation, (ii) is not an Insolvency Collateral Debt Obligation, (iii) with respect to any Underlying Instruments related to such Collateral Debt Obligation, there shall not have occurred any 'event of default' or any 'default' by the Obligor thereon with respect to any covenant, representation or warranty contained therein, . . . which has not been waived, (iv) with respect to the Obligor thereon, there are no negotiations, at the time of measurement, to restructure . . . the financial obligations . . . and (v) is not a [CDO] that has, in the reasonable judgment of the Collateral Manager, a significant risk of declining in credit quality or, with the passage of time, becoming Category 1,

Category 2 or Category 3." RX 1 (Zohar I Indenture) § 1.1 at 17; RX 8 (Zohar II Indenture) § 1.1 at 16.

15. The Indentures expressly contemplated and authorized the Collateral Manager's use of discretion in the categorization process. RX 1 (Zohar I Indenture) § 1.1 at 17 (incorporating "the reasonable judgment of the Collateral Manager" in one of the five factors defining Category 4); RX 8 (Zohar II Indenture) § 1.1 at 16 (same); *see also* RX 8 (Zohar II Indenture) § 1.1 at 23 (defining "Defaulted Obligation" as, among other things, a loan "as to which the *Collateral Manager believes*, that . . . a default has occurred and is continuing with respect to such Collateral Debt Obligation that in the *sole judgment of the Collateral Manager* will likely result in a default as to the payment of principal . . . .") (emphases added).

16. Each Zohar's Indenture clearly and unambiguously categorizes underlying loans based in part on whether they have defaulted. *Compare* RX 1 (Zohar I Indenture) § 1.1 at 10 (defining "Category 4"), *with id.* (defining "Category 1"); RX 8 (Zohar II Indenture) § 1.1 at 16 (defining "Category 4"), *with id.* § 1.1 at 15 (defining "Category 1"); *compare* RX 12 (Zohar III Indenture) § 1.1 at 27 (defining "Defaulted Investment"), *with id.* § 1.1 at 9, 18 (using "Collateral Investment" as universe of non-defaulted investments).

17. A "default" occurs when payment is not made on the date it is due and payable under the current terms of the parties' agreement. *See* Black's Law Dictionary (10th ed. 2014) ("Default"); *accord* Tr. 2932:23-2933:3 (Wagner); DX 16 (Expert Report of Ira Wagner, dated July 10, 2015) ¶ 96.

18. Therefore, when Respondents (as Collateral Manager) exercised their clear and unambiguous discretion to amend a loan to defer when an interest payment was due, payment made pursuant to the amended schedule was in accordance with the amended loan terms and

therefore did not constitute a default. The Indentures therefore did not require that the loan be recategorized as a Category 1 or Defaulted Investment. *See* Respondents' Post-Hearing Brief, Pt. I.A.1.[1]

19. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because the Division has not satisfied its burden to prove a misrepresentation, actionable omission, or deceptive conduct in light of Respondents' legally valid agreements to amend loan agreements to defer interest payments, and Respondents' accurate categorization of those loans according to their amended terms. *See* Respondents' Post-Hearing Brief, Pt. I.A.1.

20. Alternatively, the OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because the Division has not satisfied its burden to prove a misrepresentation, actionable omission, or deceptive conduct in light of the Indentures' provisions permitting Respondents' approach to loan categorization. *See* Respondents' Post-Hearing Brief, Pt. I.A.1.

21. Alternatively, the OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because the Division has not satisfied its burden to prove a misrepresentation, actionable omission, or deceptive conduct in light of the business objective of the Zohars, achieved by the discretion vested by the Indentures in Respondents to amend loans and to support Portfolio Companies that they intended to turn around notwithstanding those

---

[1] All citations herein to Respondents' Post-Hearing Brief are citations to its Argument section.

companies' ability *vel non* to pay interest as originally stated in the loan. *See* Respondents' Post-Hearing Brief, Pt. I.A.1.

22. "[A] sincere statement of pure opinion is not an untrue statement of material fact, regardless whether . . . ultimately prove[d] . . . wrong." *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1327 (2015).

23. Given the discretionary nature of Respondents' decision to amend the terms of loans to Portfolio Companies, Respondents' statements regarding categorization were statements of opinion, and the Division has failed to prove a misrepresentation or deception in these statements because it has not proved that Respondents did not actually believe the statements when made. *See id.*

2. There Could Be No Deception Given Respondents' Robust, Accurate Disclosures.

24. The Division cannot satisfy its burden to prove a misrepresentation, actionable omission, or deceptive conduct as to facts that are accurately disclosed elsewhere. *See, e.g.*, *Brandt, Kelly & Simmons, LLC*, 2005 WL 1584978, at *8; *cf. Frigitemp Corp. v. Fin. Dynamics Fund, Inc.*, 524 F.2d 275, 282 (2d Cir. 1975).

25. This disclosure is satisfied—and thus, accusations of deception are defeated—where the respondent has a "reasonable belief that the other party already has access to the facts," such that clarifying disclosures would "reasonably appear to be repetitive." *Frigitemp Corp.*, 524 F.2d at 282.

26. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because the Division has not satisfied its burden to prove a misrepresentation, actionable omission, or deceptive conduct in light of the disclosures in the governing documents,

Trustee Reports, investor calls, and in response to questions. *See* Respondents' Post-Hearing Brief, Pt. I.A.2.

3. Independently, The Zohars Could Not Have Been Deceived Because They Had Full Knowledge Through Imputation.

27. An agent is "a person authorized by another to act on his account and under his control." *Wasilowski v. Park Bridge Corp.*, 156 F.2d 612, 614 (2d Cir. 1946).

28. An agent's knowledge is imputed to its principal unless a narrow "adverse interest" exception applies. *See, e.g.*, *Apollo Fuel Oil v. United States*, 195 F.3d 74, 76 (2d Cir. 1999); *Lynn Tilton*, Admin. Proc. Rulings Release No. 4157, at 2 (ALJ Sept. 16, 2016).

