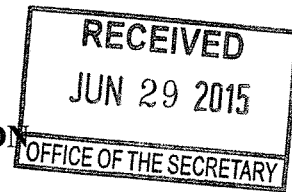


UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING  
File No. 3-16462

HARD COPY

In the Matter of

LYNN TILTON;  
PATRIARCH PARTNERS, LLC;  
PATRIARCH PARTNERS VIII, LLC;  
PATRIARCH PARTNERS XIV, LLC;  
AND  
PATRIARCH PARTNERS XV, LLC,

Respondents.

DIVISION OF ENFORCEMENT'S  
BRIEF IN OPPOSITION TO  
RESPONDENTS' MOTION FOR  
SUMMARY DISPOSITION

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The Division of Enforcement (“Division”) opposes Respondents’ motion for summary disposition, and files the below brief in opposition.

## **INTRODUCTION**

This is a case about Respondents’ deceptive scheme and false disclosures related to three Collateralized Loan Obligation (“CLO”) funds known as Zohar I, II, and III (the “Zohar Funds”). The documents underlying the funds—the indentures, which were relied upon by investors—contained objective requirements for categorizing loans that failed to pay interest. That categorization, in turn, affected a core part of the investments: the Over Collateralization Ratio (“OC Ratio”), a calculation that protected investors’ interests. Instead of categorizing loans as Respondents pledged they would in the indentures, Tilton used her own subjective judgment, resulting in a miscalculation of the OC Ratio that—by avoiding the consequences of an accurate calculation—allowed Tilton to collect about \$200 million in improper fees and stay in control of the Zohar Funds.

Respondents’ motion for summary disposition is based on three false premises about the Division’s case, and thus provides no basis for their requested relief. First, Respondents argue that because investors could determine, by making certain calculations based on regularly issued trustee reports, that there were some missed loan payments, Respondents’ alleged fraud was disclosed and therefore is not actionable. But even if investors could determine some loan payments were missed, Respondents did not disclose that the OC Ratio, if properly calculated, would have failed six years ago, and that Tilton was using a subjective categorization methodology, rather than the objective methodology described in the indentures. Respondents’ actions resulted in both fraud and breach of fiduciary duty.

Second, Respondents argue that they were under no obligation to disclose their personal interpretation of the indentures to investors. But the Division's case is based on an objective reading of the obligations in the indentures, as confirmed by investors. Any secret interpretation by Respondents is simply irrelevant.

Third, Respondents argue that they could not have defrauded the Zohar Funds because Tilton controlled those funds and thus could not have "defrauded herself." In fact, the Zohar Funds are legal entities to which Respondents owed fiduciary duties. Moreover, Respondents' misconduct led to Respondents ultimately obtaining about \$200 million of the Funds' assets to which they were not entitled, and which otherwise would have gone to reduce the Funds' obligations. This conduct was plainly adverse to the Funds' interest, and as such the Division has properly asserted fraud on the Funds themselves.

### **FACTUAL BACKGROUND**

As detailed below, there are numerous material factual disputes at issue in Respondents' motion, making summary disposition inappropriate. See 17 C.F.R. § 201.250(b).

#### **The Respondents Are Investment Advisers With Fiduciary Duties**

Patriarch Partners VII, LLC; Patriarch Partners XIV, LLC; and Patriarch Partners XV, LLC, the collateral managers for the Zohar Funds, are all registered as investment advisers with the Commission. See OIP ¶¶ 12-14; Answer ¶¶ 12-14. Patriarch Partners, LLC and Tilton also acted as investment advisers to the Zohar Funds. OIP ¶ 52. As investment advisers, each of the Respondents owed fiduciary duties to the Zohar Funds. Id. See also Exh. 1 (Patriarch's Compliance Manual (excerpt) at PP130639) (noting that the investment advisers "have a fiduciary duty to place their Clients' interests before the Firm's and its Employees' interests.")

## **The Indentures Do Not Permit Discretion In Loan Categorization**

The indentures contain specific definitions based on objective criteria for categorization of each portfolio asset. For example, a Category 1 asset under the Zohar II Indenture “does not satisfy the criteria of any of Category 2, Category 3 or Category 4.” Exh. 2 (Zohar II Indenture (excerpts) at PP050273). See also Exh. 3 (Zohar I Indenture (excerpts) at PP049946). Under the Zohar II Indenture, a Category 4 asset must be “Current.” Exh. 2, (Zohar II Indenture (excerpts) at PP050274). A loan is “Current” when it is not “Non-Current” Id. at PP050287. A “Non-Current” loan is a “Defaulted Obligation” that has “previously deferred and/or capitalized as principal any interest due thereon.” Id. at PP050309. A “Defaulted Obligation” is a loan “with respect to which a default as to the payment of principal and/or interest has occurred (without regard to any applicable grace period or any waiver of such default), but only so long as such default has not been cured.” Id. at PP050288. The indentures for the other Zohar Funds are similar. See Exh. 3 (Zohar I Indenture (excerpts) at PP049946, PP049959, PP049974); Exh. 4 (Zohar III Indenture (excerpts) at PP001771-72, 74 (definitions of “Collateral Investment” and “Defaulted Investment”).

The plain language of the Zohar indentures ties the categorization to the collection of interest and, notably, does not permit an asset to be classified as a Category 4 when contractual interest has not been paid. There is no reference in the indenture to any type of discretion for asset categorization.<sup>1</sup>

Investors, too, believe that the categorization criteria are objective:

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<sup>1</sup> As Respondents point out, the Category 4 definition includes the condition that the collateral manager does not believe that the asset faces a “significant risk of declining credit quality.” Motion at 6. However, this is not an exclusive criterion, but rather, is preceded by a list of additional requirements, including the payment of current interest, all of which must be met. See, e.g., Exh. 2, (Zohar II Indenture (excerpts) at PP050274).

Q. Do you think that the categorization of the collateral is a subjective test or do you think it's an objective test?

A. I think it's on objective test. I think it's in the document, there are definitions, and I think by that nature, it's an objective test.

Exh. 5 (McKiernan (MBIA) Tr. At 114:16-21).

Respondents rely on Section 7.7(a) of the indentures, which they argue grants Tilton the right to enter into amendments, forbearances, waivers, and supplements of loans and loan interest. Motion at 4. However, while Section 7.7(a) does allow for loan modifications, it simply does not address or alter the categorization requirements contained in those portions of the indentures described above.

#### **Respondents Do Not Follow The Categorization Method Required By The Indenture**

The Zohar Funds make loans to distressed companies (the "Portfolio Companies"). OIP ¶ 2; Answer ¶ 2. Tilton regularly monitors the interest to be paid on those loans. OIP ¶ 46; Answer ¶ 46. However, "[i]t's very frequent that the companies cannot pay the full contractual rate of interest." Exh. 6, (Tilton 6-24-14 Tr. at 55:12-13). Tilton then determines whether to accept less than the full amount of interest due by a Portfolio Company and is the ultimate decision maker on this issue. OIP ¶¶ 47-48; Answer ¶¶ 47-48. Respondents determine the categories for portfolio assets. OIP ¶ 55; Answer ¶ 55.

Tilton, however, does not recategorize assets when Portfolio Companies fail to pay interest that is due:

Q. Does a failure to pay interest by a portfolio company, or to pay the full amount of interest due by a portfolio company impact it's [sic] categorization in any way?

A. It depends on the circumstances, but not necessarily.

Exh. 6, (Tilton 6-24-14 Tr. at at 87:16-21).

Instead, Tilton employs her own subjective methodology to categorize assets:



Q. Okay. Thanks. If you intend to continue to support that company, then you consider it a Category 4 asset. Is that correct?

A. If we continue the support in terms of active funding, active management to effectuate the turnaround strategy, and we have a reasonable belief of recovery because we're taking those actions and that's what causes recovery, you know, under our history and track record, then we consider it a Category 4.

Exh. 7, (Tilton 2-12-13 Tr. at 190:15-23).

This methodology has not been disclosed to investors:

Q. Has anyone from Patriarch ever disclosed to you how Patriarch determines the categories for the loans?

A. No.

Q. Do you know if they have disclosed that to anyone at Barclays?

A. I don't believe so.

\* \* \*

Q. We have heard from Lynne [sic] Tilton that Patriarch and that she will consider a company to be a category 4 as long as she intends to continue supporting that company by providing funding, providing management resources, that type of thing. Is that something that she has ever disclosed to you as an investor?

A. No.

Q. And is that something that as an investor you would want to know?

A. Yes.

Q. Why is that?

A. Because it certainly deviates from the objective definition of the categorizations as well as a significant input into any credit position or credit risk view we may take on any of the portfolio companies.

Exh. 8 (Chaku (Barclays) Tr. at 50:21-51:1, 59:5-20).

### **Trustee Reports Did Not Contain Information On Patriarch's Categorization Method**

The monthly trustee reports for each fund contains a listing of the category for each loan in the portfolio as well as a calculation of the OC Ratio. OIP ¶ 33; Answer ¶ 33. Respondents did not disclose their categorization methodology in the trustee reports. Even if an investor could tell from the trustee report that a Portfolio Company had paid less than full interest on a loan in a particular month, investors did not know 1) that Tilton was using an undisclosed subjective methodology to categorize the assets; 2) the true categories of fund assets; and 3) that the OC Ratio was overstated.<sup>2</sup> See Exh. 18 to Motion (example trustee report).

Investors reviewed the trustee reports and relied on the categorizations reported there as information about the condition of their investment:

Q. When you review a trustee report, what is it that you are looking for?

A. We look to see any changes in the quality of the collateral or collateral assets themselves.

Q. Anything else?

A. I would say that that is primarily driven by the categorization assumptions and any new assets or restructured assets added or taken away from the portfolio. That's for the monthly reports; as well as the value assigned to those assets.

Q. How do you determine the quality of the collateral on the basis of the trustee reports?

A. The only information we're really provided around that officially is the categorization that is the responsibility of Patriarch Partners. Outside of that, it would just be whatever we can glean from basic web searches effectively.

Exh. 8 (Chaku (Barclays) Tr. at 17:23-18:14).

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<sup>2</sup> As noted by Respondents in Exhibit 13 to their Motion, an investor analyst asked about lower than expected interest collections in the Zohar I deal. This investor did not inquire about categorization and Patriarch's response to his question was simply that it has discretion to modify loans.

As noted in Respondents' Motion, parties interested in the transactions did ask why assets with unpaid interest were not marked as defaulted. See Motion at 8. There is no evidence that Patriarch ever disclosed its actual categorization method to these parties.<sup>3</sup> Although Tilton testified that she would have disclosed the categorization method if asked, she apparently did not:

Q And I understand that you had discussed the strategy with investors. What I'm wanting to know is, though: Did you actually discuss the method, by which you categorized the assets with the investors?

A I don't recall specific questions on the categories. If I had been asked the question, I certainly would have discussed it; but I can't sitting here recall a specific question asked of me on the categorizations.

Exh. 6, (Tilton 6-24-14 Tr. at 104:17-25).

### **Consequences To The Funds**

Under the indenture, in the event that certain triggers are met, there are consequences to the Funds. These consequences, which will be the subject of expert testimony, are intended to protect investors and the triggering of these consequences should not be viewed as negative events for the investors.

For example, under the payment waterfall prescribed in the indenture, in the event that the OC Ratio is not met, additional principal payments are diverted to investors. See, e.g., Exh. 2 (Zohar II Indenture (excerpts) at PP050454-56). Moreover, upon a failure of a lower OC Ratio threshold, either the insurer (Zohar I and II) or a group of investors (Zohar III) has the right to

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<sup>3</sup> Respondents cite handwritten notes as evidence of disclosure of the categorization method to one investor. The Division does not agree with the interpretation of those notes as set forth by Respondents. Motion at 7. Moreover, speculation by the trustee and a rating agency as to why assets had not been marked as defaulted is not probative as evidence of the propriety of such actions. Motion at 8.

determine the future of the fund assets.<sup>4</sup> See, e.g., id. at PP053071. These consequences were agreed to by Respondents at the time that the indentures were negotiated.

### LEGAL STANDARD

Summary disposition is appropriate only where “there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law.” 17 C.F.R. § 201.250(b). The Division’s allegations in the OIP “shall be taken as true, except as modified by stipulations or admissions made by [the Division], by uncontested affidavits, or by facts officially noted . . .” 17 C.F.R. § 201.250(a). In contested administrative proceedings such as this, “the circumstances when summary disposition prior to hearing could be appropriately sought or granted will be comparatively rare.” Rules of Prac. Adopting Rel., 60 Fed. Reg. 32738, 32768 (June 23, 1995).

### ARGUMENT

**1. The Division’s categorization theory is strongly supported by the investigative record.**

Respondents claim that the Division’s “categorization theory” of this case is simply that “investors did not know that Patriarch exercised discretion in categorizing as performing loans that do not pay the full stated interest, rather than automatically defaulting them.” Motion at 9.

Respondents then go on to assert that by examining trustee reports and performing certain calculations, investors could determine that some loans were not paying full interest. Id. at 10.

But this oversimplified argument does not even address the core fraud alleged in the OIP related to Respondents’ categorization method. As alleged in the OIP:

[Respondents] have not disclosed that they fail to consider past due interest when conducting categorization analyses and performing the OC Ratio test. Investors

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<sup>4</sup> If this were to occur, it is by no means certain that “massive investor losses” would result as asserted by Respondents. These controlling parties would presumably take whatever action was in their best economic interest which may or may not include the liquidation of collateral.

have not been told that the OC Ratio test would have failed at various points if Tilton had performed the categorization analyses in the method anticipated by the indentures.

OIP ¶ 49. The fact that investors could tell that some interest payments were missed in no way gave them the capability to determine that the OC Ratio test would have failed at various points if Respondents had complied with the plain terms of the indentures. In fact, if Respondents had applied the categorization methodology set forth in the indentures, the OC Ratio test derived from the categorizations would have failed by at least 2009. OIP ¶ 6. The OC Ratio was falsely stated in the trustee reports, and the decline in value of the Zohar funds' assets was therefore misstated to investors, which they could not tell because of the falsely reported OC Ratio. OIP ¶¶ 43-45. These facts will be further established by the Division's upcoming expert testimony.<sup>5</sup>

Respondents do not argue that investors were somehow able to calculate the true OC Ratio for the Zohar funds based on the disclosures in the trustee reports. Instead, Respondents incorrectly assert that these "reports disclosed what the Division claims was hidden: the loans categorized as performing were actually paying less than full stated interest." Motion at 12-13. The Division's claim is much more than that, as detailed in the OIP: Respondents miscategorized loans based on Tilton's undisclosed subjective judgment rather than the objective requirements of the indentures, and thus manipulated the OC Ratio, earning about \$200 million in improper fees for Tilton while keeping her in control of the funds, all of which Respondents hid from investors, breaching their fiduciary duty and defrauding investors. See OIP ¶¶ 1-6. Thus, Respondents' argument that investors could determine that some loan payments were missed is a red herring and their motion should be denied.

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<sup>5</sup> Pursuant to the Court's prehearing order, the Division's expert reports will be disclosed on July 10. Should the Court determine those reports are relevant to its decision on Respondents' Motion, the Court should defer ruling on the motion until after that time. See Rule of Prac. 250(b).

The OC Ratio test was critically important to investors:

Q. Is the OC test something that is important to you as an investor?

A. Yes.

Q. Why is that?

A. For a various amount of reasons. I think most importantly it does provide additional protection in the sense that it will divert cash from the subordinate management fee as well as any junior noteholders, and basically prevents excess spread leaking away from tranches and our notes and allows us to recapture some of the value within the deal or to better protect ourselves. And it also is just a matter of calculation and also provides a useful leading indicator in terms of the performance of the assets; and gives us better understanding of the collateral quality and another metric of performance for us to judge.

Exh. 8 (Chaku (Barclays) Tr. at 42:19-43:10).

Q. Is the categorization of the collateral something that's important to you as an investor?

A. Any investor will have great interest on the categorization of collateral, absolutely.

Exh. 9 (Aldama (Barclays) Tr. at 56:2-57:1).

Q. [W]hy was the OC ratio something you looked at?

A. Basically it's an indication of how the portfolio -- the assets within the portfolio are performing, and whether you can expect to get principal repayment or not.

Q. As an investor, was the OC ratio something that was important to you?

A. Yes.

Q. Why is that?

A. Because you would basically look to have a healthy OC ratio rather than not a healthy OC ratio. You want to make sure that the assets within the portfolio are healthy, cash flowing assets.

Exh. 10 (Ruttle (Rabobank) Tr. at 26:7-20).

Had Respondents properly categorized and calculated the OC Ratio in a manner consistent with the indentures, Tilton would have lost out on about \$200 million in fees and would have been subject to removal as collateral manager. OIP ¶¶ 29, 43 (these facts will be established by the Division's upcoming expert testimony). Investors understood and valued these consequences of the OC Ratio test:

Q. Do you have an understanding of the consequences if the funds were to fail the OC test?

A. Again, for every transaction, there is different remedies. I think for this transaction, I do believe that there would be potential manager removal rights in this transaction, and I am trying to remember if there is acceleration provisions or if the subordinated management fee would be cut off. I believe it would be in this transaction. But, for example, those are the type of things that we would be looking at and, you know.

Q. So is the OC test important to you as an investor or insurer?

A. The OC test is very important to us as an insurer, and I would think for an investor it would be important, too.

Exh. 5 (McKiernan (MBIA) Tr. at 106:21-107:11).

Furthermore, while investors understood that Tilton had certain discretion as collateral manager, categorizing an asset as a category 1 or defaulted investment was objective, and Respondents did not disclose, nor did investors understand, that Tilton was using her subjective judgment in making this determination, rather than the objective standard in the indenture:

Q. Do you think that the categorization is subjective or do you believe that it's objective?

A. I believe it is objective.

...

Q. So, based on what you are reading here [in the indenture], would you expect a company that is not current in its interest payments to be classified as a category [4]?

A. No.

Q. And why is that?

A. Because if it is not current in its interest payments and that is a default within the construct of that loan or for that obligor, then it would definitionally not be a current collateral debt obligation.

Exh. 8 (Chaku (Barclays) Tr. at 47:11-13, 50:11-20).

Q. Okay. We've heard from Patriarch that Patriarch decided whether or not to classify an asset as defaulted in Zohar III based on whether or not Patriarch intended to continue to support the portfolio company by loaning it funds, providing management resources, those types of -- those types of factors. Is that something you've ever heard before?

A. No.

Q. And is that information that, as an investor, you would have liked to have known?

A. Yes.

Q. Why is that?

A. In my opinion, it would not -- I guess if Patriarch decided to support or not support a company, would -- and then I guess their decision to do so would then determine whether it's defaulted or not defaulted, I think doesn't fit the definition as stated in the document.

Q. And when you say "the document," you mean the indenture?

A. Yes.

Exh. 10 (Ruttle (Rabobank) Tr. at 34:3-24).

Q. We have heard from Patriarch -- from Ms. Tilton specifically that she will categorize a company as a 4 as long as she intends to continue supporting the company by providing funding, management resources, that type of thing. Is that something you have heard before?

A. I have heard claims by Ms. Tilton that she has supported and put personal money in some companies to support the companies. It is hard for us to verify those statements since we don't get the financials of the companies.

Q. Sure.



A. But that's not what the indenture is.

Q. Let me ask my question again. So, she's told us that if she intends to continue providing support to a company, which maybe it's personal money or maybe it's extending more loan facilities and in management resources, that type of thing, then she will consider that company a category 4. And that's how she makes the determination of what is a category 4. Is that something you have ever heard before?

A. I never heard that statement before.

Q. And does that seem consistent with the indenture to you?

A. No.

Exh. 9 (Aldama (Barclays) Tr. at 56:2-57:1).<sup>6</sup>

Thus, Respondents failed to properly categorize loans, as promised in the indentures, resulting in a falsely stated OC Ratio, which investors did not know should have failed if categorization had been performed properly. This resulted in Tilton maintaining control over the funds and improperly receiving about \$200 million in fees. Respondents cannot overcome this fraudulent nondisclosure just by arguing that investors could have pieced together that some payments were being missed based on the trustee reports, when the OC Ratio disclosures were false and misleading, which the investors did not know. See New Jersey Carpenters Health Fund v. Royal Bank of Scotland Group, PLC, 709 F.3d 109, 126 (2d Cir. 2013) (“[a] reasonable investor

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<sup>6</sup> Respondents previously cited Aldama's testimony in their motion to halt to support their claim that investors understood that Tilton had discretion to categorize assets “whatever she wants.” Motion to Halt at 3. But Aldama clarified that testimony moments later, stating Tilton did not in fact have such discretion, even if she acted as though she did:

Let me clarify. The indenture clearly defines what a 4 is, a 3, a 2 and a 1. These are clear definitions of what a 4 is and a clear definition what a 1 is. I don't think she is using that to classify. It is my belief based on how some of the compan[ies] gone from a 4 to 1 from trustee report from November to December there is a jump from 4 to 1. I don't think she's using the internal categories that she's meant to use. I think she's using a lot of discretion. I don't [think] she has the discretion she's just -[.]

Exh. 9 (Aldama (Barclays) Tr. at 50:1-13).

can independently analyze how a security will perform in the market, but she cannot compensate for the fact that she has not received what she was told to expect”); Dodona I, LLC v. Goldman, Sachs & Co., 847 F. Supp. 2d 624, 648 (S.D.N.Y. 2012) (“Ultimately, an incomplete or misleading disclosure may be just as damaging as total concealment”). Furthermore, Tilton’s subjective categorization methodology was both undisclosed and a breach of fiduciary duty and contractual standard of conduct. OIP ¶ 56.

