HARD COPY

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

RECEIVED
FEB 27 2017
OFFICE OF THE SECRETARY

RESPONDENTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO STAY THESE PROCEEDINGS PENDING RESOLUTION OF THEIR CONSTITUTIONALITY, OR, IN THE ALTERNATIVE, FOR PERMISSION TO SEEK A STAY FROM THE COMMISSION

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

February 23, 2017

Respondents Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Respondents") submit this brief in support of their motion to stay the current proceedings pending resolution of critical issues of law by the federal courts. Should Your Honor decline to stay the proceedings, Respondents respectfully request leave to appeal that decision to, and seek a stay from, the Commission. *See* 17 C.F.R. §§ 201.400, 201.401.

PRELIMINARY STATEMENT

The federal courts are in the midst of grappling with the constitutionality of the procedure for appointing SEC ALJs, and should soon resolve this fundamental question underlying the enforcement proceeding against Ms. Tilton. This challenge goes to the legitimacy of the proceeding itself, and the appeals currently underway—including a highly expedited en banc appeal in the D.C. Circuit—provide ample grounds for a stay. Less than two months ago, the Tenth Circuit ruled that "SEC ALJs are inferior officers who must be appointed in conformity with the Appointments Clause." *Bandimere v. SEC*, 844 F.3d 1168, 1181 (10th Cir. 2016). *Bandimere* created an acknowledged circuit split with the opinion of the D.C. Circuit, the only other federal court of appeals to reach the merits of this question. Earlier this year, in *Raymond J. Lucia Cos., Inc. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016), the D.C. Circuit held that ALJs are not inferior officers and therefore not subject to the Appointments Clause. But just last week, the D.C. Circuit granted the *Lucia* petitioners' petition for rehearing en banc, vacating its decision upholding the appointment scheme for SEC ALJs and opening the door for the D.C. Circuit to follow the Tenth Circuit in finding current ALJ appointments unconstitutional. *See* Order Granting Rehearing En Banc (Dkt. 1661665), *Lucia v. SEC*, No. 15-1345 (D.C. Cir. Feb. 16, 2017). Given the broad availability

of the D.C. Circuit as a forum for respondents in SEC administrative proceedings,[1] such a finding would render the current appointment scheme all but a dead letter. *See Heartland Plymouth Court MI, LLC v. NLRB*, 838 F.3d 16, 22–23 (D.C. Cir. 2016) (agency must acquiesce when "it knows that its order will be subjected to an adverse circuit's law on appeal," including when there are "two venue choices for the party appealing" the agency's order, and "one circuit's precedent is . . . adverse to [the agency]"). If the D.C. Circuit were instead to affirm the panel's ruling, the split would remain, and U.S. Supreme Court review would likely follow.

The same question concerning the constitutionality of the appointment procedure for the SEC's ALJs is pending before Your Honor in this very proceeding. Respondents have repeatedly sought to have this proceeding dismissed on the ground that it is barred by the Appointments Clause, *see, e.g.*, Resp. Pre-Hearing Br. 38 (Oct. 17, 2016); Resp. Post-Hearing Br. 109 (Dec. 16, 2016); Resp. Proposed Conclusions of Law ("COL") ¶¶ 110-12 (Dec. 16, 2016); Resp. Post-Hearing Opp. Br. 45 (Jan. 13, 2017), and Your Honor will need to rule on the Appointments Clause question in issuing an Initial Decision in this case. Respondents have also filed a petition for certiorari seeking the Supreme Court's review of the Second Circuit's decision that jurisdiction over the Appointments Clause question in this case currently rests with Your Honor and the Commission, as well as review of the underlying question of the constitutionality of SEC ALJ appointments. *See* Petition for Writ of Certiorari, *Tilton v. SEC*, No. 16-906 (U.S. Jan. 18, 2017).

---

[1] *See* 15 U.S.C. § 80b-13(a) (Investment Advisers Act) (permitting review of Commission "order[s]" "in the United States Court of Appeals for the District of Columbia"); § 80a-14(a) (Investment Company Act) (permitting review of any "order" "in the United States Court of Appeals for the District of Columbia"); § 78y(a)(1) (Securities Exchange Act of 1934) (permitting review of "a final order of the Commission" in the "District of Columbia Circuit"); § 77i(a) (Securities Act of 1933) (permitting review of "an order of the Commission" "in the United States Court of Appeals for the District of Columbia").