29. The "adverse interest" exception is limited to the extreme situation in which "the agent . . . ha[s] *totally abandoned* his principal's interests." *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 952 (N.Y. 2010) (emphasis in original); *Lynn Tilton*, Admin. Proc. Rulings Release No. 4157, at 2 (ALJ Sept. 16, 2016) (quoting *Bank of China, N.Y. Branch v. NBM LLC*, 359 F.3d 171, 179 (2d Cir. 2004)).

30. The "adverse interest" exception does not apply "merely because [the agent] has a conflict of interest or because he is not acting primarily for his principal." *Kirschner*, 938 N.E.2d at 952.

31. Respondents were the Zohars' agents at all relevant times because the Collateral Manager to each Zohar was authorized by contract (namely, the Collateral Management Agreement) to act on the Zohar's account and under its control.

32. Each Trustee was an agent of the respective Zohar at all relevant times because the Trustee was authorized by contract (namely, the Collateral Administrator Agreement) to act on the Zohar's account and under its control.

33. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed to the extent that the charges rely on conduct toward the Zohars, because the Division has not satisfied its burden to prove a misrepresentation, actionable omission, or deceptive conduct in light of the Zohars' full and accurate knowledge by imputation from Respondents, and also, independently, by imputation from the Trustee. *See* Respondents' Post-Hearing Brief, Pt. I.A.2.b.

B. Claims Of Breach Of Fiduciary Duty

1. There Was No Breach Of Fiduciary Duty Because Conflicts Of Interest Were Expressly Disclosed And Waived.

34. The only charge in the OIP relating to breach of fiduciary duty was an alleged "undisclosed . . . conflict of interest." OIP ¶ 54.

35. Respondents cannot be found liable for breach of fiduciary duty other than on the charged "undisclosed . . . conflict of interest" theory, based on the scope of the OIP. *See supra* ¶ 7.

36. Where a collateral management agreement "waiv[es] any conflict of interest that might otherwise exist," a conflicts-based fiduciary duty claim is invalid "as a matter of law." *Bank of Am. v. Bear Stearns Asset Mgmt.*, 969 F. Supp. 2d 339, 356-57 (S.D.N.Y. 2013).

37. In determining the validity of a waiver of conflicts of interest, the waiving party's level of sophistication is a relevant consideration. *Heitman Capital Mgmt. LLC*, SEC No-Action Letter, 2007 WL 789073 (Feb. 12, 2007).

38. The OIP's charge of breach of fiduciary duty based on Respondents' loan categorization should be dismissed because the Collateral Management Agreements expressly disclosed and waived conflicts of interest. *See* Respondents' Post-Hearing Brief, Pt. I.B.1.

39. The OIP's charge of breach of fiduciary duty based on Respondents' loan categorization should be dismissed because any knowledge by Respondents of their alleged conflicts of interest is imputed to the Zohars. *See supra* ¶ 33.

40. Independently, the OIP's charge of breach of fiduciary duty based on Respondents' loan categorization should be dismissed because Respondents disclosed the categorization practices that underlie the alleged conflicts of interest. *See supra* ¶¶ 24-26.

2. No Fiduciary Duty Was Owed To Investors In The Zohars.

41. The only fiduciary duty recognized by the Advisers Act is the duty that flows from the investment adviser to the client. *See, e.g.*, *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963).

42. An investment adviser who advises a pooled investment vehicle owes a fiduciary duty exclusively to the vehicle itself, and not to the vehicle's investors. *Goldstein v. SEC*, 451 F.3d 873, 881 (D.C. Cir. 2006) ("It simply cannot be the case that investment advisers are the servants of two masters in this way.").

43. The OIP's charge of breach of fiduciary duty based on Respondents' loan categorization should be dismissed to the extent it relates to or relies on conduct toward the Zohars' noteholders, to whom no fiduciary duty was owed. *See* Respondents' Post-Hearing Brief, Pt. I.B.2.

44. Respondents had no duty of disclosure to the noteholders because they owed no fiduciary duty to the noteholders. *See* Respondents' Post-Hearing Brief, Pt. I.B.2.

45. The OIP's charges based on omission or non-disclosure of information to the noteholders should be dismissed because Respondents had no duty of disclosure to the noteholders.

3. There Was No Breach Of Fiduciary Duty Because Respondents Performed Their Duty.

46. The Division cannot satisfy its burden with respect to a claim for breach of fiduciary duty where the respondent "worked diligently" in support of the client's interests. *Brandt, Kelly & Simmons, LLC*, 2005 WL 1584978, at *8.

47. Evidence that the client continued the advisory relationship after learning of the alleged conflict of interest "suggests that [the independent Directors], at least, did not think that [Respondents] had acted in bad faith or under a conflict of interest in connection with their . . . investments." *Belmont v. MB Inv. Partners, Inc.*, 708 F.3d 470, 506 n.43 (3d Cir. 2013).

48. The OIP's charge of breach of fiduciary duty based on Respondents' loan categorization should be dismissed because the Division has not satisfied its burden to prove that Respondents acted contrary to the Zohars' interests. *See* Respondents' Post-Hearing Brief, Pt. I.B.3.

C. Claims Sounding In Breach Of Contract

49. Neither Advisers Act § 206 nor Rule 206(4)-8 creates liability for breach of contract. *See Carroll v. Bear, Stearns & Co.*, 416 F. Supp. 998, 1002 (S.D.N.Y. 1976).

50. A "breach of contract claim cannot be dressed up as a fraud claim," because fraud requires more than the mere failure to abide by a contractual promise. *Todi Exps. v. Amrav Sportswear Inc.*, 1997 WL 61063, at *3 (S.D.N.Y. Feb. 13, 1997); *see also, e.g.*, *Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.*, 98 F.3d 13, 20 (2d Cir. 1996) (vacating common-law fraud liability "premised upon an alleged breach of contractual duties").