Respondents rely heavily on an e-mail chain involving S&P discussing a proposed amendment – after the fact – to a Zohar indenture. That proposed amendment is irrelevant not only because it occurred after the fact, but primarily because it had to do with changing the definition of “Defaulted Obligation” to include new loans and restructures. Respondents’ Exh. 13 at 9413. But this case is about neither new loans nor restructures. Respondents do not appear to have made relevant new loans to avoid categorizing loans as a category 1 (or defaulted investments), and as for restructures, Tilton testified that those were formal restructurings—which were rarely used—and which did result in recategorization:

Q. Okay. What provision of the indenture did you follow when you categorized American Lafrance as a 1?

A. I made a decision to call it default, because I believed that despite all the additional funding that I had put in, and all the additional funding that I might put in, that I believed based on the current management team, the current plan, the current processes, the current location, that I didn't believe that I could improve the company performance at that time. **And I ended up putting the company into a formal restructure; and based on it being a formal restructure, I put it as a Category 1.**

...

A formal restructuring that would involve either an Article 9 foreclosure sale, a Chapter 11 bankruptcy, or perhaps even a -- you know, the discussions with outside lenders that would bring in to effect real negotiations on debt forgiveness or change of capital structure; something that would have to be negotiated over a period of time to effectuate, and that would involve outside constituencies.

Exh. 6 (Tilton 6-24-14 Tr. at 124:15-125:2) (emphasis supplied).

Conversely, this case involves Respondents' inappropriate use of less formal methods of avoiding category 1 defaults, such as interest waiver, deferral, forbearance, forgiveness, modification, and amendment, which were often done without formal documentation and/or on the basis of course of conduct, in order to manipulate the OC Ratio:

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

A Generally, it would be me.

Q Is that decision documented somewhere?

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

...

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

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

...

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

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

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

A It probably could fall into any category.

Exh. 6 (Tilton 6-24-14 Tr. at 58:4-12, 61:6-12, 67:10-18).

Instead of complying with the categorization requirements of the indentures, specifically as to categorizing as 1 or defaulted due to missed payments, as detailed in the fact section above,

Tilton used her own undisclosed subjective categorization methodology, resulting in an inflated OC Ratio and more fees and control for her:

Q Does a failure to pay interest by a portfolio company, or to pay the full amount of interest due by a portfolio company impact its categorization in any way?

A It depends on the circumstances, but not necessarily.

...

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

A Because the categorizations are based on the belief in the future recovery and the reorganization, not based on how much interest is collected. The categorizations are based on the belief in the ultimate reasonableness of the recovery and the future.

Exh. 6 (Tilton 6-24-14 Tr. at 87:16-21, 88:14-21).

**2. This case is based on a plain reading of the indentures, not any secret interpretation held by Respondents.**

Respondents argue that they were under no duty to disclose their apparently secret reading of the indentures, relying on cases involving contract negotiations. Respondents further argue that if the indentures were “inartfully drawn,” it is “not a proper subject for SEC concern.” Motion at 14-15. But this is not a contract dispute. And Respondents’ personal reading of the indentures—secret or not—is simply irrelevant. Respondents’ argument simply misses what this case is about: the Zohar indentures plainly require that a loan for which there has been a “default as to the payment of principal and/or interest” be categorized as a 1 (or defaulted investment in the case of Zohar III). Exh. 2, (Zohar II Indenture (excerpts) at PP050288); see also Exh. 3 (Zohar I Indenture (excerpts) at PP049946, PP049959, PP049974); Exh. 4 (Zohar III Indenture (excerpts) at PP001771-72, 74 (definitions of “Collateral Investment” and “Defaulted Investment”). Instead of

following the objective requirements<sup>7</sup> of the indentures, Tilton used her own subjective judgment, which Respondents did not disclose to investors, resulting in excessive fees to herself of about \$200 million and maintaining control of the Zohar funds, and which defrauded investors. Respondents' behavior also resulted in a breach of fiduciary duty because, as investment advisers, each of the Respondents owed fiduciary duties to the Zohar Funds. See Exh. 1 (Patriarch's Compliance Manual (excerpt) at PP130639) (noting that the investment advisers "have a fiduciary duty to place their Clients' interests before the Firm's and its Employees' interests."). Thus, any secret interpretation of the indentures by Respondents is irrelevant to the securities laws violations at issue here, and Respondents' motion should be denied.

**3. The Division has properly asserted claims under Advisers Act Sections 206(1) and (2).**

Respondents also contend that the Division's claims under Sections 206(1) and (2) of the Advisers Act must fail as a matter of law because Respondents' "clients" are the Zohar Funds themselves (rather than the Funds' investors) and, because Tilton ultimately owns those Funds, Tilton "could not have defrauded herself." Respondents make two arguments in support of this contention: first, they claim there are – and could be – no allegations of how the Zohar Funds were misled; and second, they claim that the Funds could not have been misled because Tilton and the other Respondents' knowledge must be imputed to the Funds. Respondents are wrong on both counts.

---

<sup>7</sup> Again, investors viewed the categorization requirements as objective. See Exh. 5 (McKiernan (MBIA) Tr. At 114:16-21); Exh. 8 (Chaku (Barclays) Tr. at 50:21-51:1, 59:5-20).

**a. The Division has alleged that Respondents defrauded the Zohar Funds.**

The Division does not dispute that under Sections 206 (1) and (2) of the Advisers Act, Respondents' "clients" are the Funds themselves, rather than the Funds' investors.<sup>8</sup> See Goldstein v. SEC, 451 F.3d 873, 881-82 (D.C. Cir. 2006). But it does not follow that Tilton and the other Respondents could not have defrauded their Fund clients. In fact, Respondents failed to disclose material information to the Funds, acted adversely to the Funds' interest, and ultimately obtained Fund assets to which they were not entitled and which otherwise would have been available to reduce the Fund obligations.

The Zohar Funds had assets and obligations. The Funds' assets consist primarily of the loans made to portfolio companies. OIP ¶ 2; Answer ¶ 2. Those loans were funded by capital raised from investors; at a specified date in the future (the "maturity date"), the Zohar Funds were obligated to repay the investors' principal. OIP ¶ 16; Answer ¶ 16. Until the maturity date, the interest payments received from the portfolio companies on their loans were used to make periodic interest payments to investors, see id., as well as to pay Patriarch a "subordinated management fee," see OIP ¶ 26; Answer ¶ 26. Under the terms of the governing documents, if the OC Ratio was breached, the Funds' obligation to pay the subordinated fee was eliminated, and investors received earlier payment on their principal, which reduced the Funds' ultimate principal repayment obligation. See OIP ¶¶ 29-30.

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<sup>8</sup> Fraud on a fund's investors is specifically addressed by Section 206(4) and Rule 206(4)-8. Respondents do not challenge the Division's charges under those provisions. Moreover, the fact that Respondents defrauded investors in the Funds does not preclude a claim that the Funds themselves were also defrauded. See SEC v. Mannion, 789 F.Supp.2d 1321, 1338 -1339 (N.D. Ga. 2011) ("Defendants are not now free to defraud the Fund on the grounds that the harm is ultimately borne by the investors.").

As described in detail above, Respondents' fraud stems from the use of Tilton's own subjective methodology to value and categorize the Funds' assets, rather than following the objective methodology disclosed in the governing documents. See, e.g., OIP ¶¶ 1-5. Tilton's subjective methodology kept loans to portfolio companies assigned to the highest valuation category even when those companies performed poorly and failed to pay interest on the loans. See, e.g., id. ¶ 43. As a result, the OC Ratio was artificially propped up when in reality it would have been breached – a breach that would have eliminated the funds' obligation to pay the subordinated management fee. See id. ¶ 44. Respondents never disclosed Tilton's subjective methodology to the Funds. See id. ¶ 49. As a result, Tilton and Respondents collected about \$200 million in fees from Fund assets that should have been used to reduce the Funds' principal obligations to investors. See id. ¶¶ 26, 29, 44. Tilton's failure to disclose her subjective methodology also breached fiduciary duties she and the other Respondents owed to the Funds, and created a significant conflict of interest, since she was categorizing loans in a way that allowed her to take money from the Funds to which she was not entitled. See id. ¶¶ 54-56.

Respondents claim that these allegations are “untenable,” since any claim that Tilton defrauded the Zohar Funds is a claim that “Tilton defrauded herself.” That is simply not so. The notes for each of the Zohar Funds were issued by two special purpose entities, each with their own boards of directors. For instance, in the Zohar II transaction, Zohar II 2005-1, Limited, a Cayman Islands company, is the Issuer. The Issuer has its own Board of Directors, located in the Cayman Islands. The Co-Issuer, Zohar II 2005-1, Corp., is Delaware corporation also with its own board of directors. Together with another entity, the issuers are defined as the Obligors on the Zohar notes. See Exh. 2 (Zohar II Indenture (excerpts) at PP050266, PP050272). Put simply, by defrauding the Funds, Tilton defrauded entities that have a legal existence separate and apart from Tilton, and to

whom she owes fiduciary duties. See Goldstein, 451 F.3d at 882 (“[F]orm matters in this area of the law because it dictates to whom fiduciary duties are owed.”). Respondents should not be permitted to disregard the corporate form that they have chosen in order to avoid charges of fraud. See U.S. v. Sain, 141 F.3d 463, 474 (3d Cir. 1998) (rejecting sole shareholder’s attempt to avoid criminal liability by claiming he could not have aided and abetted his corporation; “To hold otherwise would allow the controlling stockholder of a corporation to enjoy the benefits of the corporate form, protection from personal liability for corporation's debts, without accepting the burden of assuming criminal responsibility when the individual causes the corporation to commit a crime.”).

Moreover, Respondents’ reliance on In re Doctors Hosp. of Hyde Park, Inc. is misplaced. That case – which involves approval of a bankruptcy settlement, not an SEC enforcement action or any claim under the Advisers Act – found that, because a corporate director owes fiduciary duties only to shareholders, a director who was also a sole shareholder could not have defrauded himself. 474 F.3d 421, 428 (7th Cir. 2007). In other words, the case stands only for the principle that where the defrauder and the defrauded are identical, no fraud can occur. Whatever the import of that case (if any) in an enforcement context, the facts of that case are simply not the facts here. While Tilton may be the ultimate equity owner of the Zohar Funds, the Funds are entities separate and distinct from Tilton. Under those circumstances, claims under 206(1) and (2) are entirely proper. Cf. SEC v. Ficeto, 839 F. Supp. 2d 1101, 1106 (C.D. Cal. 2011) (SEC properly charged investment adviser under Sections 206(1) and (2) even though individual who was de facto controller of client was in on the fraud and thus argued adviser could not have defrauded client; controller of client and the client were not “identical entities” and thus client was misled).



In short, the Division has alleged how Respondents misled and defrauded the Funds: rather than follow the objective categorization methodology disclosed to the Funds, Respondents used Tilton's undisclosed, subjective methodology, and as a result of this non-disclosure and conflict of interest obtained about \$200 million in Fund assets that could otherwise have been used to reduce Fund obligations. Through this misconduct, Respondents "employ[ed] [a] device, scheme, or artifice to defraud," and "engage[d] in [a] transaction, practice, or course of business which operate[d] as a fraud or deceit upon," their clients – the Zohar Funds. 15 U.S.C. § 80b-6(1), (2).

**b. Respondents' knowledge is not imputed to the Zohar Funds.**

Respondents also argue that Tilton and Respondents could not have defrauded the Funds because, as a matter of law, their knowledge is imputed to the Funds. However, as Respondents acknowledge, there is an exception to this imputation rule where the agents' interests are adverse to the principals. As one court has explained:

The rationale behind imputation of an agent's knowledge to a principal is "the presumption that an agent has discharged his duty to disclose to his principal all material facts coming to his knowledge as to the subject of his agency." This rationale fails when the agent has an adverse interest which, by its very nature, he seeks to conceal from his principal.

Lincoln Nat. Life Ins. Co. v. Snyder, 722 F.Supp.2d 546, 556 (D. Del. 2010) (quoting KE Property Mgmt., Inc. v. 275 Madison Mgmt. Corp., 1993 WL 285900, \*5 (Del. Ch. July 21, 1993)). This "adverse interest exception" applies in SEC enforcement actions. See SEC v. DiBella, 587 F.3d 553, 568 (2d Cir. 2009) ("We have held that third party disclosure to an agent is not imputed to the principal when the agent is acting adversely to the principal's interest ....") (citation and quotations omitted).

The adverse interest exception, while defined narrowly by some courts, fits this case. Even courts that narrowly define the exception recognize that "the acts and knowledge of the agent [are

not imputed to the principal] where the agent engaged in a scheme to defraud [her] principal on [her] own behalf . . . .” In re Alphastar Ins. Grp. Ltd., 383 B.R. 231, 272 (S.D.N.Y. 2008).

Essentially, the exception recognizes that where the principal is the victim of the agent’s misconduct, imputation of the agent’s knowledge to the principal would be illogical and unjust. See, e.g., Kirschner v. KPMG LLP, 938 N.E.2d 941, 952 (N.Y. 2010) (noting the exception is reserved for cases, such as “outright theft or looting or embezzlement,” where “the corporation is actually the victim of a scheme undertaken by the agency to benefit himself or a third party personally”). That is what the Division alleges here: Respondents’ conduct resulted in their receipt of about \$200 million in Fund assets that otherwise could have been used by the Funds to reduce their obligations. On these facts, the adverse interest exception applies, and Respondents’ knowledge is not imputed to the Funds. See Symbol Technologies, Inc. v. Deloitte & Touche, LLP, 888 N.Y.S.2d 538, 543 (N.Y. App. Div. 2009) (adverse interest exception applied where plaintiff alleged senior management committed accounting fraud that resulted in over \$100 million in bonuses awarded to them); cf. Bullmore v. Ernst & Young Cayman Is., 861 N.Y.S.2d 578, 582 (N.Y. Sup. Ct. 2008) (finding adverse interest exception did not apply because “this is not a situation where the alleged wrongdoers were stealing from the Fund, such as by diverting funds to themselves . . .”).<sup>9</sup>

Respondents also argue that the adverse interest exception does not apply where the agent is the “sole shareholder” of the principal and there are no other “innocent decision makers” who could have prevented the fraud. However, Respondents do not cite – and the Division has not

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<sup>9</sup> In addition, as numerous courts have recognized, resolution of whether the adverse interest exception applies is an issue of fact best left for trial. See, e.g., Bank of China v. NBM LLC, 359 F.3d 171, 179 (2d Cir. 2004); In re Crazy Eddie Securities Litig., 802 F. Supp. 804, 818 (E.D.N.Y. 1992); Morgado Family Partners, LP v. Lipper, 2004 WL 3142198, \*4 (N.Y. Sup. Ct. Nov. 9, 2004); Capital Wireless Corp. v. Deloitte & Touche, 627 N.Y.S.2d 794, 797 (N.Y. App. Div. 1995).

found – any case importing these concepts into the enforcement context. This only makes sense, since the “innocent decision maker” analysis is relevant to causation, which the Division need not prove. See Bullmore, 861 N.Y.S.2d at 583 (“[T]he utility of the innocent insider analysis is that it may assist courts in considering causation . . . .”); see also, e.g., SEC v. Lee, 720 F.Supp.2d 305, 325 (S.D.N.Y. 2010) (“Unlike private litigants, who must comply with the PSLRA, the SEC is not required to prove investor reliance, loss causation, or damages in an action for securities fraud.”). Thus, an analysis of whether there were other “innocent” decision makers at the Funds, or rather whether Respondents were the “sole” decision makers for the Funds, is simply not relevant to this case.

In sum, Respondents are not entitled to judgment as a matter of law dismissing the Division’s claims under Sections 206(1) and (2) of the Advisers Act.

**CONCLUSION**

For the reasons stated above, Respondents’ motion summary disposition should be denied.

*Rule 450(d) Certification:* Undersigned counsel certifies that this brief contains 6,776 words and therefore complies with the limitations set forth in Rule of Practice 450(c).

Dated: June 26, 2015

Respectfully Submitted,



---

Dugan Bliss, Esq.  
Nicholas Heinke, Esq.  
Amy Sumner, Esq.  
Division of Enforcement  
Securities and Exchange Commission  
Denver Regional Office  
1961 Stout Street, Ste. 1700  
Denver, CO 80294

**CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the foregoing was served on the following on this 26<sup>th</sup> day of June, 2015, in the manner indicated below:

Securities and Exchange Commission  
Brent Fields, Secretary  
100 F Street, N.E.  
Mail Stop 1090  
Washington, D.C. 20549  
(By Facsimile and original and three copies by UPS)

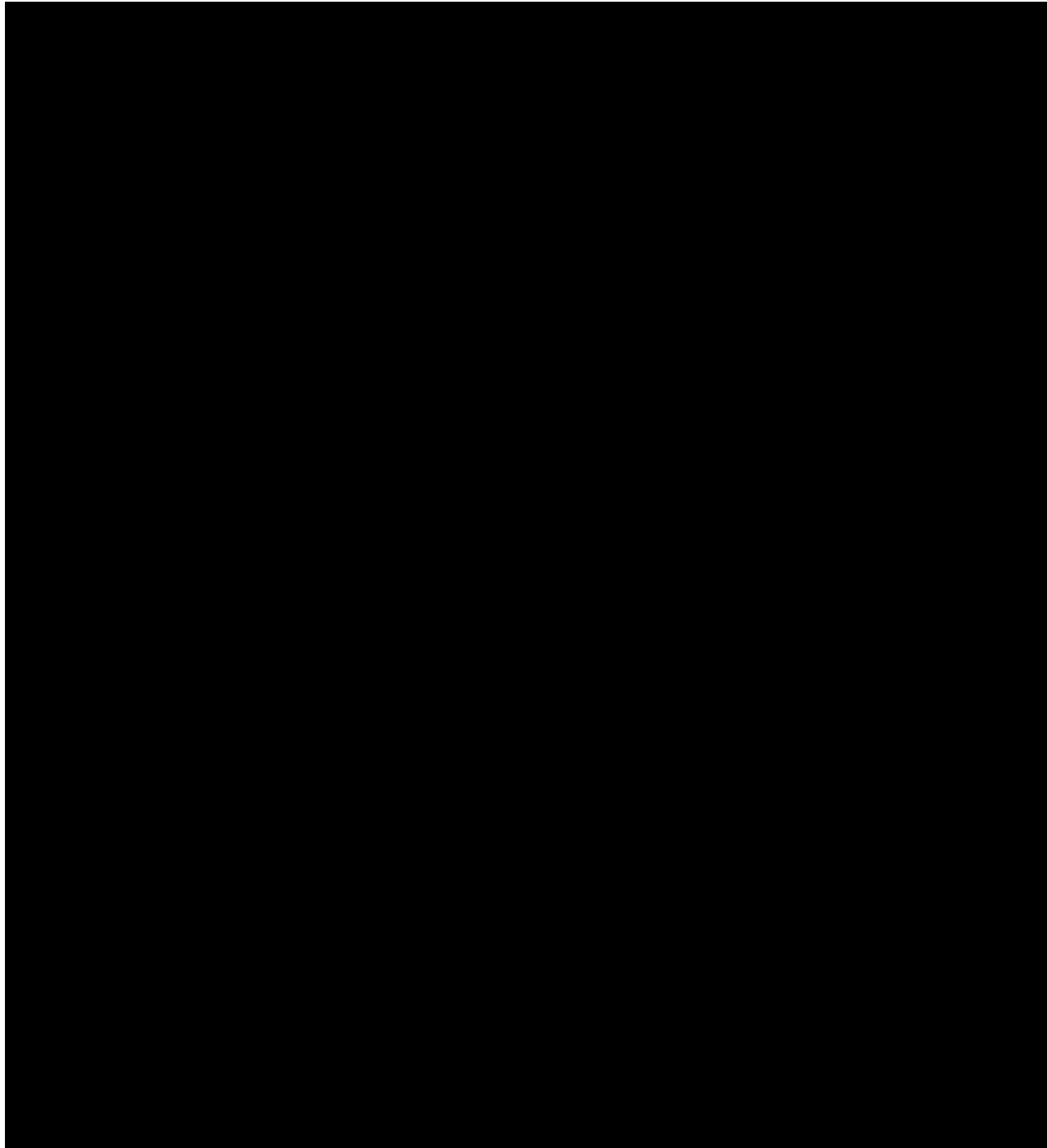
Hon. Judge Carol Fox Foelak  
100 F Street, N.E.  
Mail Stop 2557  
Washington, D.C. 20549  
(By Email)

Christopher J. Gunther  
David M. Zornow  
SKADDEN, ARPS, SLATE,  
MEAGHER & FLOM LLP  
Four Times Square  
New York, NY 10036  
(By email pursuant to the parties' agreement)

Susan E. Brune  
MaryAnn Sung  
BRUNE & RICHARD LLP  
One Battery Park Plaza  
New York, NY 10004  
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Martin J. Auerbach  
Law Firm of Martin J. Auerbach, Esq.  
1330 Avenue of the Americas  
Ste. 1100  
New York, NY 10019  
(By email pursuant to the parties' agreement)

  
\_\_\_\_\_  
Nicole L. Nesvig



CONFIDENTIAL TREATMENT REQUESTED BY BRUNE & RICHARD LLP  
ON BEHALF OF PATRIARCH PARTNERS LLC



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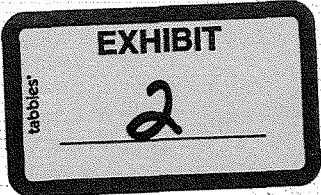
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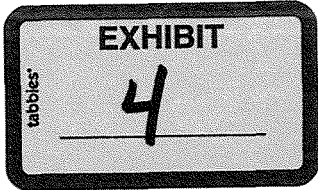
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )  
) File No. HO-11665  
PATRIARCH PARTNERS, LLC ) D-3350  
)

WITNESS: ANTHONY McKIERNAN

PAGES: 1-144  
PLACE: Securities and Exchange Commission  
Brookfield Place  
200 Vesey Street  
New York, New York 10281-1022

DATE: May 16, 2014

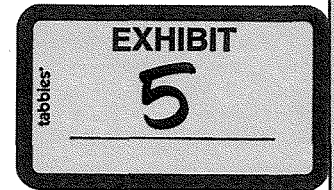
The above-entitled matter came on for hearing at 9:35 o'clock a.m.