Since the D.C. Circuit has voted to rehear the question and the Supreme Court may well address it in the near future, the appropriate and efficient course is to temporarily stay these proceedings. Additionally, the Supreme Court recently granted certiorari in *SEC v. Kokesh*, 834 F.3d 1158 (10th Cir. 2016), which presents the question of whether the five-year statute of limitations applicable to civil penalties sought by the SEC applies to claims for disgorgement. *See Kokesh v. SEC*, No. 16-529, 2017 WL 125673 (U.S. Jan. 13, 2017). Here, the Division has requested $208 million in disgorgement based in part on conduct more than 5 years before the Order Initiating Proceedings ("OIP") was filed. A ruling by the Supreme Court on the SEC's authority to do so will determine the amount of disgorgement the Commission is entitled to seek. These developments plainly present "good cause" for a stay. *See* 17 C.F.R. § 201.161(a). Given the absence of hardship to the Division, the public interest in ensuring that enforcement resources are not unnecessarily expended on administrative proceedings whose constitutionality is in serious question, and the potential significant detriment to Respondents in facing adjudication before a tribunal that may be deemed unconstitutional by the D.C. Circuit or U.S. Supreme Court and in being subject to a disgorgement penalty that may be deemed unlawful by the U.S. Supreme Court, Respondents respectfully request a stay of the current proceedings until the threshold legal questions regarding the constitutionality of these proceedings and the statute of limitations for disgorgement are resolved.

LEGAL STANDARD

Your Honor has the authority to stay a proceeding "for good cause shown." 17 C.F.R. § 201.161(a); *see also Landis v. N. Am. Co.*, 299 U.S. 248, 254 (1936) ("[T]he power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants.").

Exercise of that authority is guided by SEC Rule of Practice 161(b), which lists factors relevant to a hearing officer's determination of good cause, including substantial prejudice to the moving party if the stay is not granted, the length of the proceeding to date, the number of postponements already granted, the stage of the proceedings, the impact of the request on the hearing officer's ability to complete the proceeding in the time specified by the Commission, and "[a]ny other such matters as justice may require." Rule 400(d) states that the Commission "will not consider [a] motion for a stay" in connection with an application for interlocutory review "unless the motion shall have first been made to the hearing officer," while Rule 401(a) requires that the motion papers in support of a stay application "state the reasons for the relief requested and the facts relied upon."

The Commission has granted stays under Rule 161 where a legal issue presented in the appeal of another pending case will "likely impact" the instant case. *In re Steinberg*, Advisers Act Release No. 4008, 2015 WL 331125, *2 (Jan. 27, 2015) (granting unopposed motion for a stay under Rule 161 for "good cause shown" until "the United States Attorney's Office decide[d] whether to petition for rehearing, rehearing en banc, and/or certiorari in" *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), and "any such petitions [were] finally resolved"). Granting a stay in light of pending related or controlling cases is a common practice among district courts as well. *See, e.g., Int'l Painters & Allied Trades Indus. Pension Fund v. Painting Co.*, 569 F. Supp. 2d 113, 120–21 (D.D.C. 2008).

ARGUMENT

Respondents have repeatedly challenged, in this proceeding, the constitutionality of the SEC's procedure for appointing ALJs. *See* Resp. Pre-Hearing Br. 38 (Oct. 17, 2016); Resp. Post-Hearing Br. 109 (Dec. 16, 2016); COL ¶¶ 110–12 (Dec. 16, 2016); Resp. Post-Hearing Opp. Br. 45 (Jan. 13, 2017). In light of the D.C. Circuit's recent decision to rehear the issue en

banc and the likelihood of U.S. Supreme Court review—including, potentially, of Ms. Tilton's own petition for certiorari—Your Honor should stay these proceedings pending the resolution of their constitutionality in the federal courts. It would be both inefficient and unfair for this case to proceed to an initial decision before that occurs.

As Your Honor is aware, the constitutionality of the selection procedure for the SEC's ALJs has been repeatedly challenged by litigants in administrative proceedings, including Respondents here. SEC ALJs are not selected by the Commission or through one of the other means prescribed by the Appointments Clause, such as by the President or the courts. *See* U.S. Const. art. II, § 2, cl. 2. ALJs are chosen instead by SEC staff from candidates identified by the Office of Personnel Management.