51. A breach of fiduciary duty claim is not viable when it is duplicative of a breach of contract claim. *See BNP Paribas Mortg. Corp. v. Bank of Am., N.A.*, 949 F. Supp. 2d 486, 504 (S.D.N.Y. 2013) ("It is well established that a tort claim cannot be predicated on a mere breach

of contract," because "the plaintiff may not transmogrify the contract into one for tort.") (internal quotation marks and citations omitted); *see also Bridgestone/Firestone, Inc.*, 98 F.3d at 20.

52. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because they allege no more than a breach of contract. *See* Respondents' Post-Hearing Brief, Pts. I.A.3, I.B.2

D. All Claims Require Materiality

53. To prove the element of materiality, the Division must prove that there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having substantially altered the 'total mix' of information made available." *Russel W. Stein*, Initial Decision Release No. 150, 1999 WL 756083, at *11 (ALJ Sept. 27, 1999) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

54. When accurate information is made available, omissions or misrepresentations elsewhere do not alter the "'total mix' of information made available," and the materiality element is not satisfied. *See, e.g., Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1096-98 (1991) (noting that available information can cure potential misinformation "so obviously that the risk of real deception drops to nil"); *cf. Brandt, Kelly & Simmons, LLC*, 2005 WL 1584978, at *8 (finding "no material misrepresentations or omissions, and no violation of Sections 206(1) or 206(2) of the Advisers Act," in part because respondents "disclosed to each client individually the benefits and costs" related to the alleged violation).

55. A fact is part of the total mix of available information (and therefore undercuts the materiality of a misrepresentation or omission of that fact elsewhere) so long as the audience has access to that fact, even if they do not actually learn or acknowledge it. *See Hirsch v. du Pont*, 553 F.2d 750, 762 (2d Cir. 1977) (holding that omission of a company's capital deficiency and

related information was immaterial because an investor "could easily have obtained" information about the capital deficiency, and "[h]ad he done so, he surely would have inquired" as to the other omitted information).

56. Although the materiality standard uses the concept of a "reasonable person," a person's level of sophistication is relevant to determining whether that person had access to information. *See id.* at 762-63 (considering whether a "reasonable investor of [the victim's] level of sophistication would have made a further inquiry"). After all, "[t]he securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment." *Id.* at 763.

57. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because the Division has not satisfied its burden to prove the materiality of the allegedly omitted or misrepresented information. *See* Respondents' Post-Hearing Brief, Pt. I.C.

E. All Claims Require Scienter Or Negligence

58. For the Division to establish liability under Advisers Act § 206(1), it must prove "intent to deceive, manipulate, or defraud," or "extreme recklessness." *Steadman*, 967 F.2d at 641.

59. In order for the Division to establish liability under Advisers Act § 206(2), § 206(4), or Rule 206(4)-8, its evidence "must establish at least negligence." *SEC v. Yorkville Advisors, LLC*, 2013 WL 3989054, at *3 (S.D.N.Y. Aug. 2, 2013).

60. The respective mental state requirements of scienter and negligence are also required for the Division's claims based on an alleged breach of fiduciary duty. *See Lincolnshire Mgmt., Inc.*, Advisers Act Release No. 3927, 2014 WL 4678600, at *5 (Comm'n Sept. 22, 2014).

61. In view of the Division's burden to prove either scienter or negligence for each claim under the Advisers Act, the Division cannot prevail where Respondents exercised "due care or good faith." *Howard*, 376 F.3d at 1147 (internal quotation marks omitted).

62. Neither intent nor negligence can be found where conduct is based on a reasonable contract interpretation. *See Gen. Ins. Co. of Am. v. K. Capolino Constr. Corp.*, 983 F. Supp. 403, 437 n.63 (S.D.N.Y. 1997).

63. A contract interpretation is reasonable if "reasonable minds could differ about how the contract should be interpreted." *Bagley v. Blagojovich*, 685 F. Supp. 2d 904, 912-13 (C.D. Ill. 2010).

64. A reasonable contract interpretation cannot be the basis of a finding of negligence or bad faith, even if the interpretation is later determined to be incorrect. *See Amitie One Condo. Ass'n v. Nationwide Prop. & Cas. Ins. Co.*, 2008 WL 2973097, at *4 (M.D. Pa. Aug. 4, 2008).

65. Evidence that actions were taken through reasonably prudent processes defeats allegations of recklessness or negligence. *See, e.g., Hoemke v. N.Y. Blood Ctr.*, 912 F.2d 550, 552 (2d Cir. 1990) (negligence defeated by "procedures that reasonable prudence would dictate be instituted").

66. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed because Respondents' conduct was based on their reasonable interpretation of the Zohars' governing documents. *See* Respondents' Post-Hearing Brief, Pt. I.D.

67. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed for the additional reason that Respondents' open and notorious disclosure of their

conduct demonstrates their good faith and the reasonableness of their conduct, and defeats the mental state element of each claim. *See* Respondents' Post-Hearing Brief, Pt. I.A.2.

68. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed for the further additional reason that Respondents' conduct toward the Zohars and the noteholders was diligent and loyal, further demonstrating their good faith and the reasonableness of their conduct, and defeating the mental state element of each claim. *See* Respondents' Post-Hearing Brief, Pt. I.B.3.

69. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed for the additional reason that Respondents' reasonable and diligent processes for determining when to amend loans demonstrates their good faith and the reasonableness of their conduct, and defeats the mental state element of each claim. *See* Respondents' Post-Hearing Brief, Pt. I.D.

70. The OIP's charges based on Respondents' loan categorization—including charges for misrepresentation or deception and charges for breach of fiduciary duty—should be dismissed to the extent the Division now relies on recklessness or negligence, in light of the fact that the OIP alleged exclusively *intentional* misconduct, such that any evidence or findings relating to recklessness or negligence would be outside the scope of the OIP. *See supra* ¶ 7.

III. Claims Based On Respondents' Financial Statements

A. Elements And Burden Of Proof

71. Allegations "of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim." *Dempsey v. Vieau*, 130 F. Supp. 3d 809, 818 (S.D.N.Y. 2015) (quoting *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000)); *see also, e.g.*,

Chill v. Gen. Elec. Co., 101 F.3d 263, 270 (2d Cir. 1996); *Owens v. Jastrow*, 789 F.3d 529, 543-44 (5th Cir. 2015).