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**A P P E A R A N C E S :**

On behalf of the Securities and Exchange Commission:  
AMY A. SUMNER, ESQ.  
Enforcement Division  
Securities and Exchange Commission  
1801 California Street  
Suite 1500  
Denver, Colorado 80202

On behalf of the Witness:  
BINGHAM McCUTCHEN LLP  
399 Park Avenue  
New York, New York 10022-4689  
BY: SUSAN F. DiCICCO, ESQ.  
BRYAN P. GOFF, ESQ.



**P R O C E E D I N G S**

MS. SUMNER: We are on the record at 9:35 on May 16, 2014.

Will you please raise your right hand:  
Do you swear to tell the truth, the

whole truth and nothing but the truth?

THE WITNESS: I do.

Whereupon,

ANTHONY McKIERNAN,

appeared as a witness herein and, having been first duly sworn, was examined and testified as follows:

**EXAMINATION BY**

MS. SUMNER:

Q. Please state and spell your full name for the record.

A. My name is Anthony Matthew McKiernan; A-N-T-H-O-N-Y M-A-T-T-H-E-W M-c-K-I-E-R-N-A-N.

Q. Mr. McKiernan, my name is Amy Sumner. I'm a member of the staff of the Enforcement Division of the Denver Regional Office of the Securities and Exchange Commission. I am also an officer of the Commission for the purposes of this proceeding.

This is an investigation by the United States Securities and Exchange Commission in the matter of Patriarch Partners to determine whether

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there have been violations of certain provisions of the Federal Securities Laws. However, the facts developed in this investigation may constitute violations of other federal or state, civil or criminal laws.

Prior to the opening of the record, you were provided with a copy of the Formal Order of Investigation in this matter. It will be available for your examination during the course of this proceeding.

Mr. McKiernan, have you had an opportunity to review the Formal Order?

A. Yes.

Q. Prior to the opening of the record, you were also provided with a copy of the Commission's Supplemental Information Form 1662. A copy of that notice has been previously marked as Exhibit 33.

Mr. McKiernan, have you had an opportunity to read Exhibit 33?

A. Yes.

Q. Do you have any questions concerning this exhibit?

A. No.

Q. Mr. McKiernan, are you represented by counsel?

1 A. Yes.  
 2 MS. SUMNER: Would counsel please  
 3 identify themselves for the record?  
 4 MS. DiCICCO: Susan DiCicco, Bingham  
 5 McCutchen, New York.  
 6 MR. GOFF: Bryan Goff, Bingham  
 7 McCutchen, New York.  
 8 MS. SUMNER: Ms. DiCicco, are you  
 9 representing Mr. McKiernan as his counsel today?  
 10 MS. DiCICCO: Yes.  
 11 MS. SUMNER: Mr. Goff, are you  
 12 representing Mr. McKiernan as his counsel today?  
 13 MR. GOFF: Yes.  
 14 MS. SUMNER: Please mark this  
 15 Exhibit 181.  
 16 (Subpoena marked Exhibit 181 for  
 17 identification.)  
 18 Q. Mr. McKiernan, I am handing you a  
 19 document that's been marked as Exhibit 181. This is  
 20 a copy of a subpoena. Is this the subpoena -- is  
 21 this a copy of the subpoena pursuant to which you are  
 22 appearing here today?  
 23 A. Yes.  
 24 Q. I know from talking to your counsel that  
 25 you have provided sworn testimony before, but I'd

1 A. No.  
 2 Q. Did you discuss your testimony here  
 3 today with anyone other than your counsel?  
 4 A. Not my testimony, just telling people my  
 5 whereabouts today.  
 6 Q. What did you do to prepare for  
 7 testimony?  
 8 A. I just met with counsel.  
 9 Q. Anything else?  
 10 A. That was it.  
 11 Q. Have you discussed the SEC's  
 12 investigation with anyone other than your counsel?  
 13 A. The only other people I have discussed  
 14 the general investigation with are my colleagues, my  
 15 senior management colleagues at MBIA.  
 16 Q. Who from MBIA have you talked about it  
 17 with?  
 18 A. My CEO.  
 19 Q. Who is that?  
 20 A. Jay Brown. The president of MBIA, Bill  
 21 Fallon, F-A-L-L-O-N. And our general counsel, Ram  
 22 Wertheim, R-A-M W-E-R-T-H-E-I-M. And our CFO, Chuck  
 23 Chaplin. That's the core senior management team of  
 24 the company. We meet privately and discuss matters  
 25 related to the different companies and MBIA.

1 just like to touch on some of the ground rules to  
 2 make sure that things go smoothly.  
 3 As you know, everything we say will be  
 4 taken down by a court reporter. So for that reason,  
 5 your responses to my questions must be verbal as a  
 6 nod of the head won't show up on the transcript.  
 7 A. Right.  
 8 Q. In order to keep the transcript clean,  
 9 please try to let me finish my question, get my  
 10 question all the way out before you answer, and I  
 11 will do the same, I will endeavor to do the same at  
 12 least, in order to make sure that we are not talking  
 13 over each other.  
 14 If you don't understand a question that  
 15 I ask, please ask me to restate it or rephrase it.  
 16 Otherwise I will assume that you understood the  
 17 question that I asked.  
 18 I control the record. What that means  
 19 is the court reporter will only go off the record if  
 20 I instruct her to do so. She will not go off the  
 21 record at the instruction of you or your counsel.  
 22 However, if you do need a break, let me know and we  
 23 will work it in.  
 24 Is there any reason you won't be able to  
 25 answer my questions fully and accurately today?

1 Q. Could you spell Chuck's last name?  
 2 A. CHAPLIN.  
 3 MS. SUMNER: Let's go off the record at  
 4 9:40.  
 5 (Recess taken.)  
 6 MS. SUMNER: We are back on the record  
 7 at 9:44.  
 8 Q. During the break, Mr. McKiernan, did you  
 9 have any substantive conversations with the SEC staff  
 10 regarding this investigation?  
 11 A. No.  
 12 MS. DiCICCO: With her.  
 13 A. No, I'm sorry.  
 14 Q. I will ask you that every time we go on  
 15 and off the record to make sure that everything we  
 16 talk about is captured on the record.  
 17 You did indicate that you needed to add  
 18 some more names?  
 19 A. Yes. I had also had a conversation with  
 20 Jon, J-O-N, Harris, who works for Ram Wertheim. He  
 21 is the assistant general counsel. And not really  
 22 discussing the investigation, but more just technical  
 23 aspects of our deals to my analysts, I have had  
 24 conversations about the transactions: Keith Borelli,  
 25 B-O-R-E-L-L-I, and Kristen Calandra, C-A-L-A-N-D-R-A

1 A. Yes.

2 Q. What does the OC test measure?

3 A. Generally, over collateralization tests

4 measure how much collateral or notional coverage is

5 available to cover the outstanding debt. So to the

6 degree that there's value in the transaction, in

7 terms of asset value that exceeds the debt balance,

8 for example, you'd have positive coverage there.

9 Q. And what's the importance of this test?

10 A. It's an important test to determine what

11 kind of protection the transaction actually has. So

12 to the degree that for any type of secured financing,

13 by nature of that, you're protected by collateral in

14 the form of some assets.

15 To the degree that that protection,

16 which you normally would hope would be in excess of

17 the debt outstanding, might start to deteriorate or

18 that coverage would start to shrink and potentially

19 there might not be enough notional value to cover the

20 debt, that obviously brings up some concerns and

21 makes other potential protections even more important

22 in the deal.

23 Q. What concerns does it bring up?

24 A. It brings a concern that the values that

25 one would enter into a transaction on or an investor,

1 for example, would buy into a transaction believing

2 that there were certain levels of protection at asset

3 value, to the degree that that value was ultimately

4 determined not to be there and you really wind up

5 having an under secured facility, that has a big

6 impact on a number of things.

7 If you're an investor, it could affect

8 how you mark the security. It could affect whether

9 you would buy or sell the security versus hold it.

10 The capital charge associated with having the asset.

11 It could have major financial impact depending on the

12 size of the holdings.

13 For a mono line insurance company, it's

14 important for us because we are guaranteeing the

15 bonds which are interest and principal. And to the

16 degree that we feel that the underlying assets are

17 underperforming, our first instinct is: How do we

18 mitigate any risk that would be growing within a

19 transaction?

20 That's one of the roles that we perform.

21 Q. Do you have an understanding of the

22 consequences if the funds were to fail the OC test?

23 A. Again, for every transaction, there is

24 different remedies. I think for this transaction, I

25 do believe that there would be potential manager

1 removal rights in this transaction, and I am trying

2 to remember if there is acceleration provisions or if

3 the subordinated management fee would be cut off. I

4 believe it would be in this transaction.

5 But, for example, those are the type of

6 things that we would be looking at and, you know.

7 Q. So is the OC test important to you as an

8 investor or insurer?

9 A. The OC test is very important to us as

10 an insurer, and I would think for an investor it

11 would be important, too.

12 Q. So why is it important to you as an

13 insurer?

14 A. From the standpoint as of how we

15 classify the transaction, how we think of the

16 perceived risk, to the degree that there are rights

17 and remedies that come to bear if there is a default

18 or a breach of that trigger, those are clearly things

19 that are very important to us.

20 And even prior to getting to that point,

21 having an understanding of how a transaction is

22 performing, our history has shown that the ability to

23 remediate early on is almost more effective for us

24 than when it's a foregone conclusion that there is a

25 major problem and we are, to use an expression, on

1 our heels to try to remediate.

2 Q. And why is the outcome typically better

3 when you know early on?

4 A. Just generally, early problem detection,

5 there is more options available and there is an

6 opportunity to have a long runway for a soft landing

7 versus being faced with an event where you may have

8 to make very rash decisions and it also effects the

9 way we manage our company, and we think about our

10 liquidity, our capital adequacy. So we are somewhat

11 reliant on the reporting of all of our issuers and

12 services to get a gauge of how we are running the

13 company.

14 Q. What about the IC test, is that

15 something you're familiar with as well?

16 A. I am.

17 Q. What is that IC test?

18 A. The IC test is an interest coverage

19 test. Again, for every deal there is a different

20 calculation. But, generally, it's the coverage level

21 from which interest cash flows on the assets or

22 collateral generate enough coverage to satisfy the

23 interest on the underlying debt, generally speaking.

24 Q. And is the IC test something that's

25 important to you as an insurer?

1 some were not. They certainly would be not  
2 necessarily considered, you know, distressed at that  
3 point.

4 But, generally, that's how I would think  
5 of it from a qualitative perspective.

6 Q. What do you base your understanding on?

7 A. I think I've -- there is a business  
8 perspective on it where given how -- when these deals  
9 were done, it was before my time. So I am trying to  
10 fit some of these definitions into how I look at the  
11 current status. I can't say it jibes, but I am  
12 looking at the exit of the situation.

13 But I would say a combination from my  
14 own understanding from my own personnel and from  
15 talking to counsel as far as, you know, looking at  
16 the documents and so forth, I wouldn't -- I have  
17 trouble pinning any of the companies into a category  
18 the way they are written candidly on level 4. But to  
19 the degree that they're not in a bankruptcy  
20 proceeding, they're not under some kind of Letter of  
21 Intent related to restructuring or anything of that  
22 nature, it's almost the absence of those items and  
23 assuming they are paying everything they are supposed  
24 to pay, that shapes my understanding of a degree of  
25 category 4.

1 Q. And is that something that's important  
2 to you as an investor or insurer?

3 A. Very important.

4 Q. And why is that important?

5 A. Because the transaction that we've  
6 entered into as an insurer, and that I assume an  
7 investor is buying into, there is -- the only  
8 understanding of what you're buying into is what are  
9 the operative documents and elements of the  
10 transaction that I'm entering into?

11 So to the degree that I'll speak from  
12 the insurer's standpoint, we certainly rely on the  
13 documents because we are holding that security, we  
14 are essentially long in that security. We need to  
15 make sure that the documents are being adhered to  
16 because it's how we ultimately made the decision to  
17 actually wrap the security in the first place. How  
18 we priced our premium. That's not the benefit of the  
19 bargain that we signed up for, that's a big issue for  
20 us.

21 Q. So has anyone at Patriarch ever  
22 disclosed to you how the categorization decisions are  
23 made?

24 A. Not specifically.

25 Q. Was it it disclosed to you more

1 Q. Why do you think they are paying  
2 everything they need to pay?

3 A. To the degree that they are not able to  
4 service their debt, that to me would exemplify a  
5 company that wouldn't be a category 4.

6 Q. And why is that?

7 A. To the degree that they're performing in  
8 all their obligations, there is no loan default that  
9 I would be able to perceive that would question the  
10 company's viability as a going concern. I should say  
11 that's one indicator, but that certainly would be one  
12 that would, you know, make me believe that a going  
13 concern issue, which would certainly I think question  
14 whether it was a category 4 or not, it would be less  
15 likely if that would be the case.

16 Q. Do you think that the categorization of  
17 the collateral is a subjective test or do you think  
18 it's an objective test?

19 A. I think it's on objective test. I think  
20 it's in the document, there are definitions, and I  
21 think by that nature, it's an objective test.

22 Q. Do you expect that the collateral  
23 manager will follow the indenture when making  
24 decisions relating to the collateral?

25 A. Yes.

1 generally in some way?

2 A. I think more to what I talked about  
3 before, which is I think the way it was generally  
4 described to me is really there is only two real  
5 categories here, which is category 4 or 1. And,  
6 obviously, the ramifications of 1, I think, are  
7 known, and when it comes to the other two categories,  
8 I've never really gotten any clarity as to what would  
9 result in a company being put into a category 3 or a  
10 category 2.

11 Q. And have you asked why they don't use  
12 those two categories?

13 A. I don't -- I recall having a  
14 conversation on the general categories and the  
15 relevance of some of them. Any conversation I wound  
16 up having just ended up coming around the category 1  
17 and, frankly, category 4 is anything that was, my  
18 words, "still breathing," but that there was an  
19 opportunity for the manager to inject some kind of  
20 life in it, operationally or otherwise.

21 Q. We've heard from Patriarch that --  
22 specifically from Ms. Tilton -- that she will  
23 classify a portfolio company or the loans to the  
24 portfolio companies as 4s as long as she intends to  
25 continue supporting the company, whatever that means.



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3       WITNESS        EXAMINED BY        PAGE  
4       ANTHONY McKIERNAN   Ms. Sumner        3  
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6                    \* \* \*  
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1                    SCOPIST'S CERTIFICATE  
2  
3                    I, Rena Farber, hereby certify that  
4       the foregoing transcript consisting of 144 pages,  
5       is a complete, true and accurate transcript of the  
6       investigative hearing, held on Friday, May 16,  
7       2014, at Brookfield Place, 200 Vesey Street, New  
8       York, New York, in the matter of PATRIARCH  
9       PARTNERS, LLC.  
10                    I further certify that this  
11       proceeding was reported by Deborah Moschitto and  
12       that the foregoing transcript has been scoped by  
13       me.  
14  
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16       \_\_\_\_\_  
17       Rena Farber                    Date  
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1  
2                    UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
3                    REPORTER'S CERTIFICATE  
4  
5       I, Deborah Moschitto, reporter, hereby certify  
6       that the foregoing transcript of 144 pages is a  
7       complete, true, and accurate transcript of the  
8       testimony indicated, held on Friday, May 16, 2014,  
9       at Brookfield Place, 200 Vesey Street, New York,  
10       New York, in the matter of:  
11                    PATRIARCH PARTNERS, LLC.  
12       I further certify that this proceeding was  
13       recorded by me and that the foregoing transcript  
14       was prepared under my direction.  
15  
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17       \_\_\_\_\_  
18       Deborah Moschitto                    Date  
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PROOFREADER'S CERTIFICATE

In the Matter of: PATRIARCH PARTNERS, LLC

Witness: ANTHONY McKiernan

File Numbers: HO-11665 and D-3350

Date: May 16, 2014

Location: Brookfield Place

200 Vesey Street

New York, New York

This is to certify that I, Deborah  
Moschitto, do hereby swear and affirm that the  
attached proceedings before the United States  
Securities and Exchange Commission were held  
according to the record and that this is the  
original, complete, true and accurate transcript  
that has been compared to the reporting or  
recording accomplished at the hearing.

\_\_\_\_\_  
Deborah Moschitto      Date

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )  
 ) File No. H0-11695-A  
PATRIARCH PARTNERS, LLC )

WITNESS: Lynn Tilton  
PAGES: 1 through 213  
PLACE: Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C.  
DATE: Tuesday, June 24, 2014

The above-entitled matter came on for hearing, pursuant to notice, at 9:00 a.m.

Diversified Reporting Services, Inc.  
(202) 467-9200

APPEARANCES:

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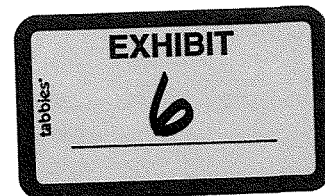
APPEARANCES: (Continued)

On Behalf of the Witness:

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## PROCEEDINGS

1 MS. SUMNER: We are on the record at 9:00  
2 o'clock on June 24, 2014. Would you please raise your  
3 right hand.

4 Whereupon,

5 LYNN TILTON

6 was called as a witness, and after having been first  
7 duly sworn, was examined and testified as follows:

8 EXAMINATION

9 BY MS. SUMNER:

10 Q Please state, and spell your full name for  
11 the record.

12 A My name is Lynn Tilton, L-Y-N-N T-I-L-T-O-N.  
13 Q Ms. Tilton, my name is Amy Sumner, with me is  
14 John Smith. We are members of the staff of the  
15 Enforcement Division of the Denver Regional Office of  
16 the United States Securities and Exchange Commission.

17 We're also officers of the Commission for the purposes  
18 of this proceeding.  
19 This is an investigation by the United States  
20 Securities and Exchange Commission for the matter of  
21 Patriarch Partners to determine whether there have been  
22 violations of certain provisions of the Federal  
23 Securities laws. However, the facts developed in this  
24 investigation may constitute violations of other  
25

1 there?

2 A Yes, I have.

3 Q Prior to the opening of the record, you were  
4 also provided with a copy of the Commission's  
5 Supplemental Information Form 1662. A copy of that  
6 notice has been previously marked as Exhibit 33. Have  
7 you had an opportunity to read Exhibit 33?

8 A I have read most of it sitting here, yes.

9 Q Do you have any questions concerning this  
10 exhibit?

11 A No, I don't.

12 Q Ms. Tilton, are you represented by counsel?

13 A Yes, I am.

14 MS. SUMNER: Would counsel please identify  
15 themselves for the record.

16 MR. SULLIVAN: Yes, Brendan Sullivan.

17 MR. ZINN: David Zinn.

18 MS. BRUNE: Susan Brune.

19 MS. SUNG: MaryAnn Sung.

20 MR. NIEMEIER: Charles Niemeier.

21 MR. RABBIT: Brian Rabbit.

22 MS. SUMNER: Are you each representing Ms.  
23 Tilton as her counsel today?

24 MR. ZINN: Yes, we are.

25 MR. SULLIVAN: Yes.

1 federal or state, civil or criminal laws. Prior to the  
2 opening of the record, you were provided with a copy of  
3 the formal order of investigation in this matter. It  
4 will be available for your examination during the  
5 course of this proceeding.

6 Ms. Tilton, have you had an opportunity to  
7 review the formal order?

8 A I don't believe so.

9 Q Okay. Would you like to take some time now  
10 to review it?

11 A I can do that.

12 MR. SULLIVAN: Does your question go to both  
13 documents?

14 MS. SUMNER: It just goes to the formal order  
15 at this point, but I will be asking about the other one  
16 in just a moment or two. So if she wants to take the  
17 time to review that one now, that's fine, too.

18 THE WITNESS: I've read enough of it.

19 BY MS. SUMNER:

20 Q Okay.

21 A If I need to go back based on a question,  
22 I'll do so.

23 Q Okay.

24 Have you had an opportunity to review  
25 the formal order, which is the document on your right

1 (Commission Exhibit Number  
2 204 was marked for  
3 identification.)

4 BY MS. SUMNER:

5 Q Ms. Tilton, I'm handing you a copy of the  
6 subpoena that's been marked as Exhibit 204. Is this a  
7 copy of the subpoena, pursuant to which you are  
8 appearing here today?

9 A Yes, I believe so.

10 Q I know you have provided sworn testimony  
11 before, but I just want to remind you of some of the  
12 ground rules to make sure we get it clear on the  
13 transcript. Because the court reporter will be taking  
14 down everything we say, we need to make sure that your  
15 responses to my questions are verbal, as a nod or a  
16 shake of the head won't show up on the transcript. I  
17 ask that you let me finish asking a question before you  
18 start answering, and I will -- I will do the same, let  
19 you finish talking before I start asking my next  
20 question, just so that we're not talking over each  
21 other, in order to keep the transcript clean. If you  
22 don't understand a question, please ask me to restate  
23 it or rephrase it, otherwise, I will assume that you  
24 understood the question that I asked.

25 John and I control the record, and the court

1 waterfall on the off-month; but I rarely review the  
2 report as a whole.

3 Q Who provides you the summary of the Trustee  
4 Report?

5 A Someone in the Structured Finance Department.

6 Q And what info's contained in that summary?

7 A You have certain, you know, in -- you know,  
8 significant information from the Trustee Report,  
9 including certain tests, certain balances, certain, you  
10 know, payments that will be made. I can't sitting here  
11 give you the act summary, but --

12 Q Okay. What tests are included in the  
13 summary?

14 A Many tests. I can give you some examples.

15 Q Some examples would be fine.

16 A I believe the interest coverage, the OC Test,  
17 the Diversity score, the WARF score, and certain  
18 buckets; but I can't give you -- sitting here -- the  
19 exact information.

20 Q Do you know what balances are reflected in  
21 the summary?

22 A I can't sitting here tell you the exact  
23 balances.

24 Q But the categories of the balances, I mean,  
25 is it the -- the principal or the --

1 A It's the principal balances, the cash  
2 balances, certain accounts that are significant, but I  
3 can't by memory tell you exactly what's on the summary,  
4 but certainly significant or important, as the  
5 Structured Finance Team would see it -- data that they  
6 would like me to see.