In August 2016, the U.S. Court of Appeals for the District of Columbia Circuit held that SEC ALJs were not inferior officers, and therefore not subject to the Appointments Clause's requirements. *See Lucia*, 832 F.3d at 288. On December 27, 2016, the Tenth Circuit—the same circuit where the SEC Regional Office prosecuting this case is located—held exactly the opposite: that SEC ALJs were inferior officers because they exercise significant authority under federal law. *See Bandimere*, 844 F.3d at 1181. As a result, under the U.S. Supreme Court's decision in *Freytag v. Commissioner*, 501 U.S. 868 (1991), they were subject to, yet failed to meet, the selection requirements of the Appointments Clause. *Id.*[2] A number of district courts in other circuits have reached the same conclusion. *See Hill v. SEC*, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015) ("*Freytag* mandates a finding that . . . SEC ALJs exercise 'significant authority' and are thus inferior officers."), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016); *Duka v. SEC*, No. 15 Civ. 357 (RMB) (SN), 2015 WL 4940057, at *2 (S.D.N.Y. Aug. 3, 2015) ("The

[2] As a result of its ruling, the Tenth Circuit "set aside the SEC's opinion," noting that the panel's resolution of "this question relieves Mr. Bandimere of all liability." *Bandimere*, 844 F.3d at 1172, 1188.

Court here concludes that SEC ALJs are 'inferior officers' because they exercise 'significant authority pursuant to the laws of the United States.'" (quoting *Freytag*, 501 U.S. at 881)), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016).

Bandimere created a split with the D.C. Circuit's decision in *Lucia* on the constitutionality of these administrative proceedings. Now, the D.C. Circuit has voted to vacate its decision and grant rehearing en banc of *Lucia*—even though the D.C. Circuit "rehears virtually none of its cases." *See* Jonathan H. Adler, "Is *Halbig v. Burwell* En Banc Worthy?", The Volokh Conspiracy via *The Washington Post* (Aug. 5, 2014) (quoting Adam J. White, No Need for a Halbig Rehearing," *Wall Street Journal* (Aug. 4, 2014)) (commenting that the "bar on *en banc* rehearing in the D.C. Circuit has been higher than the bar for certiorari in the Supreme Court"). "Each year the court's three-judge panels make roughly 500 hearings, but the court averages roughly one *en banc* rehearing." *Id.* In 2014, the D.C. Circuit heard only two. *Id.* In 2013, zero. *Id.* The D.C. Circuit's decision to rehear *Lucia* and vacate its prior decision upholding the appointment scheme for SEC ALJs illustrates the importance and unsettled nature of the controversy on this issue.

If the en banc D.C. Circuit upholds the SEC ALJ appointment scheme, the circuit split on the question would persist, increasing the likelihood of Supreme Court review. If the D.C. Circuit finds in favor of the petitioners in *Lucia*, the decision would effectively bar proceedings like this one before an ALJ, given the availability of the D.C. Circuit as a venue for review of Commission orders. *See, e.g.*, 15 U.S.C. § 80b-13(a) (permitting review of Commission "order[s]" "in the United States Court of Appeals for the District of Columbia").

Moreover, as Your Honor knows, Respondents challenged the constitutionality of the SEC's appointment scheme in federal district court (in addition to raising the Appointments Clause issue in this proceeding). The Second Circuit held that jurisdiction over that question in

this case currently rests with Your Honor and the Commission. On January 18, 2017, Respondents filed a petition for certiorari seeking the Supreme Court's review of that decision, as well as the underlying question of the constitutionality of SEC ALJ appointments. *See* Petition for Writ of Certiorari, *Tilton v. SEC*, No. 16-906 (U.S. Jan. 18, 2017) Thus, the constitutionality of the administrative proceedings pending before Your Honor might be resolved via several different vehicles: the D.C. Circuit could hold the appointment procedure unconstitutional in *Lucia*, or the Supreme Court could grant review of *Bandimere*, *Lucia*, or *Tilton*.[3] A decision in any of those cases is likely to present grounds for dismissal of this action prior to a decision on the merits of the SEC's charges.

Granting a stay in these circumstances not only furthers efficiency and fairness, but is also consistent with Commission practice, which makes clear that a stay is appropriate where there is a likelihood that a dispositive legal issue will be resolved in pending circuit court cases or by the U.S. Supreme Court. In *Steinberg*, for example, the respondent requested a stay under Rule 161 after the Second Circuit's decision in *Newman*, 773 F.3d 438, concerning the elements required for an insider trading conviction. *In re Steinberg*, 2015 WL 331125, at *1–2. The Commission granted Steinberg's stay motion for "good cause shown," in light of the *Newman* case's "likely impact on Steinberg's conviction," and ordered that the stay would remain in place until "the United States Attorney's Office decide[d] whether to petition for rehearing, rehearing

---

[3] As noted, Petitioners' petition for rehearing en banc in *Lucia* was granted by the D.C. Circuit on February 16, 2017, and Petitioners in this case filed a petition for certiorari in *Tilton* on January 18, 2017. The government recently requested an extension of time to petition for rehearing en banc in *Bandimere* until March 30, 2017, which the Tenth Circuit has granted. *See* Unopposed Motion for 30-Day Extension of Time in Which to File Petition for Rehearing En Banc (Dkt. 01019758575), *Bandimere v. SEC*, No. 15-9586 (10th Cir. Jan. 31, 2017); Order Granting Motion for Extension of Time, Dkt. 01019758910, *Bandimere v. SEC*, No. 15-9586 (10th Cir. Jan. 31, 2017).