72. To establish a securities fraud claim based on alleged GAAP violations or accounting irregularities, the Division must prove that: (1) the financial statements contained false or misleading representations, *see Brandt, Kelly & Simmons, LLC*, 2005 WL 1584978, at *8; (2) the materiality to investors of the purportedly false or misleading statements, *see id.*; *David J. Montanino*, Initial Decision Release No. 773, 2015 WL 1732106, at *33 (ALJ Apr. 16, 2015), meaning that the information would have altered a reasonable investor's investment decisions, *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371, 1374, 1376-77 (E.D. Pa. 1994); *Anthony Fields*, Initial Decision Release No. 474, 2012 WL 6042354, at *9 (ALJ Dec. 5, 2012) (Foelak, J.) (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988)); and (3) "[the respondent] acted with scienter with regard to both the truth and the materiality of the allegedly misleading statements," *SEC v. Snyder*, 292 F. App'x 391, 399-400 (5th Cir. 2008) (citing *Fine v. Am. Solar King Corp.*, 919 F.2d 290, 297 (5th Cir. 1990)).

73. The Division bears the burden of proving each element of its financial statements claim. *See, e.g., Ponce*, 1996 WL 700565, at *14.

B. GAAP Compliance

74. The OIP's financial statements charges allege GAAP non-compliance only as to fair value and recognition of impairments. *See* Respondents' Post-Hearing Brief, Pt. II.A. Both the measurement of fair value and the recognition of impairments are subjective assessments for which GAAP permits a range of acceptable outcomes, depending on "the particular methodology and assumptions used." *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 111-12 (2d Cir. 2011); *see also Owens*, 789 F.3d at 544.

75. Respondents' treatment of fair value and recognition of impairments in financial statements fall within the range of acceptable outcomes that GAAP permits, as a result of which the financial statements-related charges fail. *See* Respondents' Post-Hearing Brief, Pt. II.A.

76. Independently, the OIP's financial statements charges should be dismissed because the Division failed to carry its burden of establishing that the financial statements contain false or misleading representations as to fair value, recognition of impairments, or GAAP compliance. *See Ponce*, 1996 WL 700565, at *14.

77. Facts and theories outside the scope of the OIP cannot provide a basis for liability. *See supra* ¶ 7. Here, allegations related to Respondents' treatment or reporting of accrued interest on their financial statements are outside the framework of the OIP, and therefore cannot form a basis for liability. *See* Respondents' Post-Hearing Brief, Pt. II.A.3.

78. Moreover, the Division failed to carry its burden of establishing that the financial statements contained false or misleading representations concerning accrued interest, or that treatment of accrued interest was not compliant with GAAP. *See Ponce*, 1996 WL 700565, at *14.

79. To the contrary, all of the evidence supports that Respondents' treatment of accrued interest was GAAP-compliant. Therefore, even if charges relating to treatment of accrued interest had been alleged in the OIP, dismissal of them would still be required. *See id.*

80. Given the subjectivity involved in applying GAAP, Respondents' certifications of GAAP compliance were statements of opinion, and the Division has failed to prove a misrepresentation or deception in these statements because it has not proved that Respondents did not actually believe the statements when made. *See supra* ¶ 22; *Owens*, 789 F.3d at 543-44; *City of Westland Police & Fire Ret. Sys. v. Metlife, Inc.*, 129 F. Supp. 3d 48, 73 (S.D.N.Y. 2015).

C. Scienter

81. Even if Respondents were found to have made false or misleading statements, the Division would still bear the burden of establishing that Respondents possessed scienter as to the falsity or misleading nature of their representations concerning GAAP compliance. *See SEC v. Snyder*, 292 F. App'x 391, 399-400 (5th Cir. 2008) (citing *Fine v. Am. Solar King Corp.*, 919 F.2d 290, 297 (5th Cir. 1990)).

82. Where respondents "had in place several levels of internal and external review," "work[ed] diligently on ensuring that [they] got the accounting right," and "reasonabl[y] rel[ied] on the advice of numerous professionals working both inside and outside [the company]," respondents cannot be found to have acted negligently or with any higher level of scienter unless there is some affirmative evidence of intent to defraud. *SEC v. Jensen*, 2013 WL 6499699, at *29 (C.D. Cal. Dec. 10, 2013), *vacated on other grounds*, 2016 WL 4537377 (9th Cir. Aug. 31, 2016); *see also In re Digi Int'l, Inc., Sec. Litig.*, 14 F. App'x 714, 717 (8th Cir. 2001).

83. The OIP's financial statement charges should be dismissed because the Division failed to carry its burden of demonstrating that Respondents were negligent, let alone reckless, extremely reckless, or knowing regarding the alleged falsity or misleading nature of their financial statements, in light of Respondents' several layers of internal and external review, diligent work to ensure the correct accounting, and reasonable reliance on the advice of numerous professionals working both inside and outside Patriarch. *See* Respondents' Post-Hearing Brief, Pt. II.C.

D. Materiality

84. The Division bears the burden of establishing the materiality to investors of the purportedly false or misleading statements in the financial statements, *see Ponce*, 1996 WL 700565, at *14; *David J. Montanino*, 2015 WL 1732106, at *33, meaning that the information

would have altered a reasonable investor's investment decisions in light of the total mix of information available, *Vosgerichian*, 862 F. Supp. at 1374, 1377; *Fields*, 2012 WL 6042354, at *9 (citing *Basic Inc.*, 485 U.S. at 231-32, 240).

85. "In assessing the magnitude of alleged GAAP violations, one needs to look to see if the violations were 'minor or technical in nature' or 'material in light of the company's overall financial condition.'" *In re Atlas Mining Co. Sec. Litig.*, 670 F. Supp. 2d 1128, 1141 (D. Idaho 2009) (magistrate judge's order adopted by the district court) (quoting *In re Dauo Sys.*, 411 F.3d 1006, 1017-18 (9th Cir. 2005)).