7 Q And how often does a credit officer discuss  
8 the company's liquidity position with you --  
9 approximately how frequently?

10 A In writing -- I mean, as I said, it depends  
11 on -- I mean, it really depends on the credit. It  
12 depends on the -- you know, the performance of the  
13 credit, the liquidity position of the credit. It  
14 really depends on where the company is and its  
15 turnaround, its needs, the import. There's no way for  
16 me to give you the exact instance or frequency.

17 Q In an instance, where a -- an operating  
18 company is not able to pay the full amount of interest  
19 that's due, is that something that you know about? Is  
20 that something that's communicated to you?

21 A It -- I will often -- I can't say I always.

22 I will often see that based on the interest projection  
23 what would have been the contractual rate of interest,  
24 and that which a company feels comfortable paying.

25 And, you know, what we -- the decision, you know, that

1 we ultimately make or that's discussed with the credit  
2 officers based on the other financial needs of the  
3 company, and where the cash is best served, in terms of  
4 paying the interest or driving the future value and  
5 performance of the company.

6 Q In terms of -- I just want to talk about this  
7 -- the last subject a little bit more specifically. So  
8 if a company -- if you see that a company is not able  
9 to pay the full amount of interest due, talk to me  
10 about the -- the process by -- what happens after when  
11 -- when you learned about this?

12 A Well, it's very frequent that the companies  
13 cannot pay the full contractual rate of interest. We  
14 often put a very high rate of interest on the companies  
15 with the belief that we want to collect the maximum  
16 amount of cash flows from the companies without  
17 impairing its future ability to pay interest, principal  
18 and create value. So we will often put a high interest  
19 rate on with the knowledge that during certain periods,  
20 the company would be better served by paying less  
21 interest than the contractual rate, then, you know,  
22 shutting itself down or not having money to buy product  
23 or drive revenue.

24 And so it is not unusual for that to happen.

25 I will generally see that in an interest projection.

1 Sometimes I understand where the company is and that  
2 it's best served. Sometimes I believe that the company  
3 is just not paying its interest, because it would  
4 rather put it somewhere else or hire someone else or do  
5 something else. And at that point and time, I might  
6 have the credit officer push back on the company to pay  
7 more interest. Sometimes when a company is going  
8 through a long period of difficulty, there will be a  
9 change in the contractual rate. Sometimes it's just an  
10 amendment based on the period and the agreement to  
11 accept less. So it really varies and differs by  
12 company, by situation, by duration, by circumstance.

13 Q How do you determine when to push back, if a  
14 portfolio company's saying that they can't pay their  
15 interest?

16 A Usually by, you know, other information that  
17 I might have on the performance of the company, or just  
18 the perception that the company's getting very  
19 comfortable paying less interest than I feel that's  
20 appropriate based on the liquidity position; or is not  
21 being stringent enough or disciplined enough with its  
22 cash flow to make certain to meet its obligations.

23 Q And then how do you communicate that decision  
24 to a company, or who communicates it to the company?

25 A Usually my interaction will be either with

1 the credit officer or with structured finance, who will  
2 then go back to the credit officer.

3 Q The interest -- let me make sure I'm using  
4 the right term here -- the interest projection that  
5 structured finance prepares, was that something that  
6 they provide to you in writing?

7 A Generally. I mean, different circumstances,  
8 different dates, different years.

9 Q Sure.

10 A But generally, they will prepare a  
11 spreadsheet that they will get information directly  
12 from the credit officers based on the companies that  
13 they follow, and their conversations with the company.  
14 Frequently, they will come in and discuss that with me.  
15 Sometimes I'll call in credit officers to discuss the  
16 performance or the liquidity situation on different  
17 credit. And so sometimes, you know, it's by e-mail;  
18 but frequently, it's a discussion because it involves a  
19 lot of people. We've got to call the credit officers  
20 in, have to hear what the companies are saying to them,  
21 have to understand their views of the company's  
22 liquidity, and whether the company, you know, can pay  
23 more interest or whether they're just comforted by a  
24 lower rate, whether there's something that should be  
25 done in this instance based on what the company

1 forgiveness, then it will often be re-documented into  
2 the system and calculated going forward.

3 Q And then you said you believe that it's also  
4 documented in the trustee's Loan Operation System?

5 A That is correct.

6 Q What's your basis for saying that?

7 A Because we provide them the information; and  
8 from time-to-time, I have known of our loan operations  
9 group tying balances with the trustee.

10 Q And when you say you "provide them the  
11 information", what information are you referring to?

12 A Well, we provide them the amount that's  
13 received, and we often provide them with amendments,  
14 waivers, modifications, and forgiveness.

15 Q And the amendments, modifications, waivers,  
16 and forgiveness that you provide them with, is that the  
17 pro forma documents you were referring to earlier?

18 A It's both.

19 Q Okay, both.

20 A It's both by performance and course of  
21 conduct, as well as by legal document or trade ticket  
22 or change in, you know, maturity that's done with form.

23 Q And I want to just make sure I'm clear on  
24 what you're saying. So the trustee receives  
25 information that -- of the amount actually paid by the

1 projects their capability of payment. So it's dynamic,  
2 it involves a lot of people and conversations, if it's  
3 less than the contractual rate.

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

6 A Generally, it would be me.

7 Q Is that decision documented somewhere?

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

13 Q What dictates when there will be a formal  
14 document?

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

21 Q How is it documented in the Loan Operation  
22 System -- Patriarch's?

23 A By the difference between the calculation of  
24 the contractual rate, versus the received. And when  
25 there is a change of the contractual rate or formal

1 portfolio companies; is that right?

2 A That's one of the many pieces of information  
3 they receive.

4 Q Okay. And then you also provide the formal  
5 documentation of amendments to the loans, to the  
6 portfolio companies; is that right?

7 A I think what I said was that we provide many  
8 different pieces of information at different times.  
9 Originally, when a loan is booked, there is formal  
10 information that is provided to the trustee, in terms  
11 of loan balance, rate of interest, maturity,  
12 contractual rates. From time-to-time, there are  
13 amendments by course of conduct and performance that  
14 less interest is accepted, than the contractual rate.  
15 So the trustee has the contractual rate, plus the rate  
16 that has actually been collected.

17 There are also times when there are more  
18 formal changes in rate of interest, contractual rate of  
19 interest that will be provided in trade ticket form, as  
20 in the original form that was provided to reflect the  
21 change. There are also times when there's formal  
22 forgiveness in written form, and that will be known --  
23 you know, the trustee will be, you know -- you know,  
24 notified of such. And there are often amendments to  
25 the loan agreement, especially in balances, which will,

1 you know, generally, if not always be reflected because  
2 the trustee provides that cash and receives that cash.  
3 So there are balance changes, there are interest  
4 changes, but that's always, ultimately documented in  
5 the Trustee Report.

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

8 A Any time we accept less interest than the  
9 contractual rate, we basically amended that agreement  
10 on collection. By 7.7-A, we are agreeing to defer, to  
11 waive, to forgive, to amend that agreement of  
12 contractual rate of interest.

13 Q Is the trustee aware that when Patriarch  
14 accepts less than the contractual rate of interest,  
15 that it considers this to be an amendment to the  
16 contract?

17 A I believe they do. I mean, I'm not  
18 discussing it with them, but I would understand that's  
19 what they would believe.

20 Q And why do you think they would believe that?

21 A Because they have all the information that we  
22 provide, they understand that this is not a  
23 once-in-awhile event, but this is something that we do.  
24 7.7-A is at the core of our strategy of trying to  
25 maximize the cash flows of not only each individual

1 company and interest and principal and equity value  
2 over time, but maximize the cash flows of the portfolio  
3 as a whole in looking at the future. And having  
4 discretion and being able to use my business judgment  
5 and my experience and my knowledge, in terms of making  
6 those decisions is at the heart and core of the  
7 strategy. And the trustee has been -- witnessed to the  
8 accepting and the amending of contractual interest over  
9 the course of 14 years.

10 Q Have you personally ever talked to anyone  
11 and the trustees about this idea of accepting less than  
12 the contractual rate of interest is amending the  
13 contract?

14 A I don't recall having a conversation in the  
15 words that you're saying, but I have had conversations  
16 about the fact that we have the ability to modify and  
17 defer and discussions on 7.7-A over the years.

18 Q Okay. Who have you talked to as the trustee  
19 about that?

20 A I can remember, you know, one conversation  
21 with Robert Finney.

22 Q Okay. Do you recall when that was?

23 A I do not.

24 Q And when did you have this conversation?

25 A As I said, I don't remember.

1 Q And what did you talk about with Mr. Finney?

2 A Just what constituted, you know, the process  
3 of, you know, 7.7-A. You know, I know that some of the  
4 -- 7.7-A has come up with -- you know, the trustee with  
5 other people working in my department before because  
6 I've been aware of conversations or e-mail traffic; but  
7 over 14 years, you know, I can recall a few times that  
8 it was discussed with new people working as the  
9 trustee.

10 Q Who else from Patriarch has discussed the  
11 ability to modify or defer with the trustee to your  
12 knowledge?

13 A I think Karen Wu has.

14 Q And why do you think that?

15 A Because I can recall certain conversations,  
16 and I don't know whether it was a question from the  
17 trustee or through the trustee, but I can recall the  
18 fact that she either had a conversation or e-mail  
19 traffic on the subject.

20 Q Okay. Anyone else?

21 A I am sure there have been others over the  
22 years, but I can't recall specifics.

23 Q If you wanted to know how much interest was  
24 accrued and owing by a portfolio company, is that  
25 something you can find out easily?

1 A Yes.

2 Q Okay. And how would you find that out?

3 A I would ask Loan Operations to provide me  
4 with that information.

5 Q And is that information something that is on  
6 the interest projection that the structured finance  
7 folks give you?

8 A Forever? For any accrued interest?

9 Q Right.

10 A And not --

11 Q And total-accrued interest over time, is that  
12 --

13 A That would be in the Loan Operation System.

14 Q Okay. And is that information that you ever  
15 look at?

16 A I don't recall the last time I would have  
17 looked back at total accrued interest.

18 Q Does anyone keep -- is that something that  
19 anyone keeps an eye on, or keeps track of?

20 A The head of Loan Operations keeps track of  
21 that information.

22 Q Okay. And who is that?

23 A Renee Dudley right now.

24 MR. SMITH: Do you consider the total-accrued  
25 interest for a portfolio company as a relevant factor

1 in any of the business decisions you're making going  
2 forward for -- for that company?

3 THE WITNESS: What do you mean by "relevant"?

4 MR. SMITH: Something that you consider.

5 THE WITNESS: We continued to accrue for  
6 protection, but primarily what I'm doing is: I'm  
7 looking forward from where I am, to the future to  
8 maximize the cash flows that can be received by  
9 principal interest or equity value from each individual  
10 company, and to maximize that for that CDO or company,  
11 as well as for the whole portfolio. You know, it --

12 this is a deal of cash flows that are derived or  
13 originate from original collateral, you know, debt  
14 obligations. And how it is ultimately received,  
15 whether it's interest principal or equity value, it  
16 doesn't really matter. It's how we can maximize the  
17 total from all three cash flow sources.

18 MR. SMITH: Okay.

19 THE WITNESS: It's overall -- this is a deal,  
20 which is a series of cash flows that originate from  
21 distressed-loan obligations and the financial  
22 instruments that they become during the period of  
23 reorganization and restructuring, and to maximize the  
24 total cash flows received by the fund is really where I  
25 focused my attention.

1 What was the last one?

2 Q Forbearance.

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

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

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

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

18 A It probably could fall into any category.

19 Q And why is it the case that the forbearance  
20 or deferral is not always documented in a formal  
21 agreement?

22 A You know, it -- we believe that the  
23 acceptance of less-than-full interest is an amendment  
24 by conduct and by agreement with the operating company,  
25 and there are so many legal agreements that are being

1 BY MS. SUMNER:

2 Q At times, it seems that you forgiven interest  
3 by some of the portfolio companies; is that right?

4 A That is correct.

5 Q Okay. What determines when you forgive  
6 interest?

7 A You know, there are multiple factors; but  
8 primarily, if it will help improve the company's  
9 financial statements, such that it is capable of  
10 getting a big contract, attracting a big customer, a  
11 vendor agreement insurance; if the amount of accrued  
12 interest on the company's financial statements are  
13 impairing its ability for greater performance in the  
14 future, and the cash flows that will ultimately be  
15 received by the funds.

16 Q Okay. And then what's the difference between  
17 a waiver or a deferral or a forbearance? You used all  
18 those terms --

19 A Oh, because sometimes they're similar,  
20 sometime they're distinct. Sometimes, you know, we'll  
21 just waive the -- you know, part of the interest.  
22 Sometimes it will be deferred and expected to be paid  
23 late -- you know, in the next period. Sometimes it's  
24 deferred for a very long period, but will be paid when  
25 the company is in a different position of performance.

1 done by our financial law group. Sometimes it's not  
2 for a long period and it's one moment, and sometimes  
3 people are more meticulous. And other times, if it's  
4 going to be, you know, for a specific period or it's  
5 going to involve the way -- you know, the waiver of a  
6 covenant, it will be documented; but I can't tell you  
7 exactly when, but we consider it the same.

8 Q When did you -- let me backup --

9 What's the basis for your understanding that  
10 acceptance of less-than-full interest is an amendment  
11 by conduct?

12 A Just under 7.7-A, the -- that my business  
13 judgment, my discretion in this unique asset class is  
14 fundamental and according to the strategy. There's --  
15 distressed assets are a unique category, it's a winding  
16 path. There are moments when a company is doing well  
17 and the -- the fortunes can change, and they -- they  
18 can do well again. There would have been no way to use  
19 this asset class in the structured vehicle without the  
20 discretion, the business judgment, and the ability.  
21 Plus, there would be no way to book a high interest  
22 rate at the beginning, if you couldn't change that rate  
23 or accept less than full interest. It is the core to  
24 taking a company on a winding path of recovery over a  
25 long period of time.



1 to a approximately 131.5 percent IC ratio". Do you see  
2 that?

3 A I do.

4 Q Okay. The second bullet under that says,  
5 "Interest forgiveness letters provided to each borrower  
6 that doesn't pay in full to confirm that none are in  
7 default".

8 Do you know where -- were those types of  
9 interest forgiveness letters provided to each borrower?

10 A I can't recall what happened back in 2009.  
11 As I've said, you know, generally from time-to-time,  
12 when interests was forgiven, it was a formal agreement  
13 between the company and the collateral -- or the  
14 lenders and that would have been documented. So I know  
15 that from time-to-time, that definitely happened. I  
16 just can't recall the circumstances surrounding this  
17 moment and time.

18 Q Okay. The -- well, it goes on to say,  
19 "Investors are protected by: A, Your commitment to  
20 continue support the companies, and fix them".

21 Do you have an understanding of what Mr.  
22 Kaloudis means by that?

23 A No.

24 Q And then the -- "By seeing the actual IC  
25 ratio reported at its -- at each MVR Report". Do you

1 have an understanding of what he means by that?

2 A I'm sorry, I don't.

3 Q If you could stay on that same page, and look  
4 at the last bullet point that starts with "Forgiving  
5 interests". Do you see that?

6 A Yes.

7 Q Okay. It says, "Forgiving interests and  
8 major restructures are events that the indenture guides  
9 us to inform rating agencies about".

10 Do you know whether that's an accurate  
11 statement?

12 A I don't sitting here. I mean, I -- you know,  
13 Todd thought out loud, he was very concerned during  
14 this period. It was a financial crisis, the companies  
15 were getting hit very hard; this was a change in time  
16 for everyone, and Todd was very nervous and he was very  
17 diligent. And the indentures are complicated and he  
18 spent a lot of time trying to interpret them, and to  
19 make certain that we were vigilant to, you know, adhere  
20 and behave according to the indentures.

21 And I didn't always read these when I got  
22 them, but Todd sat next to me and we had lots of  
23 conversations together. I don't -- you know, I don't  
24 know whether this is him thinking out loud, his  
25 interpretation; but sitting here, you know, I'd have to

1 look at the indentures. But any kind of restructure of  
2 the loans would have been reported to the trustee,  
3 which -- and would have been ultimately founded to rate  
4 the rating agencies.

5 Q Okay. And sitting here today, though -- I  
6 just want to clarify -- you don't know one way or the  
7 other whether the indenture speaks to informing the  
8 rating agencies about these topics?

9 A I think -- you know, the timing of reporting  
10 or what it is, I can't tell you. Ultimately, we  
11 provided ratings packages to the rating agencies that  
12 any kind of formal restructure would have been  
13 documented, and I -- but I can't sitting here tell you  
14 the timing or how it was supposed to be a factor to the  
15 rating agencies.

16 Q Does a failure to pay interest by a portfolio  
17 company, or to pay the full amount of interest due by a  
18 portfolio company impact it's categorization in any  
19 way?

20 A It depends on the circumstances, but not  
21 necessarily.

22 Q Okay. Well, what are the circumstances under  
23 which it would impact the categorization?

24 A Only if that were either part of the  
25 secondary loans that would fall under, you know,

1 Category 2 or 3, depending on where it was in the  
2 process of a restructuring; or if, in fact, it was a  
3 partial payment, and we were making the judgment or the  
4 conclusion that along with that partial payment, we  
5 believed the company was going to go into a formal  
6 restructuring or bankruptcy. Or we believe that over  
7 time, the company's value would still decline, and we  
8 were going to withdraw support of it on an ongoing  
9 basis with new funding and actual operational strategy;  
10 and would be turning it into sort of a workout  
11 collection or a collection on the assets. But in and  
12 of itself, the agreement to pay less than full interest  
13 would not change its category.

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

17 A Because the categorizations are based on the  
18 belief in the future recovery and the reorganization,  
19 not based on how much interest is collected. The  
20 categorizations are based on the belief in the ultimate  
21 reasonableness of the recovery and the future.

22 Q And where was that -- that concept of the  
23 ultimate reasonableness of recovery, how is that  
24 reflected in the indenture?

25 A I'd have to review the indenture, but there

1 leave this provision out of the indenture, though?

2 A No.

3 Q And why is that?

4 A As I've said, there are certain -- there are  
5 secondary loans that are purchased, which would fall  
6 under this definition; and then there are origination  
7 loans that are controlled positions, which allowed for  
8 7.7-A or modifications, which then have to be read in  
9 unison with this definition.

10 Q Did you ever discuss the definition of a  
11 defaulted obligation with anyone at Patriarch?

12 MR. ZINN: Other than counsel?

13 MS. SUMNER: Right.

14 THE WITNESS: I -- sitting here right now, I  
15 can't recall when or if or with whom, but it wouldn't  
16 surprise me if it were discussed.

17 BY MS. SUMNER:

18 Q Did you ever discuss that issue -- or the  
19 definition of a defaulted obligation with any  
20 investors?

21 A As I said, I -- over the last 14 years, there  
22 have been many conversations with many people. I can't  
23 recall the specifics of any conversation sitting here  
24 right now, but there may have been.

25 Q Earlier, you had testified that -- I think it

1 through their journey; but we worked very closely with  
2 Milbank, we worked very closely with MBIA and Weil  
3 Gotshal and with Natixis. It was a group of people  
4 that had worked together. This was the third deal that  
5 the three parties and the lawyers had worked together,  
6 and there were ongoing negotiations because everybody  
7 -- interest was for the deal to be very successful and  
8 to ramp up, and negotiations on what different parties  
9 needed were at the core of the original drafting. And  
10 then after that, you know, the rating agencies and  
11 their counsel and each note holder and their counsel  
12 got involved, and there were lots of negotiations. But  
13 there were a core group that worked on these deals;  
14 MBIA, the investment banker, Patriarch, and our  
15 respective lawyers at the beginning to make certain  
16 that the documents were modified to, you know, be  
17 appropriate for this unique asset class and to make  
18 certain that the deals could get ramped up and be  
19 successful, and meet the tests going forward.

20 Q Were any investors aware that the -- that a  
21 -- let me -- let me start over on that.

22 Did you ever discuss with investors the  
23 concept that a portfolio company would remain a  
24 Category 4, while Patriarch was continuing to support  
25 the company and believe in the reasonableness of a

1 was Richards, Spears was the firm that represented  
2 Patriarch in the negotiation of the Zohar 2 indenture;  
3 am I correct on that?

4 A I believe Richards, Spears represented  
5 Patriarch, its collateral manager; and Milbank  
6 represented the issuer.

7 Q Okay. All right. Did any other lawyers or  
8 any other counsel provide legal advice to Patriarch on  
9 the negotiation of the indenture?

10 A There were lots of lawyers involved in the --  
11 you know, the issuer and the collateral manager work  
12 very closely.

13 Q Sure.

14 A There were many Milbank lawyers who worked on  
15 this deal, as well; and sitting here looking back to  
16 2005, I cannot tell you exactly who provided legal  
17 counsel to, you know, Patriarch, versus the issuer.

18 Q Okay. And I get that. So Milbank was  
19 involved and Richards, Spears was involved. And are  
20 there -- were there other firms involved on the  
21 Patriarch side?

22 A Well, I mean -- well, I think it was fixing  
23 -- you know, many indications of Natixis. You know, I  
24 think there were, like, four different names I -- we  
25 used the same bankers back from when they were at CBIC

1 turnaround?

2 A Well, first of all, every note holder who  
3 chooses to look at a Trustee Report can easily view the  
4 categories, can easily view the contractual rate of  
5 interest, and could easily review the received rate --  
6 the received interest. So it's very easy for any note  
7 holder to see that there's a binary categorization, and  
8 to -- to watch the cash flows and the pace of  
9 amortization. That said, I can't -- you know, I cannot  
10 sit here and recall specific conversations with  
11 specific investors or note holders, but I know that our  
12 strategy or a -- you know, has been discussed, the  
13 support, the winding path, you know, our efforts, our  
14 concerns, what we're doing. So it would shock me, if  
15 not, you know, surprise me that any investor was not  
16 aware of our efforts and what we were doing here.