In addition to the petition in *Tilton*, there is at least one other petition for certiorari pending before the Supreme Court which raises the Appointments Clause issue: Petition for Certiorari, *Pierce v. SEC*, No. 15-901 (U.S. Nov. 2, 2015).

en banc, and/or certiorari in" *Newman*, and "any such petitions [were] finally decided." *Id.* Federal district courts likewise stay cases as a routine matter when the resolution of a pending appeal would provide binding authority as to questions presented in the district court case. *See, e.g.*, *Basardh v. Gates*, 545 F.3d 1068, 1069 (D.C. Cir. 2008) (noting that the court "[o]ften" issues stays "in light of other pending proceedings that may affect the outcome of the case before us"); Order (Dkt. 28), *Acton v. Intellectual Capital Mgmt., Inc.*, No. 15-cv-4004 (JS) (ARL) (E.D.N.Y. Dec. 28, 2015) (granting stay pending resolution of *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540 (2016)).[4]

In addition, on January 13, 2017, the Supreme Court granted certiorari in *Kokesh v. SEC*, a case involving a disgorgement order based on securities law violations that occurred 15 years before the Commission filed suit. *See* Petition for Writ of Certiorari, *Kokesh v. SEC*, No. 16-529 (U.S. Oct. 18, 2016). The question presented for Supreme Court review in *Kokesh* is whether the five-year statute of limitations on the government's collection of civil penalties pursuant to 28 U.S.C. § 2462 applies to claims for disgorgement. The First Circuit, D.C. Circuit, and the Tenth Circuit have held that § 2462 does not apply to actions for disgorgement. *See SEC v. Tambone*, 550 F.3d 106, 148 (1st Cir. 2008); *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010); *Kokesh*, 834 F.3d at 1167. The Eleventh Circuit recently disagreed, holding that disgorgement is a "forfeiture" for purposes of § 2462, and thus that provision's five year

[4] *See also, e.g.*, Order (Dkt. 52), *Fontes v. Time Warner Cable, Inc.*, No. 14-2060 (C.D. Cal. Dec. 17, 2015) (granting stay "in light of the risk of wasting the resources of the Court and the parties as well as the high degree of uncertainty in this area of the law"); *Fergerstrom v. PNC Bank, N.A.*, No. CIV. 13-00526 DKW, 2014 WL 1669101, at *13 (D. Haw. Apr. 25, 2014) (accepting magistrate recommendation to grant stay "[i]n light of similar factual and legal issues raised in [pending] cases and the pending appeals"); *Munoz v. PHH Corp.*, No. 1:08CV0759 AWI DLB, 2011 WL 4048708, at *4 (E.D. Cal. Sept. 9, 2011) (holding that "[t]here is no rational reason to proceed further in this case until the standing issue has been clarified by the Supreme Court" in a case then pending before the Court).

limitations period applies to disgorgement. *SEC v. Graham*, 823 F.3d 1357, 1363 (11th Cir. 2016).

Respondents made exactly that argument to Your Honor. *See* Resp. Post-Hearing Br. 118–19 & n.71 (Dec. 16, 2016); COL ¶¶ 149, 151 (Dec. 16, 2016); Resp. Post-Hearing Opp. Br. 55 n.30 (Jan. 13, 2017). A decision in favor of the petitioner in *Kokesh* would bar disgorgement of $45,447,417 in fees and distributions that the Division seeks from Respondents based on conduct that occurred more than five years before the filing of the OIP, *i.e.*, March 30, 2015. *See* Resp. Post-Hearing Opp. Br. 55 n.30 (Jan. 13, 2017); *see also* OIP ¶ 1 (seeking sanctions based on activities "[s]ince 2003").[5]

A stay is necessary given the potential for severe repercussions from any negative ruling on the merits of Respondents' case—harm that cannot be undone even if both legal questions were later resolved in Respondents' favor. *See* Rule 161(b)(1) (stay permitted where the requesting party makes a strong showing of substantial prejudice).[6] Not only would an adverse