86. Here, the purported GAAP violations were technical in nature, and did not change the total mix of information available to noteholders. *See* Respondents' Post-Hearing Brief, Pt. II.D. The Division thus failed to carry its burden of establishing that the allegedly false or misleading representations regarding GAAP compliance were material, and the OIP's financial statement charges should be dismissed on this basis. *See In re Atlas Mining Co. Sec. Litig.*, 670 F. Supp. 2d at 1133; *Vosgerichian*, 862 F. Supp. at 1374, 1377.

87. In addition, Respondents reasonably believed that the alleged misstatements or omissions were not material, and the Division thus failed to carry its burden of establishing that Respondents "acted with scienter with regard to . . . the materiality of the allegedly misleading statements." *Snyder*, 292 F. App'x at 399-400 (citing *Fine*, 919 F.2d at 297); *ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 552 F.3d 187, 202-03 (2d Cir. 2009); *see also* Respondents' Post-Hearing Brief, Pt. II.D.

88. Independently, where the Division has "fail[ed] to quantify the financial impact of . . . the alleged GAAP violations," it cannot meet its burden of proving materiality. *In re Hansen Nat. Corp. Sec. Litig.*, 527 F. Supp. 2d 1142, 1161 (C.D. Cal. 2007) (dismissing Exchange Act

allegations arising from purported GAAP violations). Here, the Division failed to quantify the financial impact of the alleged GAAP violations, and the OIP's financial statement charges should therefore be dismissed. *See* Respondents' Post-Hearing Brief, Pt. II.D.

E. Affirmative Defense Of Reliance On Accountants

89. Even where the Division carries its burden of establishing each element of a financial statement or accounting irregularity claim such as the one the Division here asserts, reliance on the review and approval of the challenged financial statements by professional accountants remains a complete defense, defeating both intent- and negligence-based charges. *See, e.g.*, *Addington v. Comm'r*, 205 F.3d 54, 58 (2d Cir. 2000).

90. To show good faith reliance on the advice of a professional, a defendant "should show that he [1] made a complete disclosure, [2] sought the advice as to the appropriateness of the challenged conduct, [3] received advice that the conduct was appropriate, and [4] relied on that advice in good faith." *SEC v. Goldsworthy*, 2008 WL 8901272, at *4 (D. Mass. June 11, 2008). Reliance on a professional's advice is reasonable when the advice falls within the professional's area of expertise. *See United States v. Boyle*, 469 U.S. 241, 251 (1985).

91. Here, Respondents relied in good faith on accounting experts in making representations concerning impairment, fair value, and GAAP compliance, and the OIP's financial statements charges should therefore be dismissed. *See Addington*, 205 F.3d at 58; Respondents' Post-Hearing Brief, Pt. II.B.

IV. Improper Evidence

92. Testimony and reports from expert witnesses not qualified to render their opinions, or relying on inherently flawed methodologies are inadmissible and, to the extent they are admitted, should be accorded little, if any, weight. *See* Respondents' Post-Hearing Brief, Pt. III.A; *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 597 (1993); *Kumho Tire Co. v.*

Carmichael, 526 U.S. 137, 152 (1999); *In re Calabro*, Securities Act Release No. 9798, 2015 WL 3439152, at *11 & n.67 (Comm'n May 29, 2015) (the "spirit" of *Daubert* applies in administrative hearings; unreliable expert testimony "has no more place in administrative proceedings than in judicial ones") (internal citation omitted).

93. Expert witnesses' opinions regarding legal conclusions are inadmissible and, to the extent they are admitted, should be accorded little, if any, weight. *See, e.g.*, *SEC v. Tourre*, 950 F. Supp. 2d 666, 681 (S.D.N.Y. 2013); *United States v. Scop*, 846 F.2d 135, 140 (2d Cir. 1988) (government expert's opinions were "legal conclusions" that inappropriately "invade[d] the province of the court to determine applicable law").

94. Unreliable hearsay is inadmissible and, to the extent it is admitted, should be accorded little, if any, weight. *See* SEC Rule of Practice 320, 17 C.F.R. § 201.320; Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,226-27 (July 29, 2016); 5 U.S.C. § 556(d).

95. Here, evidence falling within each of these categories was admitted, *see* Respondents' Post-Hearing Br., App'x B at 4-7, and should be accorded little, if any, weight.

V. Claim Of Aiding And Abetting

96. To prevail on the claim of aiding and abetting, the Division must prove: "(1) the principal, or primary wrongdoer, has violated the securities laws; (2) the aider and abettor provided substantial assistance to the primary violator; and (3) such assistance was rendered with knowledge of, or extreme recklessness regarding, the securities law violation." *Optionsxpress, Inc.*, Securities Act Release No. 10125, 2016 WL 4413227, at *47 n.185 (Comm'n Aug. 18, 2016) (citing *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004)).

97. If the Division does not satisfy its burden to prove the principal's violation of the securities laws in the first instance, then "there is no primary violation and thus no basis for aiding and abetting." *Id.* at *47.

98. The OIP's charge of aiding and abetting by the Patriarch entities should be dismissed because the Division has not satisfied its burden to prove a primary violation. *See* Respondents' Post-Hearing Brief, at 48 n.30.[2]

VI. The Division's Litigation Misconduct

99. SEC Rule of Practice 230(b) imposes a continuing obligation on the Division to learn of and produce material evidence favorable to Respondents, pursuant to *Brady v. Maryland*, 373 U.S. 83 (1963), and *Giglio v. United States*, 405 U.S. 150 (1972). 17 C.F.R. § 201.230(b); *see also City of Anaheim*, Admin. Proc. Rulings Release No. 586, 1999 WL 623748, at *3 (ALJ July 30, 1999).

100. SEC Rule of Practice 231 and the Jencks Act, 18 U.S.C. § 3500, impose a continuing obligation on the Division to produce "any statement" of any witness or potential witness "that pertains, or is expected to pertain" to the witness's "direct testimony." 17 C.F.R. § 201.231; *see also Orlando Joseph Jett*, Admin. Proc. Rulings Release No. 504, 1996 WL 271642, at *2 n.2 (ALJ May 14, 1996).