17 Q And I understand that you had discussed the  
18 strategy with investors. What I'm wanting to know is,  
19 though: Did you actually discuss the method, by which  
20 you categorized the assets with the investors?

21 A I don't recall specific questions on the  
22 categories. If I had been asked the question, I  
23 certainly would have discussed it; but I can't sitting  
24 here recall a specific question asked of me on the  
25 categorizations.

1 A As I stated, a lot of people get involved in  
2 the decision-making process. It's not a simple  
3 decision. It's a complex decision, and it takes a lot  
4 of information, many meetings, a lot of different  
5 people; but I will ultimately -- I don't want to say  
6 under all circumstances -- but I will generally be the  
7 one who will make that final decision.

8 (Commission Exhibit Number  
9 210 was marked for  
10 identification.)

11 Q I am handing you a document that's been  
12 marked as Exhibit 210. This is a copy of the  
13 transcript from your prior testimony from the SEC. And  
14 I just -- there are a couple of things I wanted to ask  
15 you about that are here in your transcript. You can  
16 look through as much as you want, but --

17 A I have a particular section.

18 Q Yeah. The particular section, let's start  
19 with Page 171, the -- and Line 5.

20 A Okay.

21 Q Are you there? Well, I mean -- okay. For  
22 Category 4, "We are still giving it our financial  
23 support, our efforts, and there's a reasonable chance  
24 of a turnaround".

25 A I see that.

1 Q Okay. And then I just -- I just wanted to  
2 start there because it's talking about Category 4, and  
3 then the question there is: How is this concept  
4 reflected in the indenture?

5 MS. BRUNE: Other than all the testimony  
6 she's been giving so far today, the detailed  
7 presentation of --

8 BY MS. SUMNER:

9 Q What's your understanding of how that's  
10 reflected in the indenture?

11 A I think I was -- clearly stated that this  
12 really comes down to the fact do we believe with  
13 additional funding and additional strategic and  
14 operational support that the company performance will  
15 improve over the passage of time.

16 Q Okay. And where is that in the indenture?

17 A I can go back and read many -- you know,  
18 these indentures are this thick, but we did look  
19 through the definition of a Category 4. It's not  
20 insolvency, it's not a default; but it's otherwise  
21 waived or modified by Section 7.7-A. It's, you know,  
22 not in a formal bankruptcy or restructure, and that we  
23 don't believe it will have a declining credit quality  
24 based on our support over the passage of time. And I  
25 wasn't quoting, but -- the definition, but I was giving

1 you my understanding of the definition and the best way  
2 for us to explain how we make our decisions.

3 Q Okay. And then if you could turn to Page  
4 196. Line 18 on Page 196 says, "You seem to be very  
5 focused on the change from 4, to 1. The investors are  
6 not".

7 What's your basis for saying that the  
8 investors are not focused on that change?

9 A I need to read.

10 Q Yeah, sure. Take whatever time you need.

11 A What I'm saying here is there -- they are  
12 very able to see when something changes from a Category  
13 4, to a Category 1. You know, they -- the thought  
14 process that goes through is not something that I can  
15 recall being asked about, because they have all the  
16 details, they are able to see the categorizations,  
17 they're able to see the contract of interest, they're  
18 able to see the amount of interest that's received.  
19 They're able to see the pace of any principal  
20 amortization. If they're truly interested in the  
21 portfolio of cash flows that they have invested in,  
22 they can download a data file of all those cash flows  
23 and place them into a third party model like an intex  
24 or a Moody's analytic, and analyze the cash flow  
25 streams that originate from these collateral debt

1 obligations.

2 Sitting here or sitting where I was  
3 testifying the last time, I could not recall a question  
4 from any note holder over the more than 14 years asking  
5 me about my decision-making process when I called it  
6 default. And from the best of my reading, that's my  
7 understanding of what I said there.

8 Q Okay. Based on -- I'm looking at the Trustee  
9 Reports, it looks like American Lafrance was  
10 categorized as a 1 in January 2014. Do you recall  
11 that?

12 A I know that at some time there or about, I  
13 made that anguishing decision to default American  
14 Lafrance.

15 Q Okay. What provision of the indenture did  
16 you follow when you categorized American Lafrance as a  
17 1?

18 A I made a decision to call it default, because  
19 I believed that despite all the additional funding that  
20 I had put in, and all the additional funding that I  
21 might put in, that I believed based on the current  
22 management team, the current plan, the current  
23 processes, the current location, that I didn't believe  
24 that I could improve the company performance at that  
25 time. And I ended up putting the company into a formal

1 restructure; and based on it being a formal  
2 restructure, I put it as a Category 1.

3 MR. SMITH: And just for the record, what was  
4 formal about the formal restructure? Was it an actual  
5 bankruptcy? Was it a written work out -- what made it  
6 formal?

7 THE WITNESS: An Article 9 foreclosure sale,  
8 where the -- certain of the assets of American Lafrance  
9 were sold to a new entity, and a liquid -- you know, a  
10 sale of many of the non-core assets or the fixed assets  
11 of American Lafrance in certain auctions and sales that  
12 are ongoing.

13 BY MS. SUMNER:

14 Q I'm going to move on and talk about the OC  
15 ratio a bit. What is your understanding of what the OC  
16 ratio is intended to measure?

17 A It's an arithmetic formula that measures the  
18 holding or carrying value of the collateral debt  
19 obligations, plus certain cash accounts over the  
20 outstanding amount of the notes.

21 Q And is -- what's the purpose of the OC ratio?

22 A To reflect that number of companies that are  
23 still in the active state of restructuring turnaround.

24 Q Why is the OC -- why is the OC ratio  
25 something that's included in the Zohar deals?

1 different meaning in the Zohar deals, than it did in  
2 other structured deals?

3 A You know, I don't have any familiarity with  
4 any other real structured deals than the ones that we  
5 have issued and run.

6 Q Do you believe that the OC ratio is something  
7 that's important to the investors?

8 A I think it's one of many metrics that the  
9 investors look at as part and partial of this deal.

10 Q Do you think that the OC ratio is an  
11 objective measurement of the value of the collateral?

12 A Well, it's an objective formula, arithmetic  
13 of more -- of discretionary information.

14 Q And what's the discretionary information?

15 A The choice of how to categorize, and the  
16 holding or carrying value under different categories.

17 Q Do you think that the investors knew or know  
18 that the categorization of the assets was based on  
19 discretionary information?

20 A I think the investors had every ability to  
21 read the indenture, and to understand the categories of  
22 the loans and the cash flows that matched those loans  
23 and their categorizations. So I would be surprised if  
24 the investor didn't understand that, but I can't tell  
25 you what any one investor knows.

1 A I think I earlier explained that the rating  
2 agencies and people who are very familiar with other  
3 structure deals that they invested in; because most of  
4 these investors invested in tens of millions, of  
5 billions of dollars on structured deals wanted to keep  
6 the same tests that were common to other deals; but  
7 that these tests were then modified for this unique  
8 asset class to make certain that they could work, that  
9 the deals could ramp up, and that they could pass. But  
10 they didn't have the same meaning in most instances,  
11 than for deals that had high-quality corporate loan  
12 obligations.

13 Q What do you mean that they didn't have the  
14 same meaning?

15 A Because there were different definitions,  
16 there were, you know, a weighted-average rating factor  
17 of public company ratings is very different than a  
18 weighted-average rating factor of confidential, private  
19 shadow ratings that the rating agency doesn't show to  
20 anyone. You know, things had to be altered and  
21 modified for this unique asset class, and it -- you  
22 know, the categories are one thing; they're holding  
23 values, carrying values of distress collateral debt  
24 obligations during different periods of restructure.

25 Q What about the OC test; did it have a

1 (Commission Exhibit Number  
2 211 was marked for  
3 identification.)

4 Q I am handing you a document that's been  
5 marked as Exhibit 211. The Bates Numbers are  
6 S&P-SEC-PATRIARCH001074, through 1107. Go ahead and  
7 look through it, and let me know when you're ready.

8 A You're going to have me read it? I mean, I'm  
9 happy to --

10 Q Oh, no. You don't need to read the whole  
11 thing but, you know, take whatever time you need. The  
12 page I wanted to ask you about is Page 10 -- well, let  
13 me back up.

14 Do you know what this document is, Exhibit  
15 211?

16 A I see it as the presentation to Standard &  
17 Poor's. I believe that it was modified from a series  
18 of presentations that we made in person to Moody's, and  
19 then we later sent this to S&P.

20 Q Okay. And do you know what the purpose was  
21 of this presentation?

22 A To appeal the ratings downgrade.

23 Q Were you involved in the preparation of this  
24 document?

25 A I believe I was.

1 A I believe, yes, I am the manager to the best  
 2 of my recollection of the L.L.C.  
 3 Q Global Automotive?  
 4 A Yes, I am the manager of the L.L.C.  
 5 Q Petry?  
 6 A I'm not sure. I believe there was at one  
 7 time, an outside board, but I believe I am the manager.  
 8 I certainly make decisions under an authority matrix,  
 9 but I'm not sure of the exact; but I believe I am the  
 10 manager of the L.L.C.  
 11 Q And NetVersant?  
 12 A I believe, yes, I am the manager of the  
 13 L.L.C.  
 14 Q How about Intera before it was defaulted?  
 15 A I don't know if -- on that one.  
 16 Q Okay. MD, are you --  
 17 A Yes.  
 18 Q Is it an L.L.C.?  
 19 A No, it's a corporation, so -- you know what,  
 20 you're right. MD is a corp, so I don't know what my  
 21 title is; but I am the CEO, and I do make what would be  
 22 considered out-of-the-ordinary-course decisions by  
 23 written consent under the authority matrix.  
 24 Q What about MAV?  
 25 A I believe that I am the manager of the

1 L.L.C., and also making  
 2 out-of-the-ordinary-course-of-business decisions by  
 3 written consent, as the manager under the authority  
 4 matrix.  
 5 Q LBD?  
 6 A I believe I am.  
 7 Q Manager of the L.L.C.?  
 8 A Yes.  
 9 Q How about Hartwell?  
 10 A Yeah, I believe I am the manager of the -- I  
 11 believe it's an L.L.C., but I am making Board type of  
 12 decisions under the authority matrix.  
 13 Q Heritage Aviation?  
 14 A Again, I'm not sure if it's corporate, or an  
 15 L.L.C.; but I would be making authority-matrix  
 16 decisions by written consent for decisions out of the  
 17 ordinary course of business. Or even if I did under  
 18 whatever their authority matrix is, each company has an  
 19 authority matrix, where they have to go to different  
 20 levels for decisions. Sometimes it's a platform leader  
 21 as an executive director, sometimes it's up to the  
 22 manager or the Board level; but I would be making those  
 23 types of decisions.  
 24 Q And then Natura?  
 25 A I believe that I am the manager of the L.L.C.

1 and making the authority matrix decisions by written  
 2 consent under the authority matrix.  
 3 Q And then Scan Optics?  
 4 A I believe that it's the same thing.  
 5 Q Okay.  
 6 A But to the best of my recollection; there are  
 7 a lot of positions that I hold.  
 8 MS. SUMNER: Ms. Tilton, we have no further  
 9 questions at this time. We may, however, call you  
 10 again to testify in this investigation. Should this be  
 11 necessary, we'll contact your counsel. Ms. Tilton, do  
 12 you wish to clarify anything, or add anything to the  
 13 statements you've made today?  
 14 THE WITNESS: No.  
 15 MS. SUMNER: Would counsel like to ask any  
 16 clarifying questions.  
 17 MR. SULLIVAN: No, thank you.  
 18 MS. SUMNER: We are off the record at 5:25.  
 19 (Whereupon at 5:25 p.m., the deposition of  
 20 LYNN TILTON had concluded.)  
 21  
 22  
 23  
 24  
 25

1 PROOFREADER'S CERTIFICATE  
 2  
 3 In the Matter of: PATRIARCH PARTNERS, L.L.C.  
 4 Witness: Lynn Tilton  
 5 File Number: H0-11695-A  
 6 Date: Tuesday, June 24, 2014  
 7 Location: Washington, D.C.  
 8  
 9  
 10 This is to certify that I, Don R. Jennings (the  
 11 undersigned), do hereby swear and affirm that the attached  
 12 proceedings before the U.S. Securities and Exchange  
 13 Commission were held according to the record and that this is  
 14 the original, complete, true and accurate transcript that has  
 15 been compared to the reporting or recording accomplished at  
 16 the hearing.  
 17  
 18  
 19  
 20  
 21 \_\_\_\_\_  
 (Proofreader's Name) (Date)  
 22  
 23  
 24  
 25

1 DISTRICT OF COLUMBIA, to wit:  
2

3 I, Tiffanie Jones, before whom the foregoing  
4 deposition was taken, do hereby certify that the  
5 within-named witness personally appeared before me at  
6 the time and place here set out, and after having been  
7 duly sworn by me, according to law, was examined by  
8 counsel.

9 I further certify that the examination was  
10 recorded stenographically by me and this transcript is  
11 a true record of the proceedings.

12 I further certify that I am not of counsel to  
13 any party, nor an employee of counsel, nor related to  
14 any party, nor in any way interested in the outcome of  
15 this action.

16  
17 \_\_\_\_\_  
18 Tiffanie Jones, Notary Public  
19 For the District of Columbia

20  
21 MY COMMISSION EXPIRES: November 30, 2015  
22  
23  
24  
25

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )  
 ) File No. HO-11665-A  
PATRIARCH PARTNERS, LLC )

WITNESS: Lynn Tilton  
PAGES: 1 through 247  
PLACE: Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C.  
DATE: Tuesday, February 12, 2013

The above-entitled matter came on for hearing,  
pursuant to notice, at 9:50 a.m.

Diversified Reporting Services, Inc.  
(202) 467-9200

APPEARANCES:

On behalf of the Securities and Exchange Commission:

N. CREOLA KELLY, ESQ.  
BRENT S. MITCHELL, ESQ.  
AMANDA de ROO, CPA  
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ALLISON LEE, ESQ.  
LAURA METCALFE, ESQ.  
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Denver Regional Office  
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Denver, Colorado 80202

Also Present:

Young Jae Chung, SEC Paralegal



APPEARANCES (Continued:)

On behalf of the Witness:  
SUSAN E. BRUNE, ESQ.  
DAVID ELBAUM, ESQ.  
MARYANN SUNG, ESQ.  
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143	E-mail from D. Elbaum to 238
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144	CD that was attached to 238
	Exhibit 143 titled "Investor Conference call"

PROCEEDINGS

MR. MITCHELL: We'll go on the record at 9:50.

Ms. Tilton, can you just put up your right hand?

Do you swear or affirm to tell the truth, the whole truth and nothing but the truth?

THE WITNESS: I do.

Whereupon,

LYNN TILTON

was called as a witness and, having been first duly sworn, was examined and testified as follows:

MR. MITCHELL: Can you state and spell your full name for the record.

THE WITNESS: Lynn Tilton, T-i-l-t-o-n.

MR. MITCHELL: My name is Brent Mitchell and with me are a large number of people from the SEC, who I am going to have introduce themselves separately. We are officers of the Commission for purposes of this proceeding.

This is an investigation by the United States Securities and Exchange Commission in the matter of Patriarch Partners to determine whether there have been violations of certain provisions of the federal securities laws. However, the facts developed in this investigation might constitute violations of other

federal or state, civil or criminal laws.

Prior to the opening of the record, I provided you with a copy of the Formal Order of Investigation and the supplement. That will be available for your examination during the course of the proceeding.

Ms. Tilton, have you had an opportunity to read the Formal Order?

THE WITNESS: I did.

MR. MITCHELL: Also before the opening, I gave you what has been marked as Exhibit 6. Exhibit 5 is the Commission's Supplemental Information Form, sometimes called the Form 1662. And we provided that earlier.

Have you had the opportunity to read this document before?

THE WITNESS: I have.

MR. MITCHELL: Okay. And do you have any questions about that?

THE WITNESS: I don't.

MR. MITCHELL: Are you represented today by counsel?

THE WITNESS: I am.

MR. MITCHELL: Could you guys introduce yourselves.

MS. BRUNE: Susan Brune of Brune & Richard for Ms. Tilton.

MS. SUNG: MaryAnn Sung, also of Brune & Richard.

MR. ELBAUM: David Elbaum, Brune & Richard.

MR. MITCHELL: And you three are representing Ms. Tilton as her counsel today.

MS. BRUNE: Yes.

MR. MITCHELL: Could I get the SEC folks to introduce themselves. Just so the record is clear. Some of us are here in D.C. and there's a video conference to the SEC's office in Denver, where two attorneys are there.

The Court Reporter is recording, for his purposes, but this video is not being recorded.

So can you folks just go down the line and introduce yourselves.

MS. LEE: Allison Lee with the Enforcement Division.

MS. KELLY: Creola Kelly, Enforcement.

MS. de ROO: Mandy de Roo. I'm an accountant with Enforcement.

MR. INFELISE: Jeffery Infelise.

MR. CHUNG: Young Jae Chung, paralegal.

MS. METCALFE: And then we have Laura Metcalfe and John Smith here in Denver.

(SEC Exhibit No. 136 was marked

for identification.)

MR. MITCHELL: Great. I am going to show you what's on top here. It's marked Exhibit 136.

EXAMINATION

BY MR. MITCHELL:

Q Is that a copy of the subpoena you are appearing pursuant to here today?

A Yes. But I will tell you this. It was long planned and I was planning to come even if this had not been provided.

Q Absolutely. I didn't even send it until the end of last week, but we did it to make sure we have a subpoena.

A I am happy to be here.

Q Okay. So what I'd like to do probably is just start off with a little bit of background, and a very high level on that. And then get into the top of Patriarch.

Most of today we're going to just talk about really so I can understand how things work and the process. So it's mostly going to be those kinds of things.

Can you just give us sort of like a résumé on your education after high school?

A I graduated from Yale in 1981 with a degree in



1 company with capital and deeply concentrated efforts to  
2 effectuate a turnaround.

3 Q So you say you don't believe it is, that you do  
4 factor in the effect on the OC test?

5 A I'm not saying that I never look at it or that  
6 it isn't a variable. It is not the driving decision-  
7 making variable on whether or not to continue to put the  
8 deeply concentrated efforts of money and action and  
9 people into the turnaround.

10 Q Right. So it's not the driving variable, but  
11 sometimes it is a variable.

12 A Oh, we manage in accordance with the indentures  
13 and in accordance with the cash of the indentures. I am  
14 certainly going to look at the effect of the decisions I  
15 make on the tests and the criteria of the indentures. I  
16 mean I am charged in managing in accordance with the  
17 indentures.

18 Q When it is a variable in your decision, in what  
19 way does it factor in?

20 A I want to understand what's going to happen to  
21 the OC test so I understand where we stand in the deal,  
22 but it's not -- I can't sit here today and think of a  
23 time when I actually decided that I was going to lend  
24 money to a company and continue the turnaround because of  
25 the effect on the OC test.

1 If we believe that we can effectuate a turnaround  
2 strategy, we have a reasonable belief. Okay.

3 Q Right. They're not two separate things.

4 A No. Look, I took you through three. I can  
5 take you through 20 examples where companies were in a  
6 deep, dark hole and through our efforts, we took them out  
7 of the hole with the propensity of an engine driving a  
8 turnaround that ended up creating value.

9 As long as we're in that process, we have a  
10 reasonable belief that we will, with time and liquidity,  
11 in the absence of constituency conflict, effectuate that  
12 turnaround. And that gives us the reasonable belief of  
13 recovery.

14 Q And this process that you follow to determine  
15 whether to continue support, the one that you've just  
16 described at length, has that been disclosed to any of  
17 the investors?

18 A I said to you earlier that the investors  
19 heavily negotiated the information they wanted to see to  
20 invest in a structured vehicle that is the aggregation of  
21 cash flows from a distressed asset class.

22 I have many conversations -- I won't say many -  
23 - I often have conversations. I have meetings with  
24 investors, and I discuss the turnaround. They also get  
25 to look at the cash flows. When principal is going up,

1 I always want to understand the effect on the  
2 portfolios, but the biggest issue -- you know, what I  
3 look to do is to maximize value of the underlying assets  
4 so that I can pay interest and principal to the  
5 noteholders. And that is the driving force in the  
6 decisions I make. I do manage in accordance with the  
7 indentures and in accordance with the texts of the  
8 indentures.

9 Q When you described the process earlier that you  
10 used to determine how to categorize the assets, you  
11 described if you intend to continue funding.

12 A Support.

13 Q Support.

14 A Different than funding.

15 Q Okay. Thanks. If you intend to continue to  
16 support that company, then you consider it a Category 4  
17 asset. Is that correct?

18 A If we continue the support in terms of active  
19 funding, active management to effectuate the turnaround  
20 strategy, and we have a reasonable belief of recovery  
21 because we're taking those actions and that's what causes  
22 recovery, you know, under our history and track record,  
23 then we consider it a Category 4.

24 Q You say "and we have a reasonable belief."

25 A No, I keep saying. Because we are doing that.

1 they know that the companies are in the process of a  
2 turnaround, and that we are supporting it.

3 When principal is going down, it usually means  
4 the turnaround has happened and there's success and  
5 they're paying down principal, either through cash flow  
6 or refinancings or a sale.

7 But, you know, I don't get on the phone with  
8 people and say, "I'd like to tell you my thought process  
9 on everything." That's not what they bargained for.  
10 That's not what they negotiated. That's not how we run  
11 it.

12 If they wanted to invest in MD Helicopters,  
13 they would invest in Helicopters. If they want to invest  
14 in individual companies, they buy in the stock market or  
15 they buy high-yield loans. They've invested in an  
16 aggregation of cash flows that emanate from distressed  
17 companies and the loans of those distressed companies.

18 If asked how I make my decisions, I will tell  
19 them how I make my decisions. But as I told you earlier,  
20 there were certain investors that didn't even want to  
21 know the names of the underlying companies to which those  
22 cash flows belonged.