---

[5] The SEC argues in its post-hearing opposition brief that even if the Supreme Court agrees with the Eleventh Circuit, disgorgement for violations outside the statute of limitations would still be acceptable under the "continuing violation" doctrine. Div. Post-Hearing Opp. Br. 38 n.13 (Jan. 13, 2017). However, the Commission never alleged a continuing violation in the OIP, and it cannot introduce this theory for the first time now. In addition, "[t]he weight of authority in [the Second Circuit] is skeptical of the application of the continuing violation[] doctrine in securities fraud cases." *In re Comverse Tech., Inc. Sec. Litig.*, 543 F. Supp. 2d 134, 155 (E.D.N.Y. 2008); *see, e.g.*, *SEC v. Jones*, No. 05 Civ. 7044 (RCC), 2006 WL 1084276, at *4–5 (S.D.N.Y. Apr. 25, 2006); *de la Fuente v. DCI Telecommunications, Inc.*, 206 F.R.D. 369, 385–86 (S.D.N.Y. 2002). Further, it is far from certain that the continuing violation doctrine, an equitable remedy, applies in the face of Congress's explicit limitation on the government's ability to penalize past conduct. *See Toussie v. United States*, 397 U.S. 112, 114–15 (1970); *see also Gabelli v. SEC*, 133 S. Ct. 1216, 1224 (2013) (denying applicability of a similar equitable remedy, the discovery doctrine, to toll the statute of limitations). Noticeably, the Commission did not assert that such an exception to § 2462 existed in its brief to the Supreme Court agreeing that certiorari should be granted in *Kokesh*, despite describing Kokesh's securities violations as "continuing." Resp. Br. 4, *Kokesh v. SEC*, No. 16-529 (U.S. Dec. 9, 2016).

[6] The other factors listed in Rule 161 do not weigh against a stay: The proceeding has been prolonged, but through no fault of Respondents; only one postponement has been granted—and only to provide new counsel sufficient time to prepare for the hearing; and while the SEC's Rules

ruling inflict severe, irreparable reputational harm on Respondents, but it would also negatively impact the dozens of distressed companies in which Respondents have invested, and their tens of thousands of employees.

Finally, a stay at this point in the proceedings would not prejudice any party. "Rather, a stay will reduce the additional expenditure of the parties' time and resources, which is of particular importance if the Supreme Court's decision ultimately disposes of this action." *Munoz v. PHH Corp.*, No. 1:08CV0759 AWI DLB, 2011 WL 4048708, at *4 (E.D. Cal. Sept. 9, 2011). The Division is actively litigating the Appointments Clause issue before the Tenth Circuit and the D.C. Circuit, and it must litigate the scope of disgorgement in the case currently pending before the Supreme Court. There are no concerns about preserving witness memories or scheduling issues because the hearing has already concluded. There is no risk of alleged ongoing or future harm to fund investors—the Patriarch entities are no longer registered investment advisers, and no Patriarch entity has served as a collateral manager to any of the relevant funds since February 2016. And finally, Respondents are not seeking a stay of indefinite duration—rather, Respondents request a stay only until the live controversy regarding the Appointments Clause is resolved and the Supreme Court decides *Kokesh*.

In light of the substantial uncertainty surrounding the threshold constitutional question and the statutory penalties question, the public interest in efficient proceedings, and the potential for substantial and irreparable harm if a stay is not granted, a stay of these proceedings is the appropriate course.

---

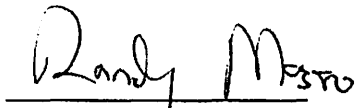
of Practice—as relevant here—impose a 300-day deadline on administrative hearings, that deadline expired on November 12, 2016 such that Your Honor will need an extension of the deadline whether the stay is granted or not.

CONCLUSION

For the foregoing reasons, Respondents respectfully request that Your Honor stay the proceedings pending resolution by the federal courts of appeal and the U.S. Supreme Court of the threshold question of their constitutionality and the permitted scope of any disgorgement claim in these proceedings.

Dated: February 23, 2017
New York, New York

GIBSON, DUNN & CRUTCHER LLP

By: 

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

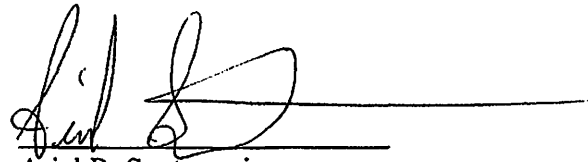
CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of Respondents' Motion to Stay These Proceedings Pending Resolution of Their Constitutionality, or, In The Alternative, For Permission to Seek a Stay From The Commission and Memorandum of Law on this 23rd day of February, 2017, 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