101. Serious misconduct on the part of the government, including failure to adhere to constitutional and statutory disclosure obligations, may warrant dismissal of charges. *See, e.g.*, *United States v. Chapman*, 524 F.3d 1073, 1085 (9th Cir. 2008) (affirming dismissal where government, having "affirmative[ly] misrepresent[ed] to the court" that it was in compliance

---

[2] The OIP does not charge Ms. Tilton with aiding and abetting. OIP at 12.

with *Brady*, failed to produce materials until mid-trial that were "relevant to impeachment of witnesses who had already testified").

102. Dismissal may be warranted regardless of whether the government's misconduct was intentional or defendant's due process rights were violated. *Id.*

103. The Division engaged in serious misconduct when it failed to disclose its experts' pre-OIP role advising the Commission as to the Division's theory in the OIP. *See, e.g.*, *Schledwitz v. United States,* 169 F.3d 1003, 1016 (6th Cir. 1999) (vacating conviction where government failed to disclose that its allegedly neutral expert had assisted extensively with pre-indictment criminal investigation); Respondents' Post-Hearing Brief, Pt. III.B.

104. The Division engaged in serious misconduct when it failed to disclose, prior to its witness, Peter Berlant of Anchin, Block & Anchin ("Anchin"), testifying, that Berlant's accounting firm was being paid hundreds of thousands of dollars by the Commission in another ongoing matter for which the Division lawyers here are also counsel. *See Wilson v. Beard*, 2006 WL 2346277 (E.D. Pa. Aug. 9, 2006) (finding a *Brady* violation for failure to disclose "[e]vidence that [the witness] may . . . have had a monetary interest in providing . . . information against Petitioner [and which] would have placed Petitioner's trial counsel in a much stronger position to impeach this key witness"), *aff'd*, 589 F.3d 651 (3d Cir. 2009); *United States v. Mahaffy*, 693 F.3d 113, 133-34 (2d Cir. 2012) (vacating conviction due to failure to timely produce *Brady* impeachment material); Respondents' Post-Hearing Brief, Pt. III.B.

105. The Division engaged in serious misconduct when it produced to Respondents only two Anchin emails produced in response to a subpoena seeking seven years of Zohar-related emails, despite Peter Berlant's testimony that Anchin had "likely" provided additional

emails to the Division. *See Chapman*, 524 F.3d at 1073; Respondents' Post-Hearing Brief, Pt. III.B.

106. The Division engaged in serious misconduct when it refused to produce to Respondents interview notes from its interviews with witnesses reflecting those witnesses' statements and bearing on their likely direct testimony. *See Goldberg v. United States*, 425 U.S. 94, 101-02 (1976) (witness statements must be disclosed even where they are contained in attorney notes or memoranda created during witness interviews); Respondents' Post-Hearing Brief, Pt. III.B.

107. The Division engaged in serious misconduct when it repeatedly, but falsely, represented to this tribunal that it was in compliance with its obligations under *Brady*, *Giglio*, and the Jencks Act. *See, e.g.*, *Chapman*, 524 F.3d at 1073; Respondents' Post-Hearing Brief, Pt. III.B.

108. The Division engaged in serious misconduct when it provided to MBIA confidential, non-public information produced by Respondents in the Division's investigation in exchange for MBIA's cooperation in this investigation. *See* Respondents' Post-Hearing Brief, Pt. III.B.

109. The Division's serious misconduct related to this proceeding, including its failure to adhere to constitutional, statutory, and ethical duties, and its false representations concerning its compliance with disclosure obligations, warrants dismissal of the OIP.

VII. This Forum's Denial Of Respondents' Constitutional Rights

110. Under the Appointments Clause of Article II of the U.S. Constitution, inferior officers of the United States must be appointed by a limited set of Executive Branch officials,

which set includes the Commission. *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010).

111. SEC ALJs are inferior officers for purposes of the Appointments Clause, yet they are not appointed by the Commission.

112. This forum is therefore unconstitutional under the Appointments Clause of Article II of the U.S. Constitution. *See Freytag v. Comm'r*, 501 U.S. 868, 878-90 (1991) (where judge serves in violation of the Appointments Clause, the error is "structural," with resulting constitutional harm regardless of how the proceeding is otherwise conducted); Respondents' Post-Hearing Brief, Pt. III.A.

113. Respondents in an adjudicative administrative proceeding are entitled to due process. *See Galvan v. Press*, 347 U.S. 522, 530-31 (1954) (finding the constitutional guarantees of substantive and procedural due process are fully applicable in administrative proceedings); *Kevin Hall*, Exchange Act Release No. 3080, 2009 WL 4809215, at *22 & n.97 (Dec. 14, 2009) (respondents are entitled to "'the full panoply' of safeguards" of due process) (quoting *Hannah v. Larche*, 363 U.S. 420, 442 (1960)); *Gregory M. Dearlove*, Initial Decision Release No. 315, 2006 WL 2080012, at *55 (ALJ July 27, 2006) ("[T]he due process clause of the Constitution and the Administrative Procedure Act do ensure the fundamental fairness of an administrative hearing.").

114. Respondents in administrative proceedings, like defendants in other contexts, have a constitutional right to be informed of the specific nature of the charges brought against them, and thereby be given notice of all grounds on which they may be found liable. *See W. Pac. Capital Mgmt. LLC*, Admin. Proc. Rulings Release No. 681, 2012 WL 8700141, at *1 (ALJ

Feb. 7, 2012) ("[R]espondents in administrative proceedings are entitled to be sufficiently informed of the charges against them so that they may adequately prepare their defense.").

115. This forum has allowed the SEC not to specify salient factual allegations in the OIP. *See* Pre-Hearing Conf. Tr. 10:7-32:6 (May 7, 2015) (partially granting Respondents' motion for a more definite statement). Moreover, it has admitted evidence relating to charges not specified in the OIP. *See* Respondents' Post-Hearing Brief, Pt. III.A. In both of these ways, this forum has denied Respondents' their due process rights under the Fifth Amendment of the U.S. Constitution to be given notice of the charges for which they may be held liable.