23 Q Okay. The answer to my question then is, no,  
24 you cannot disclose to investors this process that you  
25 described to us.

1 But we appreciate that. We appreciate all the  
2 documents that Patriarch's produced and such.

3 We want to say this to you and we've said it to  
4 people at every step.

5 We investigate. That's what this group does.  
6 The fact that we are looking at something does not mean  
7 we think anybody did anything wrong. And we're saying  
8 that to you and we've said that to other people. That's  
9 what we do and all of us have done this long enough to  
10 have done investigations that lead to a case and some  
11 that don't. We do this here.

12 THE WITNESS: Thank you. That's important to  
13 me.

14 MR. MITCHELL: So do you want to ask any  
15 questions?

16 MS. BRUNE: No, I don't at this time.

17 MR. MITCHELL: Great.

18 Anything else? So we will go off the record at  
19 5:32.

20 (Whereupon, at 5:32 p.m., the examination was  
21 concluded.)

22 \* \* \* \* \*

1 PROOFREADER'S CERTIFICATE

3 In the Matter of: PATRIARCH PARTNERS, LLC

4 Witness: Lynn Tilton

5 File Number: HO-11665-A

6 Date: Tuesday, February 12, 2013

7 Location: Washington, D.C.

10 This is to certify that I, Susan Watkins (the  
11 undersigned), do hereby swear and affirm that the attached  
12 proceedings before the U.S. Securities and Exchange  
13 Commission were held according to the record and that this is  
14 the original, complete, true and accurate transcript that has  
15 been compared to the reporting or recording accomplished at  
16 the hearing.

21 \_\_\_\_\_  
(Proofreader's Name) (Date)

1 REPORTER'S CERTIFICATE

4 I, Gary Euell, reporter, hereby certify that the  
5 foregoing transcript of 245 pages is a complete, true and  
6 accurate transcript of the testimony indicated, held on  
7 February 12, 2013, at Washington, D.C. in the matter of:  
8 PATRIARCH PARTNERS, LLC.

11 I further certify that this proceeding was recorded by me,  
12 and that the foregoing transcript has been prepared under my  
13 direction.

17 Date: \_\_\_\_\_

18 Official Reporter: \_\_\_\_\_

19 Diversified Reporting Services, Inc.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )  
) File No.  
Patriarch Partners LLC ) HO-11665  
)

WITNESS: ROBIT CHAKU  
PAGES: 1-72  
PLACE: 200 Vesey Street,  
New York, New York

DATE: Thursday, May 1, 2014

The above entitled matter came on  
for hearing at 9:47 a.m.

1 APPEARANCES:

2  
3 For the SEC:  
4 AMY A. SUMNER  
5 United States Securities and Exchange Commission  
6 1801 California Street, Suite 1500  
7 Denver, Colorado 80202

8 For Mr. Chaku:

9  
10 ANDREW Z. MICHAELSON  
11 MICHAEL S. GRISOLIA  
12 Boies, Schiller & Flexner, LLP  
13 575 Lexington Avenue, 7th Floor  
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15 ALLAN BORKOW  
16 Barclays Capital Inc.  
17 745 Seventh Avenue  
18 New York, New York 10019



1  
2 INDEX  
3 EXHIBITS

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1 PROCEEDINGS

2 MS. SUMNER: We are on the record at 9:47 on  
3 May 1st, 2014.

4 Would you raise your right hand?  
5 (The witness complied.)

6 Do you swear to tell the truth, the whole  
7 truth and nothing but the truth?

8 THE WITNESS: I do.

9 EXAMINATION BY MS. SUMNER:

10 Q. Please state and spell your full name for the  
11 record.

12 A. Rohit Chaku; R-O-H-I-T. C-H-A-K-U.

13 Q. Mr. Chaku, my name is Amy Sumner. I'm a member  
14 of the staff with the Enforcement Division of the Denver  
15 regional office of the United States Securities and  
16 Exchange Commission. I'm also an officer of the  
17 Commission for purposes of this proceeding.

18 This is an investigation by the United States  
19 Securities and Exchange Commission in the matter of  
20 Patriarch Partners to determine whether there have been  
21 violations of certain provisions of the federal  
22 securities laws. However, the facts developed in this  
23 investigation may constitute violations of other federal  
24 or state, civil or criminal laws.

25 Prior to the opening of the record you were

1 what it is that Mr. Cicero does to monitor Zohar 1?  
 2 A. Sorry; can you rephrase the question?  
 3 Q. How do you know he does the things you told me  
 4 that he does?  
 5 A. We talk about it routinely, and as well as he has  
 6 produced some papers and e-mails basically just kind of  
 7 outlining the output of his work product.  
 8 Q. Do you review the periodic trustee reports for  
 9 Zohar 1?  
 10 A. Yes.  
 11 Q. How frequently do you do that?  
 12 A. The quarterly reports which are reflective of the  
 13 payments each quarter. The monthly reports are a little  
 14 bit less consistent than regular I'd say, so when they  
 15 are out we try to review them.  
 16 Q. And you say "we." Do you personally?  
 17 A. Justin and myself.  
 18 Q. And so you review the monthlies when they're  
 19 available; is that correct?  
 20 A. Right.  
 21 Q. And the quarterlies?  
 22 A. Each quarter.  
 23 Q. When you review a trustee report, what is it that  
 24 you are looking for?  
 25 A. We look to see any changes in the quality of the

1 effectively secured by the loans and equity to these  
 2 portfolio companies, and so the performance of those  
 3 portfolio companies and their ability to repay their  
 4 debt obligations is tantamount to our ultimate recovery.  
 5 And that is fundamentally what we're secured by and have  
 6 recourse through.  
 7 Q. What is Barclays current investment in Zohar 1?  
 8 A. We're owners of the entire notes of the A3 notes  
 9 of Zohar -- I think the official name is 2003-1. And A3  
 10 notes are split into two notes, the A3A and A3B. I  
 11 believe the total current notional at this moment is  
 12 approximately \$303 million.  
 13 Q. And how is that position marked?  
 14 A. Meaning the actual price or how do we get to that  
 15 price or both?  
 16 Q. Both.  
 17 A. We have the A3A marked at about 64. That  
 18 translates into a value of, I believe, \$160 million in  
 19 terms of balance sheet value. The A3B we've written  
 20 down to zero because it is subordinate to the A3A. And  
 21 so we do believe that -- so the way we mark the position  
 22 is we have basically just taken an estimation of  
 23 recovery value on each underlying obligation and each of  
 24 the loans which is based on just basic news reports and  
 25 the limited data that has been provided by Patriarch

1 collateral or collateral assets themselves.  
 2 Q. Anything else?  
 3 A. I would say that that is primarily driven by the  
 4 categorization assumptions and any new assets or  
 5 restructured assets added or taken away from the  
 6 portfolio. That's for the monthly reports; as well as  
 7 the value assigned to those assets.  
 8 Q. How do you determine the quality of the  
 9 collateral on the basis of the trustee reports?  
 10 A. The only information we're really provided around  
 11 that officially is the categorization that is the  
 12 responsibility of Patriarch Partners. Outside of that,  
 13 it would just be whatever we can glean from basic web  
 14 searches effectively.  
 15 Q. And when you say the categorization, are you  
 16 talking about the categories 1 through 4 that Patriarch  
 17 assigns to the assets on the portfolio?  
 18 A. Yes.  
 19 Q. And why is looking at the quality of the  
 20 collateral something that you do?  
 21 A. It is our main way for us to estimate our  
 22 ultimate recovery value on our ownership.  
 23 Q. Explain to me how that works. How does quality  
 24 of collateral play into your ultimate recovery?  
 25 A. So, our ownership interest in the Zohar 1 deal is

1 Partners in terms of the financial performance of the  
 2 country and some generic recovery estimates around  
 3 sectors, seniority of these loan positions. And use  
 4 that all to back into a value in terms of where we think  
 5 ultimate recovery may come out on our A3 notes.  
 6 Q. So, from what I understand you are saying, you  
 7 research each individual portfolio company to determine  
 8 its prospect of repayment to Patriarch to help lead into  
 9 this valuation?  
 10 A. We attempt to, yes.  
 11 Q. How do you try to get that information on the  
 12 portfolio companies?  
 13 A. Just very basic web searches and news report  
 14 searches.  
 15 Q. And are you successful in finding much on the  
 16 company?  
 17 A. Not at a article level in terms of really  
 18 receiving hard data and financials. The best we can do  
 19 at the moment is glean what we can from news reports  
 20 about performance or what the companies are up to, what  
 21 they do. On occasion there's some publicly available  
 22 lawsuits or bankruptcy proceedings that we can go  
 23 through, but the accuracy and timeliness of those  
 24 reports is sometimes lacking.  
 25 Q. We will come back and talk about the

1 cash diversion such that it would divert fees from, I  
2 believe, the arranger fee, subordinate manager fees and  
3 the arranger fee. So it would have diverted cash flows  
4 from those fees back up to the class A notes in order to  
5 pay them down faster.

6 Q. Any other consequences you are aware of?

7 A. There's a similar test, I believe it's called the  
8 collateral value ratio, which is a similar concept  
9 though I believe the calculation is technically  
10 different. And that would also be one of the drivers of  
11 an event of default for that test to be breached for  
12 failing.

13 Q. Do you have an understanding of what the  
14 difference is between those two, the OC test and  
15 collateral value ratio?

16 A. Yes.

17 Q. What do you understand the difference to be?

18 A. One, the OC test is applicable within the payment  
19 of priorities in the waterfall. So it will actually  
20 affect how cash moves. The other one is I'd say  
21 mostly -- collateral value ratio I think it's called,  
22 and I apologize if I'm giving you the wrong terms but  
23 that test is one of the prongs of the event of default.  
24 There's a litany of things can cause an event of  
25 default.

1 management fee as well as any junior noteholders, and  
2 basically prevents excess spread leaking away from our  
3 tranches and our notes and allows us to recapture some  
4 of the value within the deal or to better protect  
5 ourselves.

6 And it also is just a matter of calculation and  
7 also provides a useful leading indicator in terms of the  
8 performance of the assets; and gives us better  
9 understanding of the collateral quality and another  
10 metric of performance for us to judge.

11 Q. What about the interest coverage test? Is that  
12 something you are familiar with?

13 A. Yes.

14 Q. And what is your understanding of what that is?

15 A. It is similar to the OC test, but instead of  
16 measuring collateral coverage, it measures interest  
17 coverage from a very basic how much interest is being  
18 earned on the portfolio versus how much interest is due  
19 on the liability structure.

20 Q. What is the purpose of the IC test?

21 A. It's also another form of credit enhancement for  
22 senior investors. I believe it has the effect of  
23 inverted cash flows as well as similar to the  
24 overcollateralization test and very generic purpose of  
25 measuring the ability of the deal to meet its debt

1 And I believe they are also calculated  
2 differently, if I remember correctly, whereby the class  
3 A covers test includes adjustments for both category 1  
4 and category 2 assets and -- but the collateral value  
5 ratio I believe only includes adjustments for category 1  
6 assets. And I think no adjustment to work that out, the  
7 investments, but that's just what I remember off the top  
8 of my head.

9 Q. Do you know whether the replacement of Patriarch  
10 as the collateral manager was a consequence of failure  
11 of the OC test?

12 A. I believe it is, but I haven't reviewed the  
13 collateral management agreement in some time. But I  
14 believe that's also a consequence of, if not at least a  
15 event of default, indirectly the collateral value ratio  
16 breach, then perhaps also maybe class A test drops below  
17 a hundred I think, if I remember correctly. I don't  
18 know the specifics.

19 Q. Is the OC test something that is important to you  
20 as an investor?

21 A. Yes.

22 Q. Why is that?

23 A. For a various amount of reasons. I think most  
24 importantly it does provide additional protection in the  
25 sense that it will divert cash from the subordinate

1 service obligations.

2 Q. Is the IC test something that's important to you  
3 as an investor?

4 A. Yes.

5 Q. Why is that?

6 A. It gives an indicator of the deal's ability to  
7 meet its current interest obligations.

8 Q. Is one more important than the other to you as an  
9 investor, the OC versus IC?

10 A. I'd say the OC test is more important to us.

11 Q. Why is that?

12 A. Predominantly because, given the level of  
13 distress that we view the deals in, principal return and  
14 credit risk is our biggest concern.

15 (Discussion off the record.)

16 BY MS. SUMNER:

17 Q. Do you have an understanding of how the  
18 categorization of the assets in the CLO affects their  
19 valuation?

20 A. Yes.

21 Q. What is your understanding of that?

22 A. So, I'd say the categorization is very relevant  
23 to the OC test and the collateral value test. And in  
24 terms of how it affects the value within those  
25 calculations, I believe if the category goes down from a

1 four or three to a one or two, as a substitute for par  
2 value you will effectively use the lesser of market  
3 value and cost with the intent being generally that  
4 market value is the overriding factor there.

5 Q. Is the valuation of the assets something that is  
6 important to you as an investor?

7 A. Yes.

8 Q. Why is that?

9 A. It will help us estimate ultimate recovery on  
10 that asset, which impacts the ultimate recovery on our  
11 ownership.

12 Q. Is valuation of the assets important to you  
13 independent of the OC ratio?

14 A. Yes.

15 Q. Why is that?

16 A. For the same reason, that it will ultimately  
17 provide guidance in terms of the overall recovery to the  
18 portfolio company, that loan which directly impacts the  
19 ultimate recovery on our investment.

20 Q. Do you have an understanding of how Patriarch  
21 determines the categorization to which it places the  
22 assets?

23 A. Only to the extent the guidance provided within  
24 the indenture.

25 Q. Do you have understanding of what the indenture

1 says on this topic?

2 A. I believe that it's effectively within the  
3 manager's discretion. The idea is that the category 4  
4 assets are sort of current pay obligations and  
5 performing assets without any really known credit issues  
6 that would give rise to believe that those assets had a  
7 chance of becoming riskier and down the line  
8 recategorized as a category 3, 4 -- sorry, 3, 2 or 1;  
9 and with each level of category reflecting an increased  
10 level of credit riskiness and insolvency down to  
11 category 1 being more or less the worst category.

12 Q. Where did you come to that understanding?

13 A. From the indenture definition, various categories  
14 in the indenture.

15 Q. Do you believe that the categories of assets in  
16 the Zohar deal, the categorization, is governed by the  
17 terms of the indenture?

18 A. Yes.

19 Q. And why do you think that?

20 A. I think the definitions sort of speak for  
21 themselves in terms of really providing guidance in  
22 terms of certainly the spirit and within the framework  
23 of the definitions and how they're supposed to operate.

24 Q. Is it important to you as an investor that a  
25 collateral manager follow the terms of the indenture?

1 A. Yes.

2 Q. Why is that?

3 A. Because the indenture is there to govern  
4 basically how the structure and deal operates and really  
5 provide protections for all investors, senior investors  
6 specifically who have spent time bargaining for certain  
7 rights and protection within -- forwarded within the  
8 operating documents of the indenture; and so it is very  
9 important that the manager especially adhere to those  
10 operating documents properly.

11 Q. Do you think that the categorization is  
12 subjective or do you believe that it's objective?

13 A. I believe it is objective.

14 Q. And why do you think that?

15 A. There's certain objective points where very  
16 clearly if discussions are being had of a restructuring,  
17 whether it's within inside or outside of a bankruptcy  
18 proceeding or other official proceeding, it cannot be a  
19 category 4. There is definitive guidelines for  
20 insolvency proceedings and court processes that  
21 establish which categories it can also be in.

22 Q. Other than insolvency, are there other  
23 circumstances that you recall?

24 A. I believe if the manager has an idea that the

25 loans are going to be structured they will become more

1 credit risky; and if conversations are being had around  
2 restructuring the loans they objectively cannot be  
3 within category 4.

4 Q. I'm handing your a document that's previously  
5 been marked Exhibit No. 1.

6 (Indicating.)

7 This is a copy of the Zohar 1 indenture.

8 (Discussion off the record.)

9 BY MS. SUMNER:

10 Q. I'd like to talk to you in a little more depth  
11 about the categorization and your testimony that you  
12 think it is an objective type of test based on the  
13 indenture. So I don't know where the best place for you  
14 to start is, but I can tell that you on page 10 is where  
15 the different categories appear.

16 Maybe you could explain to me why you think that  
17 the categorization is an objective type measure, or  
18 specifically what in the indenture leads you to think  
19 that?

20 A. Sure. So, I think I would point to the  
21 definition of category 4 where there is definite  
22 guidelines in terms of a collateral debt obligation not  
23 being -- well, affirmatively being current and not an  
24 insolvency collateral obligation as well as no events of  
25 default occurring; and I think most importantly, prong,

1 at 4, where it does say with respect to the obligor  
2 thereon there are no negotiations at the time of  
3 measurement to restructure either inside or outside of a  
4 bankruptcy or reorganization proceeding.

5 Q. So, with respect to little Roman Numeral IV that  
6 you just pointed to, what does that particular provision  
7 mean to you?

8 A. Essentially that there's no plans or no knowledge  
9 of the loans within the deal being restructured.

10 Q. And then, the first item listed under category 4  
11 is a current collateral debt obligation which is a  
12 defined term. If you want to look at that definition,  
13 it is on page 23. And that also includes the defined  
14 term of noncurrent, which is on page 39. And if you  
15 could just read through those definitions and let me  
16 know to your reading -- and I'm not asking for a legal  
17 opinion -- but to your reading what a current collateral  
18 debt obligation means to you.

19 A. What it basically mean to me is an asset that is  
20 making timely interest payments on its obligations.

21 Q. Why do you think it means that?

22 A. So if it's neither a noncurrent obligation nor  
23 work out obligation with the exception of it being --  
24 having interest payments approved by a bankruptcy court,  
25 effectively noncurrent obligation is more or less

1 defined as a defaulted asset, which would mean that it's  
2 not paying interest and the work out obligation would  
3 also -- it's just simply a different definition outside  
4 of the current collateral debt obligation.

5 Q. And then you said that you think defaulted is  
6 defined as not paying interest. Where are you getting  
7 that?

8 A. If we look at defaulted obligation right at the  
9 bottom of page 23 with respect to which the default as  
10 the payment principal and/or interest has occurred.

11 Q. So, based on what you are reading here, would you  
12 expect a company that is not current in its interest  
13 payments to be classified as a category?

14 A. No.

15 Q. And why is that?

16 A. Because if it is not current in its interest  
17 payments and that is a default within the construct of  
18 that loan or for that obligor, then it would  
19 definitionally not be a current collateral debt  
20 obligation.

21 Q. Has anyone from Patriarch ever disclosed to you  
22 how Patriarch determines the categories for the loans?

23 A. No.

24 Q. Do you know if they have disclosed that to anyone  
25 at Barclays?

1 A. I don't believe so.

2 Q. Have you ever talked about that with anyone at  
3 Barclays?

4 A. Sorry, the question?

5 Q. Have you ever talked with anyone at Barclays  
6 about whether Patriarch has told Barclays how it  
7 categorizes loans?

8 A. No, I think in one of -- my understanding is that  
9 one of the calls or investments meetings that I was at  
10 Lynne Tilton started off the meeting saying we're not  
11 going to talk about how assets are categorized. So, I  
12 think we probably never ever really asked the question.

13 Q. If Patriarch had agreed to defer interest from a  
14 portfolio company, how would that impact the  
15 categorization, to your understanding?

16 A. I think if it's just a deferral and the loan  
17 documents allow for a deferral, I don't think that  
18 actually in and of itself affects the categorization.  
19 I'd have to go through the definitions to confirm that.

20 But one would also assume however, that if a  
21 company who can't make its interest payments and has to  
22 defer its interest payments, that there is a significant  
23 risk of a decline in credit quality. And so under one  
24 of these prongs of the category 4 definitions you would  
25 think it should not qualify as a category 4.

1 Q. Even if Patriarch's allowed to make loan  
2 modification or deferrals under the deal documents, do  
3 you believe that that's a separate -- let me ask it a  
4 little differently.

5 We will come back to that issue.

6 Are you aware that in cases where there are  
7 high levels of unpaid interest on loans to portfolio  
8 companies those loans are still classified as a category  
9 4? Patriarch's still classifying as a category 4?

10 A. So, that's a situation where there is unpaid  
11 interest amounts?

12 Q. Right.

13 A. And so I don't believe that -- I know we have  
14 seen reductions in interest margins. I don't believe we  
15 have seen actual unpaid interest amounts.

16 Q. Based on my investigation, I have seen instances  
17 where there are large amounts of unpaid interest by  
18 portfolio companies and at the same time those loans to  
19 the portfolio companies are still categorized as 4s  
20 rather than 1s. Is that something that you were aware  
21 of?

22 A. No.

23 Q. Is that something you would want to be aware of  
24 as an investor?

25 A. Yes.

1 too that this does cut off in January of 2013. That's  
2 the cutoff date from when it was produced to us. It  
3 doesn't necessarily indicate there weren't any payments  
4 after January 2013.

5 A. Sure.

6 Q. However, I can represent that American LaFrance  
7 did not get caught up on its interest payments between  
8 January 2013 and January 2014.

9 A. You can represent that they did not get caught  
10 up?

11 Q. They did not. Yeah, they did not pay all past  
12 due interest in that year period.

13 Is this information something that you would  
14 want to know, information relating to missing interest  
15 payments something you'd want to know as an investor?

16 A. Yes.

17 Q. Why is that?

18 A. Because it is a indication of the  
19 creditworthiness of the company and its ability to repay  
20 debt; as well as from a cash level perspective it  
21 impairs the ability for the deal to repay its timely  
22 debt interest obligations.

23 Q. Were you aware that American LaFrance ceased  
24 operations in January of this year? Did you know that?

25 A. We were aware that they had closed some factories

1 across the country. We were unaware as to whether or  
2 not it actually officially ceased operations.

3 Q. I'm handing you a document previously been marked  
4 as Exhibit No. 162.

5 (Indicating.)

6 This is a document that was produced to us  
7 by Patriarch. This is an e-mail from Karen Wu who  
8 worked in the structured finance department at Patriarch  
9 to Todd -- who also worked in the structured finance  
10 department there, and it attaches a spreadsheet. And in  
11 the e-mail Wu says that she is attaching a calculation  
12 for dailies past due amount giving a little less than \$5  
13 million for the total unpaid interest due and this is --  
14 Galey is a portfolio company.

15 A. Right.

16 Q. Marked as a category 4. And this is showing that  
17 as of this date, January of 2009, there's about \$5  
18 million interest by Galey across all three Zohar  
19 portfolios.

20 Is this something you were aware of?

21 A. No.

22 Q. And given \$5 million in past due interest or just  
23 under \$5 million in past due interest owed by Galey, do  
24 you think that that should impact the categorization of  
25 Galey in the Zohar portfolio?

1 A. Yes.

2 Q. Why is that?

3 A. It also impacts the creditworthiness and ability  
4 for the borrower to repay their debts.

5 Q. We have heard from Lynne Tilton that Patriarch  
6 and that she will consider a company to be a category 4  
7 as long as she intends to continue supporting that  
8 company by providing funding, providing management  
9 resources, that type of thing.

10 Is that something that she has ever disclosed to  
11 you as an investor?

12 A. No.

13 Q. And is that something that as an investor you  
14 would want to know?

15 A. Yes.

16 Q. Why is that?

17 A. Because it certainly deviates from the objective  
18 definition of the categorizations as well as a  
19 significant input into any credit position or credit  
20 risk view we may take on any of the portfolio companies.

21 Q. We have also heard from Patriarch that it had the  
22 right to modify loan agreements with the portfolio  
23 companies, that that right was granted to it in the  
24 indenture.

25 Assuming that that's true, that Patriarch can

1 modify loan agreements, is modification of loan  
2 agreements to you a separate issue from how the assets  
3 are categorized?

4 A. I'd say they are connected just in the sense that  
5 one would assume that modification to loan agreements  
6 would be necessary in events of distress, in times of  
7 distress. And so, to the extent that the modification  
8 was a result of a decrease in creditworthiness of the  
9 portfolio company, I think that would be very relevant.

10 Q. How is it relevant?

11 A. Certainly from the perspective of the  
12 creditworthiness and the categorizations and -- but I'm  
13 not -- I couldn't say I'm specifically familiar what the  
14 indenture provides for her ability to modify loans, but  
15 I would think on a very fundamental basis there should  
16 be an inability to certainly write off debt or write off  
17 interest payments. Certainly interest payments should  
18 be capitalized such that they're still obligations of  
19 issuer.

20 And I would think that those obligations should  
21 also be reflected one way or another within either the  
22 collateral value ratio or the IC or OC test.

23 Q. And how would they be shown in the IC or OC test?

24 A. As an additional liability, effectively, in  
25 either test.



1 Q. Anyone else?  
 2 A. Not that I can remember.  
 3 Q. We've been through a lot of information today.  
 4 Is there anything that I didn't ask you about that you  
 5 can tell me that you think might be helpful to my  
 6 investigation?  
 7 A. I don't think so. I think we've certainly  
 8 discussed a lot. I think there was coverage of the  
 9 salient points at least.  
 10 Q. Mr. Chaku, I have no further questions at this  
 11 time. We may, however, call you again to testify in  
 12 this investigation. Should this be necessary we'll  
 13 contact your counsel. Do you wish to clarify anything  
 14 or add anything to the statements you've made today?  
 15 A. Not at this time.  
 16 MS. SUMNER: Counsel, do you wish to ask any  
 17 questions?  
 18 MR. MICHAELSON: No, thank you.  
 19 MS. SUMNER: We're off the record at 12:35  
 20 on May 1st, 2014.  
 21 (Time noted: 12:35 p.m.)  
 22  
 23  
 24  
 25

1  
 2 SCOPIST CERTIFICATE  
 3  
 4 I, JEFFREY SHAPIRO, hereby certify  
 5 that the foregoing transcript consisting of 72 pages is  
 6 a complete, true and accurate transcript of the  
 7 investigative hearing, held on Thursday, May 1, 2014, at  
 8 Brookfield Plaza, 200 Vesey Street, New York, New York  
 9 10281, in the matter of Patriarch Partners, LLC.  
 10 I further certify that this  
 11 proceeding was reported by me and that the foregoing  
 12 transcript has been scoped by me.  
 13  
 14  
 15  
 16 \_\_\_\_\_  
 17 JEFFREY SHAPIRO  
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 25

1  
 2 UNITED STATES  
 3 SECURITIES AND EXCHANGE COMMISSION  
 4 REPORTER'S CERTIFICATE  
 5  
 6 I, Jeffrey Shapiro, reporter, hereby certify  
 7 that the foregoing transcript of 72 pages is a complete,  
 8 true, and accurate transcript of the testimony  
 9 indicated, held on May 1, 2014, at the Securities and  
 10 Exchange Commission, Brookfield Plaza, 200 Vesey Street,  
 11 New York, New York 10281, in the matter of:  
 12 Patriarch Partners, LLC.  
 13  
 14 I further certify that this proceeding was  
 15 recorded by me and that the foregoing transcript was  
 16 prepared under my direction.  
 17  
 18 \_\_\_\_\_ Date  
 19 JEFFREY SHAPIRO  
 20  
 21  
 22  
 23  
 24  
 25

1 PROOFREADER'S CERTIFICATE  
 2  
 3 In the Matter of: Patriarch Partners, LLC  
 4 File Number: HO-11665  
 5 Date: May 1, 2014  
 6 Location: Brookfield Plaza  
 7 200 Vesey Street  
 8 New York, New York 10281  
 9  
 10  
 11 This is to certify that I,  
 12 JEFFREY SHAPIRO, the undersigned, do hereby swear and  
 13 affirm that the attached proceedings before the United  
 14 States Securities and Exchange Commission were held  
 15 according to the record, and that this is the original,  
 16 complete, true and accurate transcript that has been  
 17 compared to the reporting or recording accomplished at  
 18 the hearing.  
 19  
 20 \_\_\_\_\_ Date  
 21 JEFFREY SHAPIRO  
 22  
 23  
 24  
 25



1 provided with a copy of the formal order of  
 2 investigation in this matter. It will be available for  
 3 your examination during the course of this proceeding.  
 4 Mr. Aldama, have you had an opportunity to review  
 5 the formal order?  
 6 A. Yes.  
 7 Q. Prior to the opening of the record, you were also  
 8 provided with a copy of the commission's supplemental  
 9 information form 1662. A copy of that notice has been  
 10 previously marked as Exhibit No. 33.  
 11 Mr. Aldama, have you had an opportunity to read  
 12 Exhibit No. 33?  
 13 A. Yes.  
 14 Q. Do you have questions concerning this notice?  
 15 A. I don't.  
 16 Q. Mr. Aldama, are you represented by counsel?  
 17 A. Yes.  
 18 MS. SUMNER: Counsel, please identify yourselves  
 19 for the record.  
 20 MR. MICHAELSON: Andrew Michaelson from  
 21 Boies, Schiller and Flexner; joined by Michael Grisolia  
 22 also from Boies, Schiller and Flexner; as well as Allan  
 23 Borkow from Barclays Legal.  
 24 MS. SUMNER: Are you each representing Mr.  
 25 Aldama as his counsel today?

1 MR. MICHAELSON: Yes.  
 2 (Exhibit No. 177 was so marked and received  
 3 into evidence.)  
 4 BY MS. SUMNER:  
 5 Q. Mr. Aldama, I'm handing you a copy of the  
 6 subpoena that's been marked as Exhibit No. 177.  
 7 Is this a copy of the subpoena pursuant to which  
 8 you are appearing here today?  
 9 A. Yes.  
 10 Q. I know that you have been deposed before so  
 11 you've provided sworn testimony. But I thought we  
 12 should go over some of the ground rules to make things  
 13 go smoothly today. As you see, there's a court reporter  
 14 here and he will be taking down everything that we say.  
 15 For that reason, your responses to my questions need to  
 16 verbal because nodding your head won't show up on the  
 17 transcript or shaking your head won't either.  
 18 I also ask that you use yes or no rather than  
 19 "huh-huh" or "uh-uh," because those phrases aren't clear  
 20 on a transcript. I will do my best to let you finish  
 21 talking before I start talking, and if you could try to  
 22 let me finish my question before you start to answer I  
 23 would appreciate it. That will help keep the record  
 24 clear as well.  
 25 If you don't understand a question, please

1 just ask me to restate it or rephrase it. Otherwise I  
 2 will assume that you understood the question that I  
 3 asked.  
 4 And I control the record, and that means the  
 5 court reporter will only go off the record if he's  
 6 instructed to do so by me. He won't go off the record  
 7 if instructed to do so by you or your counsel. However,  
 8 if you need a break just let me know and we'll work one  
 9 in.  
 10 Is there any reason you won't be able to  
 11 answer my questions fully and accurately today?  
 12 A. No.  
 13 Q. Did you discuss your testimony here today with  
 14 anyone other than your counsel?  
 15 A. My supervisor.  
 16 Q. Anyone else?  
 17 A. No.  
 18 Q. What did you do to prepare for testimony?  
 19 A. I met with counsel and reviewed a couple of  
 20 e-mails that were produced between 2011 and 2012.  
 21 Q. And other than that, did you do anything else to  
 22 prepare for testimony today?  
 23 A. No.  
 24 Q. Have you discussed the SEC's investigation with  
 25 anyone other than your counsel?

1 A. My supervisor.  
 2 Q. Anyone else?  
 3 A. No.  
 4 Q. Who is your supervisor?  
 5 A. Bill Hirschberg.  
 6 Q. How do you spell his last name?  
 7 A. H-I-R-S-C-H-B-E-R-G.  
 8 Q. Does that sound right to you?  
 9 A. Yes.  
 10 (Exhibit No. 178 was so marked and received  
 11 into evidence.)  
 12 BY MS. SUMNER:  
 13 Q. Mr. Aldama, I'm handing you a document that's  
 14 been marked as Exhibit No. 178. This is a document  
 15 entitled background questionnaire.  
 16 Do you recognize Exhibit No. 178?  
 17 A. Yes.  
 18 Q. Can you tell me what it is?  
 19 A. The background questionnaire that I filled out  
 20 before coming here.  
 21 Q. Did you complete this background questionnaire?  
 22 A. Yes.  
 23 Q. Did you type it or did someone else type it?  
 24 A. Someone else typed it.  
 25 Q. And you provided the information?

1 again is the standard in every structured transaction  
2 and for investors to have that and rely on that  
3 information.

4 Q. Do you have an understanding of when an asset is  
5 considered a category 4?

6 A. My understanding is from what the indenture says  
7 what a category 4 should be. My understanding is that  
8 Lynne can decide what is a category 4 and she has some  
9 discretion to what to call 4 whatever she wants.

10 Q. Why do you think she has full discretion?

11 A. I don't think -- my understanding, my belief that  
12 it is Lynne and Patriarch that assign the internal  
13 ratings to the facility's reference on the portfolio.

14 And there is no mechanic to dispute the categorization.  
15 So a defaulted security that has been publicly labelled  
16 defaulted she can call that 4 if she wants to. It would  
17 be hard for her to justify herself but there is no -- as  
18 the manager of the portfolio she has a lot of discretion  
19 to use and call whatever she wants. She shouldn't,  
20 but --

21 Q. Do you believe that under the terms of the  
22 indenture she has the right to label something 4 at her  
23 own discretion?

24 A. I don't think so. I just feel that that's what  
25 she has been doing for the past few years.

1 seen the number 3 or the number 2. In fact, I don't  
2 think I've ever seen the number 3 or number 2 in the  
3 trustee reports. I know there is 4 and there is 1 but  
4 in between seems to be always a jump.

5 Q. I think that's right.

6 What does that say to you?

7 A. She didn't know that the companies were going to  
8 file the day before and she only found out that day or  
9 she is not performing her duties as stated in the  
10 collateral management agreement.

11 MS. SUMNER: Let's go off the record at  
12 3:27. Let's take a short break.

13 (Recess taken.)

14 MS. SUMNER: We are back on the record at  
15 3:45.

16 BY MS. SUMNER:

17 Q. During the break, Mr. Aldama, did you have any  
18 substantive conversations with the SEC staff about this  
19 investigation?

20 A. No.

21 Q. Have you reviewed the indenture for Zohar 1?

22 A. I have at some point reviewed and read some  
23 sections on indenture, yes.

24 Q. What parts have you reviewed?

25 A. Basically related to the rights that we would

1 Q. You don't think she has the right to do that  
2 necessarily but you think she --

3 (Talking over each other.)

4 A. Let me clarify. The indenture clearly defines  
5 what a 4 is, a 3, a 2 and a 1. These are clear  
6 definitions of what a 4 is and a clear definition what a  
7 1 is. I don't think she is using that to classify. It  
8 is my belief based on how some of the company's gone  
9 from a 4 to 1 from trustee report from November to  
10 December there is a jump from 4 to 1. I don't think  
11 she's using the internal categories that she's meant to  
12 use. I think she's using a lot of discretion. I don't  
13 she has the discretion she's just --

14 Q. What companies are you specifically thinking of?

15 A. There are companies like -- the one that comes to  
16 mind is American LaFrance and that was labeled as a  
17 category 4 shortly before we had to read in the paper  
18 that she has shut down the entire company and news  
19 reports seem to imply that a company was doing very bad  
20 much earlier and that went from a 4 to a 1.

21 And I don't believe that one day the company is a  
22 4 and in good standing and the following day you have to  
23 shut down the entire plan. It just seems to me  
24 unrealistic. I don't remember specific names, but when  
25 you track the recharacterization I don't think I have

1 have under the indenture upon an event of default of the  
2 deal and then around the portfolio management. The  
3 section that talks about characterization of assets, the  
4 section that talks about the rights that Lynne has to  
5 extend maturities and so on and so forth.

6 Q. And you testified earlier that you received the  
7 trustee reports. Why is that something that you look  
8 at? Why do you look at the trustee reports?

9 A. Any structured vehicle that we own, that Barclays  
10 or any of the clients that we work owns, the trustee  
11 report is the means that the manager has to distribute  
12 information on the portfolio to all investors. As  
13 opposed to bilateral discussion with the manager, asset  
14 managers use the trustee reports as a distribution  
15 platform to all investors of the security around the  
16 performance of the portfolio, the current levels on the  
17 coverage ratios and how the deal is performing.

18 Q. Have you had any discussions with anyone at  
19 Natixis about restructuring the Zohar 1 deal?

20 A. We have had over time different discussions at  
21 different points in time.

22 Q. Who have you dealt with at Natixis?

23 A. So, mostly Kevin Alexander. But I have had calls  
24 and proposals from people at Natixis and over the years  
25 that I believe worked for Kevin Alexander, but they're

1 more in change of the structuring of the position.  
 2 Q. Kevin Alexander is a lawyer; right?  
 3 A. No. He's a trader. I'm not sure if he's  
 4 otherwise.  
 5 Q. Trader, okay.  
 6 A. I think there's another Kevin who could be a  
 7 lawyer.  
 8 Q. But he's a trader, to your knowledge?  
 9 A. Yeah, he is a trader.  
 10 Q. And then I just need to circle back a little bit.  
 11 On the issue of categorization, do you believe that the  
 12 indenture governs the way that the assets should be  
 13 classified, the 1 through 4?  
 14 A. The indenture does govern the characterization of  
 15 assets, yes.  
 16 Q. What is your understanding of what a category 4  
 17 asset is?  
 18 A. In terms of performing assets, a good asset that  
 19 doesn't seem to have imminent problems.  
 20 Q. When you say no imminent problems, what do you  
 21 mean by that?  
 22 A. That is not in imminent danger of defaulting.  
 23 Q. How do you define "imminent"?  
 24 A. The next day. When a company is getting closer  
 25 to filing a Chapter 11, experience shows that it's not

1 something that happens from month to month. It does  
 2 take time and it's a build-up of problems but you can  
 3 project this filings over time.  
 4 Q. What about a company that is not paying  
 5 significant sums of interest but is due on its loans?  
 6 Based on your understanding of the indenture would that  
 7 type of a company be considered a category 4?  
 8 A. Can you repeat the question?  
 9 Q. A company that hasn't paid considerable or  
 10 significant percentages of interest that are due under  
 11 its loans?  
 12 A. If the company doesn't pay interest that is due  
 13 and payable under the terms of the facility, that would  
 14 not be a category 4, no.  
 15 Q. And what is your basis for saying that?  
 16 A. It is in breach of -- a company that is in breach  
 17 of their financial obligations and it's unable to make  
 18 payments on amounts that are due and payable, And does  
 19 not have the money to cover those amounts. It is a  
 20 company that I don't think personally, I don't think  
 21 should be considered as performing.  
 22 Q. Let's take a look at the indenture and maybe we  
 23 can nail it down a little bit better. I'm handing you  
 24 what's been previously marked as Exhibit No. 1, a copy  
 25 of the Zohar 1 indenture.

1 (Indicating.)  
 2 Take whatever time you need to look through  
 3 it. The categories are defined in the definition  
 4 section on page 10.  
 5 A. Okay.  
 6 Q. The category 4 specifically contains within the  
 7 defined terms current collateral debt obligation and  
 8 that takes you to page 23?  
 9 A. Okay.  
 10 Q. And so, based on your reading of the indenture,  
 11 do you believe that if a company has not paid interest  
 12 on its loan facilities, it should be considered a  
 13 category 4?  
 14 A. Repeat the question, sorry.  
 15 Q. Sure. If a company has not paid interest owed on  
 16 its loan facilities should it be considered a category 4  
 17 or if it's not paid a significant amount of interest  
 18 owed under its loan facilities?  
 19 A. No.  
 20 Q. Why is that?  
 21 A. Because it is not, I guess, performing, it's not  
 22 current under obligations -- that would be page 39 of  
 23 noncurrent obligations.  
 24 Q. Has anyone from Patriarch ever disclosed to you  
 25 how it determines the categorization of the assets?

1 A. No.  
 2 Q. We have heard from Patriarch -- from Ms. Tilton  
 3 specifically that she will categorize a company as a 4  
 4 as long as she intends to continue supporting the  
 5 company by providing funding, management resources, that  
 6 type of thing.  
 7 Is that something you have heard before?  
 8 A. I have heard claims by Ms. Tilton that she has  
 9 supported and put personal money in some companies to  
 10 support the companies. It is hard for us to verify  
 11 those statements since we don't get the financials of  
 12 the companies.  
 13 Q. Sure.  
 14 A. But that's not what the indenture is.  
 15 Q. Let me ask my question again. So, she's told us  
 16 that if she intends to continue providing support to a  
 17 company, which maybe it's personal money or maybe it's  
 18 extending more loan facilities and in management  
 19 resources, that type of thing, then she will consider  
 20 that company a category 4. And that's how she makes the  
 21 determination of what is a category 4.  
 22 Is that something you have ever heard before?  
 23 A. I never heard that statement before.  
 24 Q. And does that seem consistent with the indenture  
 25 to you?

1 A. No.  
 2 Q. I know you weren't at Barclays at the time Zohar  
 3 was purchased, but have you ever heard from anyone at  
 4 Barclays that the reason they purchased Zohar 1 was to  
 5 purchase Lynne Tilton's expertise?  
 6 A. I have not heard that statement before, no.  
 7 Q. As an investor, is it important to you that a  
 8 collateral manager follow the terms of the indenture?  
 9 A. Extremely important, yes.  
 10 Q. Why is that?  
 11 A. The documents, indenture, collateral and  
 12 agreement, offer memorandum, these government documents  
 13 are the legal contract that we have with the manager  
 14 insofar it comes to managing the CDO or the portfolio.  
 15 My experience have shown that managers that tend to  
 16 deviate from indenture and interpret their own ratings  
 17 tend to be -- end up problematic.  
 18 We have had experiences where managers deviate  
 19 from the indenture and has significantly deteriorated  
 20 our economic position. The reason we have an indenture  
 21 is to protect our interest as investors. The moment the  
 22 manager starts deviating from indenture it's -- our  
 23 interests greatly harmed as holders of the position.  
 24 Q. I'm handing you two exhibits that have been  
 25 previously marked Exhibits No. 160 and 161.

1 (Indicating.)  
 2 And these are documents that were produced  
 3 to us by Patriarch. They are internal Patriarch  
 4 documents. And you are looking at 160 now. And this is  
 5 based on what we understand -- this is a spreadsheet  
 6 from Patriarch's loan administration system and  
 7 basically this shows all the various loan facilities to  
 8 one specific portfolio company. These are loans to  
 9 American LaFrance.  
 10 A. Correct.  
 11 Q. And what it shows is the principal balance of the  
 12 loan at inception and then accrued interest.  
 13 A. I can see that.  
 14 Q. And then if you look at 161. This is also from  
 15 Patriarch's internal system and what this shows is the  
 16 amount of interest that has actually been paid by the  
 17 portfolio company or by this portfolio company on the  
 18 specific loan facility.  
 19 And I just want to make sure that we're comparing  
 20 apples to apples so if you look at the first page of the  
 21 spreadsheet on 160, it ends in 001, that facility 8511  
 22 for Zohar 1. And then if you look at the page ending in  
 23 002 on Exhibit No. 161 that facility 8511 for Zohar 1.  
 24 A. Yes.  
 25 Q. So what this document is showing is that there

1 are significant amounts of interest that are owed by  
 2 American LaFrance or that were owed by American LaFrance  
 3 that were not paid. Can you see where I'm getting  
 4 that -- drawing that conclusion?  
 5 A. No, I can't clearly see where you're getting that  
 6 conclusion.  
 7 Q. Is that something that you were aware of?  
 8 A. No.  
 9 Q. And as an investor, is that something that you  
 10 would have wanted to know?  
 11 A. Yes. We would have expected for this to be  
 12 flagged on the trustee report.  
 13 Q. And how would it be flagged?  
 14 A. As interest not paid.  
 15 Q. Do you think that the fact that American LaFrance  
 16 failed to pay a significant amount of its interest and  
 17 at times didn't make interest payments for significant  
 18 periods, should affect its categorization?  
 19 A. Yes.  
 20 Q. Why is that?  
 21 A. Because it seems obvious from the lack of  
 22 payments that they were already in trouble back in 2009  
 23 from my report, and they did not have enough resources  
 24 to cover the interest that were due and payable and so  
 25 it is hard to call it a category 4. It's already

1 failing to pay interest.  
 2 Q. Did you review the funds, the Zohar fund  
 3 quarterly financial statements or Zohar 1's quarterly  
 4 financial statements?  
 5 A. The quarterly report you mean.  
 6 Q. Well, they also file financial statements that  
 7 are required under the indenture but they are separate  
 8 from the quarterly report?  
 9 A. I don't think I have.  
 10 Q. Let me show you one and see if it is something  
 11 you looked at before.  
 12 (Indicating.)  
 13 I'm handing you a document that's previously  
 14 been marked as Exhibit No. 175; and just take a look at  
 15 that and see if you've seen either that one or one  
 16 similar to it.  
 17 (Indicating.)  
 18 A. I don't think I have seen this before.  
 19 Q. Have you ever discussed Zohar 1's financial  
 20 statements with anyone?  
 21 A. No.  
 22 (Exhibit No. 179 was so marked and received  
 23 into evidence.)  
 24 BY MS. SUMNER:  
 25 Q. Mr. Aldama, I'm handing you a document that's

1 point. But they're not exclusive. There are more  
2 issues that we found with this position.