116. The Division has a continuing obligation to produce to Respondents all material exculpatory and impeachment evidence pursuant to the Due Process Clause of the Fifth Amendment of the U.S. Constitution, the *Brady* doctrine, the Jencks Act, and SEC Rules of Practice 230 and 231, 17 C.F.R. §§ 201.230, .231. *See supra* ¶¶ 99-100.

117. This forum has interpreted in overly narrow terms the Division's obligation to turn over exculpatory and impeachment materials. *See* Respondents' Post-Hearing Brief, Pt. III.A. This forum has thereby denied Respondents' due process rights under the Fifth Amendment of the U.S. Constitution.

118. Denial of discovery that "deprives one of the right to present a full defense may violate due process." *Carrillo v. Colombi-Monguio*, 862 F.2d 318 (9th Cir. 1988) (unpublished table decision) (citing *W. Elec. Co. v. Stern,* 544 F.2d 1196, 1199 (3d Cir. 1976)); *see also Hous. Auth. of Cty. of King v. Pierce*, 711 F. Supp. 19, 21-23 (D.D.C. 1989); *McClelland v. Andrus*, 606 F.2d 1278, 1286 (D.C. Cir. 1979) ("[D]iscovery must be granted if in the particular situation a refusal to do so would so prejudice a party as to deny him due process.").

119. This forum has not permitted depositions, has refused deposition requests, has permitted the withholding of notes of interviews, and failed to compel production of improperly withheld documents on the ground that witnesses to whom the documents would relate have already testified. *See* Respondents' Post-Hearing Brief, Pt. III.A. This forum thus has denied Respondents discovery that would provide a meaningful opportunity to gather information from key witnesses, and thereby present a full defense. By denying Respondents' the right to present a full defense, this forum has denied Respondents' due process rights under the Fifth Amendment of the U.S. Constitution. *See* Respondents' Post-Hearing Brief, Pt. III.A.

120. Respondents are entitled to "the 'full panoply' of safeguards" of due process, including the right to confront witnesses against them. *See Kevin Hall*, 2009 WL 4809215, at *22 & n.97 (quoting *Hannah*, 363 U.S. at 442 (1960)) (distinguishing between investigative and adjudicative Commission proceedings and explaining that a witness's right of confrontation applies in the latter).

121. The admission of unreliable hearsay evidence, without the ability to subject the declarant to cross-examination, disregards Respondents' right to a fair trial. *See* 3 Wigmore on Evidence § 1018 (Chadbourn rev. 1974) (noting that "[t]he whole purpose of the Hearsay rule" is satisfied where the witness is "present and subject to cross-examination"); *see also California v. Green*, 399 U.S. 149, 155 (1970).

122. By admitting hearsay and other forms of unreliable evidence, this forum has denied Respondents' due process rights under the Fifth Amendment of the U.S. Constitution.

123. Respondents' right to a fair trial includes the right to be represented by counsel who have been given an adequate opportunity to prepare for trial in light of the complexities of the case. *See Dearlove*, 2008 WL 281105, at *35 (Jan. 31, 2008) (explaining that, following "the

principles articulated in *Ungar*[*v. Sarafite*, 376 U.S. 575 (1964)]," denial of a postponement may sometimes violate due process).

124. This forum has required enforcement cases to be tried to an initial decision in an unduly limited timeframe regardless of their complexity. *See* SEC Rule of Practice 360, 17 C.F.R. § 201.360; *Lynn Tilton*, No. 3-16462, Admin. Proc. Rulings Release No. 4004 (ALJ July 20, 2016) (moving hearing date to October 2016 but denying Respondents' request to postpone hearing until December 2016); *Lynn Tilton*, No. 3-16462, Advisers Act Release No. 4495 (Comm'n Aug. 24, 2016) (denying petition for interlocutory review and extension of hearing date). In doing so, it has denied Respondents' due process rights under the Fifth Amendment of the U.S. Constitution.

125. The Equal Protection Clause of the Fifth Amendment provides that the government shall not deny to any person equal protection under the law.

126. The Commission deliberately targeted Respondents and similarly situated individuals and denied them the benefit of Amended Rules that were promulgated to correct procedural and discovery deficiencies in administrative proceedings. *See* Respondents' Post-Hearing Brief, Pt. III.A.

127. This forum's failure to apply all of the revised SEC Rules of Practice, including the rule regarding depositions and the rule extending the time for the issuance of an initial decision violates Respondents' equal protection rights under the Fifth Amendment of the U.S. Constitution.

VIII. Requests For Sanctions

A. The Division Bears The Burden Of Showing The Appropriateness Of Requested Sanctions And That They Are In The Public Interest

128. The Division bears the burden of showing the appropriateness of the sanctions it seeks, including the "burden to show with particularity the facts and policies that support th[e] sanctions [it seeks] and why less severe action would not serve to protect investors." *Steadman v. SEC*, 603 F.2d 1126, 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).

129. Sanctions are available only to the extent they are supported by the "public interest." *See, e.g.*, *Steadman*, 603 F.2d at 1142; *Nicholas D. Skaltsounis*, Admin. Proc. Rulings Release No. 729, 2014 WL 7407487, at *4 (ALJ Dec. 31, 2014).

130. There are six factors courts and tribunals weigh in determining whether the public interest supports the imposition of a given sanction on a given respondent:

(1) "the egregiousness of the defendant's actions,"

(2) "the isolated or recurrent nature of the infraction,"

(3) "the degree of scienter involved,"

(4) "the sincerity of the defendant's assurances against future violations,"

(5) "the defendant's recognition of the wrongful nature of his conduct," and

(6) "the likelihood that the defendant's occupation will present opportunities for future violations."

Steadman, 603 F.2d at 1140.

131. The OIP's requests for drastic sanctions are inappropriate because the public interests, and in particular the six public interest factors, weigh strongly against their imposition. *See* Respondents' Post-Hearing Brief, Pt. IV.