3 With regard to the dates, I may have been very  
4 vague on the dates. I recollect many things. I  
5 recollect what was said but I may be off by months on  
6 those meetings and dates. I think that's my part on  
7 clarification. There may be another one around Lynne  
8 Tilton's intent to buy the position.

9 I mentioned before throughout the conversation  
10 that she offered 10 cents on the dollar to buy the  
11 position. I don't think that was what she felt the  
12 position was worth at the time. She did caveat that  
13 level with the fact that she didn't really have the  
14 capital to buy our position. So that was as much as she  
15 was willing to pay for the position. But I don't think  
16 that was bid granted and it wasn't a serious bid, I  
17 guess.

18 MS. SUMNER: Counsel, any clarifying  
19 question?

20 MR. MICHAELSON: No questions.

21 MS. SUMNER: We're off the record at 4:47 on  
22 May 1st, 2014.

23 (Time noted: 4:47 p.m.)  
24  
25

1  
2 SCOPIST CERTIFICATE

3  
4 I, JEFFREY SHAPIRO, hereby certify that the  
5 foregoing transcript consisting of 84 pages is a  
6 complete, true and accurate transcript of the  
7 investigative hearing, held on Thursday, May 1, 2014, at  
8 Brookfield Plaza, 200 Vesey Street, New York, New York  
9 10281, in the matter of Patriarch Partners, LLC.

10 I further certify that this proceeding was  
11 reported by me and that the foregoing transcript has  
12 been scoped by me.  
13  
14  
15  
16

17 \_\_\_\_\_  
18 JEFFREY SHAPIRO Date

1  
2 UNITED STATES  
3 SECURITIES AND EXCHANGE COMMISSION  
4 REPORTER'S CERTIFICATE

5  
6 I, Jeffrey Shapiro, reporter, hereby certify  
7 that the foregoing transcript of 84 pages is a complete,  
8 true, and accurate transcript of the testimony  
9 indicated, held on May 1, 2014, at the Securities and  
10 Exchange Commission, Brookfield Plaza, 200 Vesey Street,  
11 New York, New York 10281, in the matter of:  
12 Patriarch Partners, LLC.

13  
14 I further certify that this proceeding was  
15 recorded by me and that the foregoing transcript was  
16 prepared under my direction.  
17  
18

19 \_\_\_\_\_  
20 JEFFREY SHAPIRO Date

1 PROOFREADER'S CERTIFICATE

2  
3 In the Matter of: Patriarch Partners, LLC  
4 File Number: HO-11665  
5 Date: May 1, 2014  
6 Location: Brookfield Plaza  
7 200 Vesey Street  
8 New York, New York 10281  
9

10  
11 This is to certify that I,  
12 JEFFREY SHAPIRO, the undersigned, do hereby swear and  
13 affirm that the attached proceedings before the United  
14 States Securities and Exchange Commission were held  
15 according to the record, and that this is the original,  
16 complete, true and accurate transcript that has been  
17 compared to the reporting or recording accomplished at  
18 the hearing.  
19

20 \_\_\_\_\_  
21 JEFFREY SHAPIRO Date  
22  
23  
24  
25

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

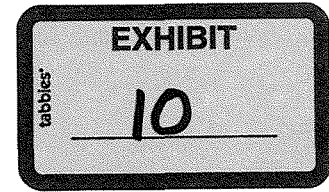
In the Matter of: )  
 ) File No. HO-11665  
 PATRIARCH PARTNERS, LLC ) D-3350  
 )  
 WITNESS: WENDY RUTTLE  
 PAGES: 1-46  
 PLACE: Securities and Exchange Commission  
 Brookfield Place  
 200 Vesey Street  
 New York, New York 10281-1022  
 DATE: April 9, 2014

The above-entitled matter came on for hearing at 2:18 o'clock p.m.

APPEARANCES:

On behalf of the Securities and Exchange Commission:  
 AMY A. SUMNER, ESQ.  
 Enforcement Division  
 Securities and Exchange Commission  
 1801 California Street  
 Suite 1500  
 Denver, Colorado 80202

On behalf of the Witness:  
 ZEICHNER ELLMAN & KRAUSE LLP  
 1211 Avenue of the Americas  
 New York, New York 10036  
 BY: JANTRA VAN ROY, ESQ.  
 MICHAEL SIMS, ESQ.



PROCEEDINGS

MS. SUMNER: We are on the record at 2:18 on April 9, 2014.

Will you please raise your right hand:  
 Do you swear to tell the truth, the whole truth and nothing but the truth?

THE WITNESS: Yes.

Whereupon,  
 WENDY RUTTLE,

appeared as a witness herein and, having been first duly sworn, was examined and testified as follows:

EXAMINATION BY

MS. SUMNER:

Q. Please state and spell your full name for the record.

A. Wendy Lani Ruttle; W-E-N-D-Y L-A-N-I R-U-T-T-L-E.

Q. Ms. Ruttle, my name is Amy Sumner. I'm a member of the staff of the Enforcement Division of the Denver Regional Office of the United States Securities and Exchange Commission. I am also an officer of the Commission for the purposes of this proceeding.

This is an investigation by the United States Securities and Exchange Commission in the

matter of Patriarch Partners to determine whether there have been violations of certain provisions of the Federal Securities Laws. However, the facts developed in this investigation may constitute violations of other federal or state, civil or criminal laws.

Prior to the opening of the record, you were provided with a copy of the Formal Order of Investigation in this matter. It will be available for your examination during the course of this proceeding.

Ms. Ruttle, have you had an opportunity to review the Formal Order?

A. Yes.

Q. Prior to the opening of the record, you were also provided with a copy of the Commission's Supplemental Information Form 1662. A copy of that notice has been previously marked as Exhibit 33.

Ms. Ruttle, have you had an opportunity to read Exhibit 33?

A. Yes.

Q. Do you have any questions concerning this exhibit?

A. No.

Q. Ms. Ruttle, are you represented by



1 counsel?  
 2 A. Yes.  
 3 MS. SUMNER: Would counsel please  
 4 identify themselves for the record.  
 5 MS. VAN ROY: Jantra Van Roy and Michael  
 6 Sims, both of Zeichner, Ellman & Krause.  
 7 MS. SUMNER: Ms. Van Roy, are you  
 8 representing Ms. Ruttle as her counsel today?  
 9 MS. VAN ROY: Yes.  
 10 MS. SUMNER: Mr. Sims, are you  
 11 representing Ms. Ruttle as her counsel today?  
 12 MR. SIMS: Yes.  
 13 MS. SUMNER: Mark this, please.  
 14 (Subpoena marked Exhibit 149 for  
 15 identification.)  
 16 Q. Ms. Ruttle, I'm handing you a copy of a  
 17 subpoena that's been marked as Exhibit 149. Is this  
 18 a copy of the subpoena pursuant to which you are  
 19 appearing here today?  
 20 A. Yes.  
 21 Q. Have you ever provided sworn testimony  
 22 before?  
 23 A. No.  
 24 Q. Let's just go over some of the rules to  
 25 make things move a little more smoothly today.

1 Everything we say here today will be  
 2 taken down by our court reporter and will be returned  
 3 in the form of a written transcript, so for that  
 4 reason, your responses to my questions need to be  
 5 verbal. Nods of the head won't show up on a  
 6 transcript. I ask that you use yes or no rather than  
 7 uh-huh or uh-uh, because the meanings of those  
 8 phrases isn't clear on the transcript.  
 9 I will do my best to let you finish  
 10 talking before I start speaking again, and I ask you  
 11 to try to do the same. I know it's not always easy  
 12 to remember, but it will make sure that she is able  
 13 to take down everything that we are saying. Even if  
 14 you think you know what I'm going to ask, let me go  
 15 ahead and ask the full question just so that we make  
 16 sure the record is clear.  
 17 If you don't understand my question,  
 18 please ask me to restate it or rephrase it.  
 19 Otherwise, I will assume that you understood the  
 20 question that I asked.  
 21 If you need a break, just let me know,  
 22 and we will work one in at an appropriate time. I do  
 23 control the record and the court reporter will only  
 24 go off the record if I instruct her to do so. Like I  
 25 said, let me know if you need a break and that's

1 fine.  
 2 Is there any reason that you won't be  
 3 able to answer my questions fully and accurately  
 4 today?  
 5 A. No.  
 6 Q. Did you discuss your testimony here  
 7 today with anyone other than your counsel?  
 8 A. No.  
 9 Q. What did you do to prepare for  
 10 testimony?  
 11 A. I met with my counsel. We discussed --  
 12 Q. I don't want you to tell me what you  
 13 discussed.  
 14 You met with your counsel. Did you do  
 15 anything else?  
 16 A. No.  
 17 Q. Have you discussed the SEC's  
 18 investigation with anyone other than your counsel?  
 19 A. No. Internal counsel at our bank  
 20 informed me, so...  
 21 Q. All right. Anyone else?  
 22 A. No.  
 23 MS. SUMNER: Mark this, please.  
 24 (Background Questionnaire marked Exhibit  
 25 150 for identification.)

1 Q. Ms. Ruttle, the court reporter has  
 2 handed you a document that's been marked as  
 3 Exhibit 150. This is a document titled "Background  
 4 Questionnaire." Do you recognize Exhibit 150?  
 5 A. Yes.  
 6 Q. What is it?  
 7 A. The background questionnaire that I  
 8 filled out in preparation for this meeting.  
 9 Q. Did you complete this background  
 10 questionnaire?  
 11 A. Yes.  
 12 Q. Did anyone help you complete the  
 13 background questionnaire?  
 14 A. No.  
 15 Q. I had told your counsel that certain  
 16 information in the background questionnaire wasn't  
 17 necessary for you to fill out. For the responses  
 18 that you did complete, are your answers true,  
 19 complete and accurate, to the best of your knowledge?  
 20 A. Yes, to the best of my knowledge.  
 21 Q. And do you agree to incorporate this  
 22 information in the background questionnaire as part  
 23 of your testimony today?  
 24 A. Yes.  
 25 Q. Let's talk about your employment

1 specifically monitors this deal?

2 A. No, I'm do not. I'm not sure.

3 Q. So from the time that Zohar III closed  
4 until it was transferred to the other group, can you  
5 describe what you did to monitor the ongoing  
6 performance of the deal?

7 A. I would basically look at the deal  
8 performance, primarily through the trustee report. I  
9 also received compliance documents from the company  
10 via the trustee. So we also reviewed those and then  
11 filed them. And that's about -- did you have  
12 specific questions?

13 Q. No. That's what I was wondering. What  
14 types of compliance documents are you referring to?

15 A. Basically officer statements that the  
16 deal is in compliance with stated terms of the  
17 indenture, financial statements.

18 Q. And those came from -- you received  
19 those from the trustee?

20 A. Yes, on behalf of the issuer.

21 Q. When you reviewed the trustee reports,  
22 what were you -- what did you look for in the trustee  
23 reports?

24 A. We would look at the OC, the over  
25 collateralization. The IC, the interest

1 collateralization. Those are primary. We would look  
2 at basically what was outstanding on other tranches.

3 We would look at the cash on hand in the deal. Look  
4 at the defaulted securities, the diversification of  
5 the deal and basically look at the trends within the  
6 portfolio.

7 Q. Why was the IC -- why was the OC ratio  
8 something you looked at?

9 A. Basically it's an indication of how the  
10 portfolio -- the assets within the portfolio are  
11 performing, and whether you can expect to get  
12 principal repayment or not.

13 Q. As an investor, was the OC ratio  
14 something that was important to you?

15 A. Yes.

16 Q. Why is that?

17 A. Because you would basically look to have  
18 a healthy OC ratio rather than not a healthy OC  
19 ratio. You want to make sure that the assets within  
20 the portfolio are healthy, cash flowing assets.

21 Q. And what about the IC ratio, why is that  
22 something you looked at?

23 A. Basically you want to know that the  
24 assets within the portfolio are able to pay off their  
25 daily obligations in the form of interest and that

1 basically any interest that's earned within the  
2 portfolio would then be used to pay off the  
3 obligations of that debt, which were assets of the  
4 conduit, so...

5 Q. The financial statements for the funds  
6 are also something you reviewed; is that correct?

7 A. Yes.

8 Q. What were you looking for in those?

9 A. Basically, you know, the portfolio asset  
10 size. We would read any kind of, I guess  
11 particularly interesting would be the notes that the  
12 company would write to see if there is any language  
13 that would stand out, or sometimes the company would  
14 disclose facts that you wouldn't necessarily get just  
15 looking at numbers.

16 Q. The financial statements for the fund  
17 contain a notation that they are compliant with GAAP.  
18 Is that something that's important to you?

19 A. Yes.

20 Q. Why is that?

21 A. Basically, the industry standard. So  
22 you would hope that the accounting that's performed  
23 on the portfolio would be -- you know, performed  
24 according to the industry standard.

25 Q. I need to go back to a question I meant

1 to ask before: Was the IC test something that was  
2 important to you as an investor?

3 A. Yes.

4 Q. Why is that?

5 A. I thought you asked that.

6 Q. I asked about the OC test. I want to  
7 ask the same question about the IC test.

8 A. Oh, okay. Basically you want to know  
9 that the interest that's expected is coming through  
10 the deal. The portfolio will use the interest  
11 received to pay off the obligations of the debt and  
12 so that will be used to pay interest owed to the  
13 conduit. So definitely you want a healthy OC -- I'm  
14 sorry -- an IC ratio.

15 Q. Is one more important than the other to  
16 you as an investor, the OC versus the IC?

17 A. In my opinion, they are both very  
18 important.

19 Q. Do you have an understanding of what the  
20 consequences are if the funds were to fail the OC  
21 test?

22 A. Uh-hum.

23 Q. And what's your understanding of that?

24 A. From, I guess, that, what would be  
25 important to me is that we would no longer fund those

1 time as you want looking through Exhibit 3, but it  
2 might be more productive for me to point to you what  
3 I'm interested in. If you need to look at more at  
4 that point, feel free, but the definition section is  
5 where I'm looking, and the specific definition is on  
6 page 21 of the indenture.

7 And there is -- the fourth entry down is  
8 a definition for defaulted investment.

9 A. Uh-hum.

10 Q. It says, "Any collateral investment  
11 included in the collateral (other than a current pay  
12 investment):" And then it goes on to say, "With  
13 respect to which a default as to the payment of  
14 principal and/or interest has occurred, but only so  
15 long as such default has not been cured."

16 I'm not asking you for a legal opinion,  
17 but sitting here today, as you read that, what does  
18 that mean to you?

19 A. Basically, whatever asset hasn't paid  
20 the principal interest obligation, and has not been  
21 able to do so.

22 Q. And that means that if the asset has not  
23 paid, it should be -- would be considered a defaulted  
24 investment under this definition?

25 A. Yes, in my opinion.

1 you mean the portion that we've just been reading  
2 together?

3 THE WITNESS: Yes.

4 Q. And is it important to you that an  
5 asset -- that the assets in Zohar III be valued  
6 correctly?

7 A. Yes.

8 Q. And why is that?

9 A. I think you want to know basically an  
10 accurate picture of the portfolio composition,  
11 because it really will -- is a portrait of what the  
12 risk is to that portfolio. So if you're not valuing  
13 your portfolio correctly, then Rabobank, as the  
14 investor of that debt, doesn't have an accurate  
15 picture of the risk.

16 Q. What about, is it important to you as an  
17 investor that the assets be appropriately categorized  
18 as either defaulted or not defaulted?

19 A. Yes.

20 Q. And why is that?

21 A. Because it would determine what kind of  
22 haircut is applied to the asset, and then if your  
23 assets are -- if you're counting more assets as  
24 defaulted and they're not, then your investment would  
25 seem more risky.

1 Q. In your opinion?

2 A. Yes.

3 Q. Okay. We've heard from Patriarch that  
4 Patriarch decided whether or not to classify an asset  
5 as defaulted in Zohar III based on whether or not  
6 Patriarch intended to continue to support the  
7 portfolio company by loaning it funds, providing  
8 management resources, those types of -- those types  
9 of factors. Is that something you've ever heard  
10 before?

11 A. No.

12 Q. And is that information that, as an  
13 investor, you would have liked to have known?

14 A. Yes.

15 Q. Why is that?

16 A. In my opinion, it would not -- I guess  
17 if Patriarch decided to support or not support a  
18 company, would -- and then I guess their decision to  
19 do so would then determine whether it's defaulted or  
20 not defaulted, I think doesn't fit the definition as  
21 stated in the document.

22 Q. And when you say "the document," you  
23 mean the indenture?

24 A. Yes.

25 MS. VAN ROY: And by "the definition,"

1 Vice versa, if you would then categorize  
2 assets that were defaulted but categorized them as  
3 collateral, then you would be portraying your  
4 portfolio as stronger and therefore less risky than  
5 it really is.

6 Q. Based on some of the work that we --  
7 strike that.

8 Based on some of the information that's  
9 been produced by Patriarch, it appears that in  
10 certain cases, portfolio companies that were not  
11 categorized as defaulted failed to pay large  
12 percentages of interest that were due to Patriarch  
13 under the terms of their loans.

14 For instance, one company called  
15 "American La France," which was a fire truck  
16 manufacturer, did not pay approximately 81 percent of  
17 the interest it was due -- that was due to Patriarch  
18 between 2008 and 2013. That's across all three Zohar  
19 deals, it's not specific to Zohar III.

20 But is that information something -- is  
21 that surprising to you, that a company that's not  
22 paying 81 percent of the interest is not listed as  
23 defaulted?

24 A. Yes.

25 Q. And why is that?

1 A. Yes.  
 2 Q. Was there a specific person at the  
 3 trustee that you dealt with?  
 4 A. There was a lot of turnover at the  
 5 trustee, so the name that comes to mind is Rob  
 6 Feeney. I think he was the trustee on the deal.  
 7 Q. What types of -- what types of  
 8 communications would you have with the trustee?  
 9 A. Basically asking him whether compliance  
 10 reports were ready, whether the rating agency  
 11 confirmation was received, you know, things like  
 12 that.  
 13 Q. Did you ever have any interaction or  
 14 communications with either the rating agencies that  
 15 rated the Zohar III deal, on the Zohar III?  
 16 A. No.  
 17 Q. Ms. Ruttle, I have no further questions  
 18 at this time. We may however call you again to  
 19 testify in this investigation. Should this be  
 20 necessary we will contact your counsel.  
 21 Ms. Ruttle do you wish to clarify  
 22 anything or add anything to the statements you've  
 23 made today?  
 24 A. No.  
 25 MS. SUMNER: Counsel, do you wish to ask

1 any clarifying questions?  
 2 MS. VAN ROY: No.  
 3 MS. SUMNER: We are off the record at  
 4 3:30.  
 5 (Time noted: 3:30 o'clock p.m.)  
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 4 WENDY RUTTLE Ms. Sumner 3  
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 10 149 Subpoena 5  
 11 150 Background Questionnaire 7  
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 13 PREVIOUSLY MARKED EXHIBITS REFERRED TO  
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1 SCOPIST'S CERTIFICATE  
 2  
 3 I, Rena Farber, hereby certify that  
 4 the foregoing transcript consisting of 46 pages,  
 5 is a complete, true and accurate transcript of the  
 6 investigative hearing, held on Wednesday, April 9,  
 7 2014, at 3 World Financial Center, New York, New  
 8 York, in the matter of PATRIARCH PARTNERS, LLC.  
 9 I further certify that this  
 10 proceeding was reported by Deborah Moschitto and  
 11 that the foregoing transcript has been scoped by  
 12 me.  
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 15 Rena Farber Date  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
REPORTER'S CERTIFICATE

I, Deborah Moschitto, reporter, hereby certify that the foregoing transcript of 46 pages is a complete, true, and accurate transcript of the testimony indicated, held on Wednesday, April 9, 2014, at 3 World Financial Center, New York, New York, in the matter of:

PATRIARCH PARTNERS, LLC.

I further certify that this proceeding was recorded by me and that the foregoing transcript was prepared under my direction.

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Deborah Moschitto      Date

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PROOFREADER'S CERTIFICATE

In the Matter of: PATRIARCH PARTNERS, LLC

Witness: WENDY RUTTLE

File Number: HO-11665/D-3350

Date: APRIL 9, 2014

Location: 3 World Financial Center  
New York, New York

This is to certify that I, Deborah Moschitto, do hereby swear and affirm that the attached proceedings before the United States Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

\_\_\_\_\_  
Deborah Moschitto      Date