B. An Industry Bar Should Not Be Imposed Given The Division's Failure To Demonstrate Scienter And In Light Of The Public Interest

132. An industry bar is one of "the most drastic remedies at [the Commission's] disposal." *Steadman*, 603 F.2d at 1137.

133. An industry bar is "excessively harsh" where there is no showing of scienter. *See, e.g.*, *Valicenti Advisory Servs., Inc.*, Initial Decision Release No. 111, 1997 WL 362000, at *19 (ALJ July 2, 1997) (Foelak, J.).

134. Before imposing an industry bar, a law judge is required to consider the public interests, and in particular the six public interest factors. *See Steadman*, 603 F.2d at 1140.

135. The OIP's request for an industry bar is inappropriate because there has been no showing of scienter. *See* Respondents' Post-Hearing Brief, Pt. IV.A.

136. The OIP's request for an industry bar is inappropriate for the additional reason that the public interests, and in particular the six public interest factors, weigh strongly against the imposition of this drastic remedy. *See* Respondents' Post-Hearing Brief, Pt. IV.A.

C. Significant Monetary Penalties Should Not Be Imposed Given The Division's Failure To Demonstrate Scienter And In Light Of The Public Interest

137. "Significant monetary penalt[ies]" may be inappropriate without a showing of scienter. *Terry T. Steen*, Initial Decision Release No. 107, 1997 WL 104603, at *10-12 (ALJ Mar. 7, 1997) (Foelak, J.) (internal quotation marks omitted); *see also SEC v. Mannion*, 28 F. Supp. 3d 1304, 1311 n.8 (N.D. Ga. 2014).

138. Before imposing a disgorgement award, a law judge must consider the public interests, and in particular the six public interest factors. *See, e.g.*, *Timbervest, LLC*, Admin. Proc. Rulings Release No. 658, 2014 WL 4090371, at *64 (ALJ Aug. 20, 2014) (considering whether "the *Steadman* factors weigh in favor of ordering disgorgement"); *supra* ¶¶ 128-130.

139. Before imposing civil penalties, a law judge considers the public interests, and in particular the six public interest factors. *See, e.g.*, *Terry T. Steen*, Initial Decision Release No. 107, 1997 WL 104603, at *11-12 (ALJ Mar. 7, 1997) (Foelak, J.) (applying *Steadman* factors to civil penalties analysis); *supra* ¶¶ 128-130.

140. The Division's request for over $200 million in disgorgement, in addition to civil penalties, is a significant monetary penalty, which should not be granted because there has been no showing of scienter. *See* Respondents' Post-Hearing Brief, Pt. IV.B.

141. The Division's request for over $200 million in disgorgement should not be granted because the public interests, and in particular the six public interest factors, weigh strongly against its imposition. *See* Respondents' Post-Hearing Brief, Pt. IV.

142. Civil penalties should not be imposed because, though the OIP requests civil penalties, the Division has not quantified or otherwise proffered any evidence or testimony in support of such penalties. *See* Respondents' Post-Hearing Brief, Pt. IV.

143. The Division's request for civil penalties should not be granted because the public interests, and in particular the six public interest factors, weigh strongly against the imposition of civil penalties. *See* Respondents' Post-Hearing Brief, Pt. IV.B.

D. The Requested Disgorgement Amount Is Inappropriate Because It Is Not Causally Related To The Alleged Wrongdoing, Is Speculative, And Does Not Reflect Offsets

144. A disgorgement award is not permitted to exceed the amount obtained by the alleged wrongdoing, and is strictly limited to *net* profits. *SEC v. Contorinis*, 743 F.3d 296, 301 (2d Cir. 2014).

145. The Division bears the burden of proving any disgorgement figure. *United States v. Dobruna*, 146 F. Supp. 3d 458, 460 (E.D.N.Y. 2015).

precede the beginning of the five-year limitations period under 28 U.S.C. § 2462. *See* Respondents' Post-Hearing Brief, Pt. IV.C.

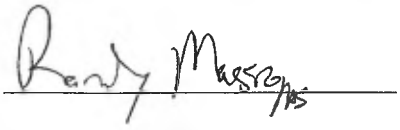
152. The amount of the OIP's requested disgorgement award (more than $200 million) is inappropriate because the Division has not satisfied its burden of proving that amount with accurate and non-speculative calculations. *See* Respondents' Post-Hearing Brief, Pt. IV.C.

153. The amount of the OIP's requested disgorgement award (more than $200 million) is inappropriate for the additional reason that Respondents' transfers to the Zohars directly and through investors in the Portfolio Companies (which far exceed $200 million) must be subtracted from the alleged gains. *See* Respondents' Post-Hearing Brief, Pt. IV.C.

154. The amount of the OIP's requested disgorgement award (more than $200 million) is dwarfed by the offsets, including $441 million that Ms. Tilton personally invested and approximately $70 million in uncollected fees that Respondents are owed, so any disgorgement should be reduced to nil. *See* Respondents' Post-Hearing Brief, Pt. IV.C.

Dated: New York, New York
December 16, 2016

GIBSON, DUNN & CRUTCHER LLP

By: 

Randy M. Mastro
Reed Brodsky
Barry Goldsmith
Caitlin J. Halligan
Mark A. Kirsch
Monica Loseman
Lawrence J. Zweifach
Lisa H. Rubin

200 Park Avenue
New York, NY 10166-0193
Telephone: 212.351.4000
Fax: 212.351.4035

Susan E. Brune
BRUNE LAW P.C.
450 Park Avenue
New York, NY 10022
Telephone: 212.668.1900
Fax: 212.668.0315

Counsel for Respondents

CERTIFICATE OF SERVICE

I hereby certify that I served true and correct copies of 1) Respondents' Post-Hearing Brief, 2) Appendix A, 3) Appendix B, 4) Respondents' Proposed Findings of Fact, and 5) Respondents' Proposed Conclusions of Law on this 16th day of December, 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 Federal Express)

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)

Nilly Gezgin